

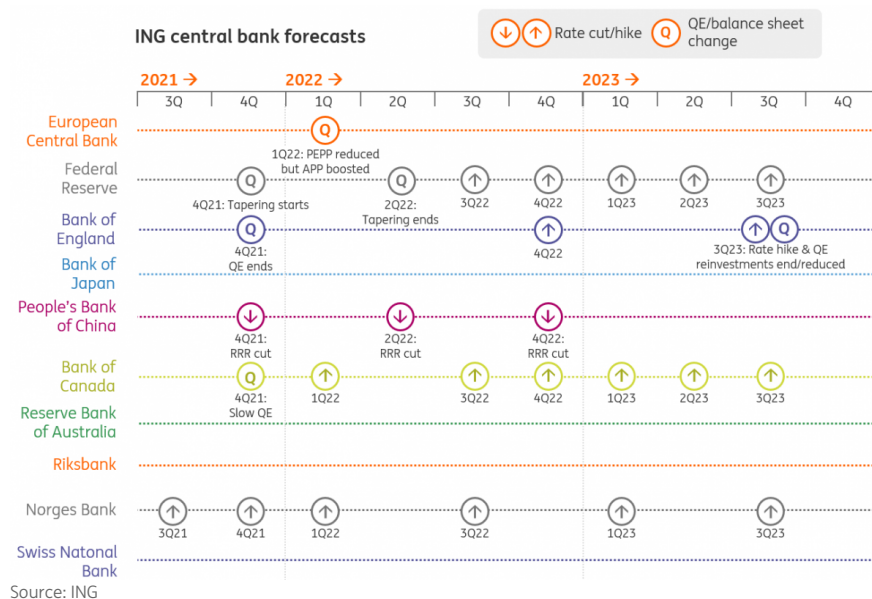
ING's outlook for central banks

Our economists look at the places where monetary policy is likely to be tightened first over the next few years



PBoC governor, Yi Gang, with the Fed's Jerome Powell in 2019

The race to hike interest rates and end QE



✓ Federal Reserve

More and more Federal Reserve officials believe that it is time to “dial back” on the policy stimulus. Fed Chair Jerome Powell has been more cautious, but he too now recognises it “could” be appropriate to taper the \$120bn per month of quantitative easing this year. His wariness stems from the resurgence of Covid and the sense that an “ill-timed policy move” could be “particularly harmful”.

Moreover, while “substantial further progress” has been made with regards to inflation, there are still 5.7mn fewer people in work than in February 2020, meaning there is still “much ground to cover to reach maximum employment,” according to Powell.

Consequently, a huge gain in August nonfarm payrolls will be needed for him and other Fed governors to support a September taper announcement. It looks as though a November agreement with a December starting point is the most likely path ahead.

In terms of rates we remain optimistic on growth, but supply chain disruptions and labour market shortages may not ease as quickly the Fed anticipates. We see inflation staying higher for longer, and with additional fiscal spending hitting the economy we expect the Fed to start hiking interest rates in the latter part of 2022.

✓ European Central Bank

Over the summer, the ECB has clearly become more dovish with its new monetary policy strategy and the clear intention of bringing inflation expectations sustainably back to 2%. This means that the ECB will continue its benign stance on inflation and keep everything unchanged. Even an end to the front-loading of asset purchases looks unlikely as it would de facto mean earlier tapering in the eurozone than in the US.

We expect a first announcement of asset purchase reductions at the end of this year. This will mean a rotation out of the Pandemic Emergency Purchase Programme into the Asset Purchase

Programme and only a very gradual reduction of total purchases. Consequently, the ECB will not be in a hurry to completely unwind QE.

With the new dovishness, a first rate hike should not be expected before 2024.

People's Bank of China

The PBoC is expected to continue cutting the reserve requirement ratio (RRR) in 4Q21, following a cut in July, to ease the rising pressure from credit costs. The economy is currently facing challenges from reforms in the real estate, technology and education sectors, as well as chip shortages that have affected production. Occasional localised Covid-19 lockdowns have also affected air and marine freight operations.

The RRR cut has been effective in lowering bank lending rates and bond yields. Further easing from monetary policies will be needed given the risks stated above are not going away for the rest of 2021. The anticipated RRR cut can help to put further downward pressure on market interest rates. It is therefore unlikely that the PBoC will need to cut policy interest rates unless economic growth were to slow excessively, which is not our base case scenario.

Bank of England

While the Bank of England doesn't explicitly tell us when the first rate rise will come, its latest forecasts effectively endorsed market expectations from late July. At that point, investors were pricing the first (partial) rate rise in mid-2022 with another 25bp move around a year later.

In practice, that's unlikely to be too wide of the mark, but we are a little more cautious than the BoE on a few key parts of the outlook. We think inflation is likely to fall more quickly back to target next year, and we disagree with the Bank's prediction that there will be no rise in unemployment when the furlough scheme ends this month.

We're now pencilling in the first rate rise in the final quarter of 2022, with another in the second half of 2023. The Bank has signalled this latter move will be accompanied by the end of reinvestments of its pool of government bonds, which were accumulated under successive rounds of QE. This 'quantitative tightening' process will be a first for the BoE which, unlike the Fed, didn't shrink its balance sheet in the post-crisis years.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.