

Central banks: Our latest calls

What to expect from central banks as inflation concerns persist and recession risks rise



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Federal Reserve

Our call: 75bp in July, 50bp in September and November before switching to 25bp in December. Rate cuts from summer 2023. Quantitative tightening (QT) to continue until rate cuts begin.

Rationale: To get inflation down quickly we would ideally like to see the supply-side capacity improve to meet strong demand in the US economy. However, supply chain strains, geopolitics/energy prices, and a lack of suitable workers mean this isn't likely in the near term. Consequently, the onus is on the Fed to respond aggressively to dampen demand, but moving into restrictive territory means a rising chance of recession. Inflation could fall quickly from early next year, opening the door to rate cuts from summer 2023.

Risk to our call: Two-way. On the one hand, the tight labour market continues with rising wages making inflation stickier at high levels. Conversely, the economy reacts badly to rate hikes (the

housing market is vulnerable) and recession prompts a lower peak and a more rapid reversal in Fed policy.

European Central Bank (ECB)

Our call: Rate hikes totalling 100bp before the end of the year.

Rationale: Stubbornly high inflation and longer-term inflation projections above the 2% target have made a first rate hike overdue. Still, the very gradual (read: slow) approach to normalising when other central banks have acted more aggressively suggests a still-divided ECB. Support within the ECB to end net asset purchases and the era of negative interest rates is strong but views on the timing and pace still differ. With a high risk of the eurozone and US economy falling into technical recession towards the end of the year and inflation coming down in 2023, there will be hardly any room for the ECB to deliver additional hikes in 2023.

Risk to our call: A faster and more severe recession could push the ECB to stop normalising after 75bp and could even trigger cuts in early 2023. On the other hand, positive growth surprises and few signs of inflation weakening could motivate the ECB to hike more aggressively this year and bring the refi rate to 2% in 2023.

Bank of England

Our call: 50bp rate hike in August, 25bp in September before a pause.

Rationale: It's a very close call on August's meeting, and in isolation, there's not much in the latest data to suggest the Bank needs to move more aggressively. Core inflation looks like it is at, or close to, a peak (even if the headline will go to 11% in October), while unemployment has stopped falling. But the hawks are clearly worried about recent weakness in sterling, and the prospect of another 75bp Fed hike coupled with the fact that a 50bp rate hike is virtually priced in for August, means we narrowly think that's the most likely outcome. Still, a 50bp hike – if it happens – is likely to be a one-off. We're not far from what's arguably neutral interest rate territory now (probably around 2%), and the Bank loses one of its biggest hawks after August, who will be replaced by a more dovish official. We still doubt the Bank rate will go as high as 3% or above, as markets are still pricing.

Risk to our call: If the Fed hikes even more aggressively, or if core inflation moves unexpectedly higher in the coming months, then we could see more than one 50bp hike and a higher terminal rate.

Bank of Japan

Our call: Bank of Japan will maintain an accommodative policy stance.

Rationale: CPI will stay above 2% until the end of 2022, but the BoJ will downplay it as cost-push-driven inflation that will prove temporary. Market expectations of possible policy changes (at least broadening the long-end yield target) are still alive but are not going to materialise easily for a while.

Risk to our call: If signs of wage growth are detected and the sharp yen weakening continues over 135, then the bank could reconsider its policy stance, but that will become more likely when Governor Haruhiko Kuroda retires next April.

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