Global central banks are treading carefully

The Fed is cautious, and so is the Bank of Japan. The ECB seems determined to keep cutting and the Bank of England might be tempted to speed up its rate reduction pace later in the year

The US Federal Reserve

After 100bp of interest rate cuts in the latter part of 2024, the Fed held policy steady in January and suggested it was in no hurry to cut again. The recent developments surrounding tariffs are likely to keep it that way through the first half of 2025. We expect stronger near-term consumer demand as households bring forward spending on big-ticket items to avoid tariffs, together with the risk of more elevated inflation over the medium term.

Weaker consumer demand is likely in the second half of the year, assuming tariffs materialise and squeeze household spending power. Proposed tax cuts on overtime pay, tips and social security payments will not provide financial relief until 2026, if at all – we are not confident they will be passed by Congress as currently proposed.

US business supply chains will be tested and exporters will be hurt by retaliatory tariffs from trade partners. Risk assets also appear vulnerable to a more stressed growth environment. A cooling jobs market adds to the belief that the Fed may 'look through' near-term inflation and cut rates twice in the second half of this year. What happens next is highly uncertain, but assuming a gradual de-escalation of tensions that sees tariffs being removed, we are forecasting one further rate cut in early 2026.

The European Central Bank

The latest data once again confirmed that the ECB is currently looking at a mild version of stagflationary tendencies: continued sluggishness of the economy and accelerating inflation. Still, the ECB seems to be looking through this temporary acceleration of inflation and sounds determined to continue cutting rates. The desire to stay ahead of the curve – also in light of potential incoming economic worries for the eurozone stemming from the US administration – remains a compelling reason to return interest rates to neutral.

According to the ECB's logic, the Bank will have to bring interest rates to where market expectations were in December in order to deliver the December forecasts' outcome. This would imply cutting rates by a total of another 75bp. Otherwise, inflation would undershoot and growth underperform. This means that another 25bp rate cut at the March meeting is almost a done deal. But this is not where we see the ECB stopping. Instead, a further weakening of the eurozone growth outlook will force it to cut interest rates to at least 2% by the summer.

The Bank of England

Markets are pricing between three and four rate cuts this year, up from less than 30 basis points in total back in mid-January. The path of least resistance for the Bank is to keep cutting rates once per quarter, and that's what we currently expect until rates bottom out at 3.25% next year. There is still a chance that the BoE will move faster, given that the jobs market is looking shaky, particularly with big tax hikes coming in for businesses in April. Wage growth should gradually fall this year, while services inflation is likely to show a lot more progress by the spring; it's set to fall below 4% in the second quarter, and progress is likely to look even better if you exclude volatile/less relevant items.

December's meeting, which saw three out of nine committee members dissent in favour of a more immediate rate cut, hints that the balance of opinion at the Bank is slowly shifting in a less hawkish direction. Still, for now, our base case is for cuts in May, August and November.

The Bank of Japan

The Bank of Japan raised its target rate in January. Unlike last July's unexpected hike, this one was relatively well-telegraphed, with messages from top BoJ officials a few weeks before the meeting. Later, the Summary of Opinions suggested that further hikes were on the way. The market is currently pricing in another hike in July given the BoJ's cautious approach, but we believe that if Shunto's results are as strong as last year's - that's the annual round of wage negotiations - an earlier hike in May is possible.

Core inflation is expected to remain above 2% for most of this year, while growth should improve thanks to healthy wage increases and consumption. The latest labour cash earnings rose the highest since 1997, with an almost 3% steady growth of base payment. The biggest risk factor should be Trump's trade policy towards Japan, but so far, Trump's arrow hasn't yet targeted Japanese firms. It seems like the BoJ would like to reduce the market volatility risk, so the markets will be listening closely to messages from BoJ officials and whether it drops any hints about the rate hike prior to the meeting. We have also raised the BoJ's terminal rate from 1.00% to 1.25% based on recent data outcomes and the BoJ's latest quarterly outlook revision, and we expect two more hikes in 2025 (May and October), and a 25bp hike in 2026.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@ing.com