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UNITED STATES

Our latest views on the major central banks

We re now expecting two European Central Bank rate hikes in the summer, though we re still not convinced that the Federal Reserve will tighten policy this year



What to expect from the Fed, ECB, BoE and BoJ in the coming months

Federal Reserve

The US economy is more insulated from Middle East risks than most countries due to its energy independence, but it is not immune. Higher motor fuel costs are adding to cost pressures, with inflation breaking above 4%. Business surveys currently point to 2-2.5% GDP growth; the economy is adding jobs and equity markets are at record highs. Understandably, market expectations of potential Federal Reserve rate hikes have increased.

That said, the US growth story is concentrated in high-income household spending and tech investment, while only three sectors – government, private education & healthcare services and leisure & hospitality – are actually adding jobs. The low-hire, low-fire economy means weak wage growth, with real household disposable income having fallen for three consecutive months. Consequently, a renewed spike in energy costs risks demand destruction.

It is a very close call whether the Fed will hike rates this year, but on balance we think it will instead choose to look through a near-term energy spike and hold rates steady for an extended period. Consumer and market inflation expectations remain in tolerable ranges and

slowing housing rents, weak wage growth, a waning influence from tariffs and eventual energy price falls mean that inflation could undershoot the target in the second half of 2027. We look for 25bp rate cuts in 2Q 2027 and 3Q 2027 as policy eventually returns to a neutral setting.

James Knightley

European Central Bank

Even if the current inflation wave in the eurozone is very different from soaring and self-enforcing inflation in 2022, a lot of the European Central Bank's actions seem to be driven by the institutional memory of 2022. Not so much by recent inflation developments. So far, the increase in headline inflation has remained moderate. And while the knock-on effects of higher energy prices on other prices, like transportation and food, will be hard to avoid, the latest survey-based inflation expectations have come down a bit. Selling price expectations in both industry and services, and the ECB's own longer-term consumer inflation expectations, all dropped slightly in May.

Even as some critics argue the ECB risks repeating its 2022 mistake of reacting too late to an obvious inflation shock, the comparison with that period is flawed – not least in terms of fiscal stimulus and savings. Back in 2022, eurozone inflation was already above 4% YoY when the energy price shock hit. The ECB's infamous late reaction came with the first rate hike in July 2022, when headline inflation was actually above 8% YoY. Also, back then, less than 25% of the main inflation components recorded an inflation rate of less than 1% YoY. In April this year, it was 50%. Finally, the first rate hike in 2022 came from a policy rate of -0.5%. Currently, the policy rate is at 2%.

Still, memories of 2022 – and the acknowledgement that the ECB held on too long to the 'transitory' inflation narrative – are now driving the push for rate hikes. This is a kind of insurance rate hike, as the risk of doing nothing and potentially falling behind the curve is larger than the risk of any adverse effects on growth from higher interest rates. With our new oil price and inflation forecasts, there is now a probability of more than 50% that the ECB will actually opt for a second hike this summer.

However, as long as the bond market is doing part of the ECB's job in tightening financial conditions, governments are not fuelling an inflationary spiral with fiscal stimulus, and sentiment indicators remain weak, it's hard to imagine that the ECB would really want to fight an exogenous supply shock at the cost of worsening an economic downturn.

Carsten Brzeski

Bank of England

For the UK, the 2022 comparison is even more extreme than it is in the eurozone. The drop in vacancies has been comparatively more severe. Unemployment is up and consumer-facing

sectors have shrunk their workforces by 2-3% since last year's payroll tax and minimum wage hikes. Wage growth is falling rapidly.

What's more, last year's spike in food inflation – which took headline CPI close to 4% – hasn't generated the sort of second-round effects that the Bank of England's hawks feared at the time. It's a reminder that UK businesses don't enjoy the pricing power they had after the pandemic and during the last energy shock – nor do workers have the same power on pay. In that environment, the rise in consumer inflation expectations we've seen over recent weeks may not matter all that much.

We think the Bank is stuck somewhere between a prolonged pause and a symbolic rate hike this summer. For now, with natural gas prices so benign, the need to act is limited. Remember that the Bank was otherwise on track to cut rates at least twice this year, so simply not doing that acts as de facto tightening.

However, under ING's new base case for energy prices, with a big spike in July, we think the Bank will struggle to avoid a rate hike over the summer. But we're still unconvinced by market pricing; two hikes are priced by next spring and this may well increase with our projected rise in oil prices. Our view is that if we do get a hike this summer, it's more likely to be a one-and-done move.

James Smith

Bank of Japan

The Bank of Japan is expected to deliver a 25bp hike at its June meeting. Despite Middle East uncertainty, resilient growth, negative real interest rates, and persistent upside risks to inflation justify BoJ rate hikes. There were already three dissenting votes in favour of a rate hike in April, and two others have since signalled support for further normalisation. Hawkish comments from several BoJ officials have led markets to price in another rate hike in 4Q26, in line with our forecasts.

While May inflation was quite soft at 1.4% YoY, this largely reflected government interventions and a high food-price base last year. Pipeline prices have climbed since March while the weak yen is expected to add more inflationary pressures. The BoJ is therefore likely to look through the current softness and instead focus on underlying inflation pressures that could build later this year. Firm wage growth is another reason to support the BoJ's rate hikes. With growth near potential and inflation expected to remain around 2% through 2027, we expect the BoJ to raise its policy rate to 1.50% by the first half of next year.

Meanwhile, the BoJ will also announce its latest JGB purchase plan at its June meeting. Currently, it is reducing purchases by 200 billion JPY per quarter through next March, but on the back of improved market functioning, the BoJ may pause tapering. Even if the BoJ pauses

tightening from next April, its JGB holdings should continue to decline as redemptions remain sizeable. We expect this to help calm concerns about a sharp JGB sell-off and ease Prime Minister Sanae Takaichi's opposition to further rate hikes. With the policy rate rising, JGB10Y yields are expected to climb, albeit at a moderate pace, reaching 3.0% by 2027.

Min Joo Kang

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

James Knightley

Chief International Economist, US

james.knightley@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

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