

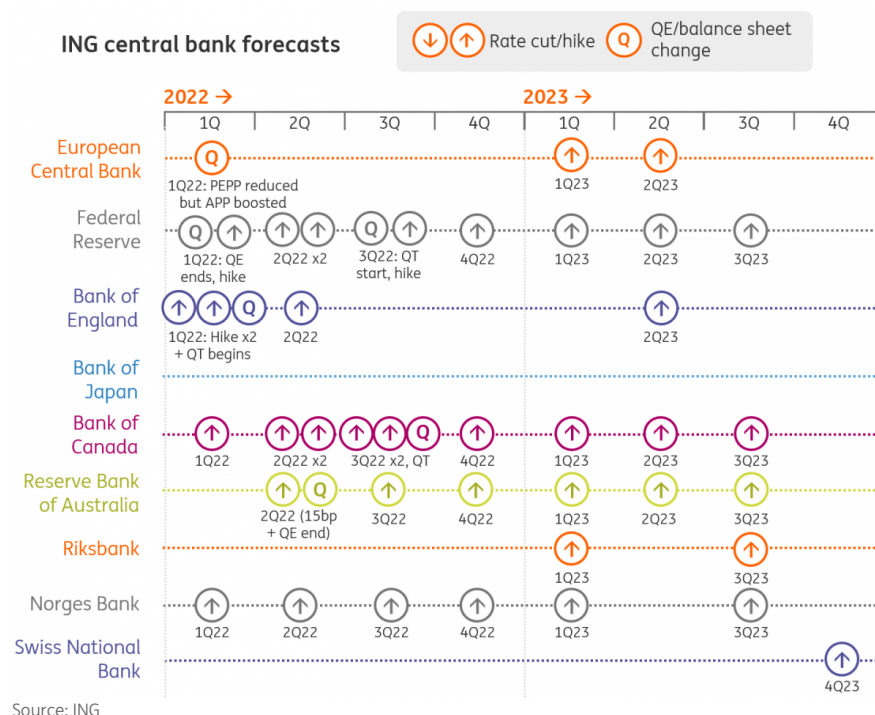
Our guide to central banks and the race to hike rates

Several central banks have taken a decidedly more hawkish stance over the past couple of months. Our economists look at what's likely to come next



The ECB's Christine Lagarde and the Fed's Jerome Powell pictured in 2019

Our central bank forecasts



US Federal Reserve

Hawkish commentary from Fed Chair Jerome Powell following the January FOMC meeting suggests the central bank means business. With inflation at 7% and the labour market tightening far more quickly than officials expected, he didn't rule out raising rates at every FOMC meeting this year, arguing they have plenty of room to do so without hurting the jobs market.

The market is even pricing a chance of a 50bp move, although we don't think this is likely given the Omicron wave has heavily dampened activity and job creation at the start of 2022. Instead, they are set to raise rates 25bp at consecutive meetings in March, May and June, with a further two hikes in the second half of the year. They will also start running down their balance sheet (Quantitative Tightening) from 3Q and this is likely to do a lot of the heavy lifting for policy tightening. This means the eventual peak in the Fed funds target rate is likely to be closer to 2% than 3%.

European Central Bank

Even if headline inflation stays at elevated levels for longer than expected, we see the ECB in no position to consider hiking interest rates any time soon. The drivers behind high inflation and higher inflation projections are still mainly driven by supply-side constraints and not by demand. In other words, tightening monetary policy would do little to ship containers faster from Asia to Europe or reduce energy prices. Consequently, the ECB needs to make a fine distinction between a dropping necessity to continue stimulating the economy and actually bringing higher inflation down.

With high inflation and inflation projections surrounded by high uncertainty, the eurozone economy back at its pre-crisis level, and labour shortages soon leading to higher wages, we expect

the ECB to accelerate tapering and eventually stop net asset purchases in September, keeping the door open for a rate hike, possibly even before the end of this year.

Bank of England

The Bank of England has increased interest rates for the second consecutive meeting, amid ongoing concern about high headline inflation rates. In fact four-out-of-nine policymakers voted for an even faster, 50bp hike.

Clearly the Bank is keen to act pre-emptively, with inflation set to remain well above target this year. We expect another rate rise in March and May. The fact that the Bank has now begun quantitative tightening is unlikely to alter that timeline all that much.

However, if our rate hike forecast is roughly accurate, the BoE will also 'consider' actively selling gilts back to the market – and this could come before the summer. This is a process fraught with challenges, and we suspect if the Bank does ultimately do this, it will be in fairly low volumes. Nevertheless, this is uncharted territory, and we suspect at this point the Bank may pause on rate hikes to gauge the impact. We also suspect that by later this year, some of the current inflation concerns will have eased. That suggests the five hikes markets are pricing this year may well prove to be an overestimate.

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

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.