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What central banks are set to do next

We think the Federal Reserve has finished hiking rates, and the ECB and Bank of England aren't far behind

ECB President, Christine Lagarde's future options are somewhat limited

Federal Reserve

At the recent Jackson Hole Fed symposium, Fed Chair Jerome Powell acknowledged that monetary policy is "restrictive" and that policymakers will "proceed carefully" in determining whether to hike interest rates further. September appears set for a pause given recent encouraging signals on inflation and labour costs, but robust activity data means the door remains ajar for a further potential hike. Markets see a 50-50 chance of a final hike while we think rates have most probably peaked.

Households are rapidly running down pandemic-era savings, and rising consumer loan delinquencies indicate growing stresses that will be intensified by the restart of student loan repayments. Amid weakening global activity, we are, unfortunately, in the camp that fears this is more of a downturn-delayed rather than recession-averted story. Fortunately, we think that inflation will continue to slow rapidly and this will afford the Federal Reserve the flexibility to respond swiftly to this challenging environment with interest rate cuts through 2024.

European Central Bank

Macro developments over the summer have caused further complications for the ECB. While the rapid worsening of the economy should come as a surprise, at least judging from overly optimistic ECB growth forecasts so far, the speed with which headline inflation is coming down should still leave the central bank uncomfortable.

Core inflation also remains too high and wage growth up until now signals that even without excessive wage settlements core inflation could stay higher for longer.

We still expect headline inflation to come down significantly after the summer, mainly on the back of German headline inflation falling. However, if the ECB sticks to its stance of putting more emphasis on actual data rather than on expected data, the current inflation picture still argues in favour of another rate hike.

After 425bp of rate hikes in slightly more than a year, a pause in the ECB's hiking cycle at the September meeting would make perfect sense. However, the worsening economy and our expectation of an acceleration of disinflationary risks after the summer could easily transform a pause into an actual full stop. The question is whether everyone at the ECB could live with a terminal rate of 3.75%. We think that the hawks would prefer 4% and will therefore push for one final rate hike at the September meeting. A last one for the road, even if it remains a very close call.

Bank of England

The Bank of England looks poised to hike rates again in September, but November is less certain. Private sector wage growth is at a cycle high and looks unlikely to slow dramatically by the end of the year, and certainly not before November. Meanwhile, services inflation has risen higher again. And while we think the impact of lower gas prices should start to show through here with a lag, progress is likely to be limited by the time of the November meeting.

That said, the wider economy is showing signs of slowing amid higher interest rates, and the jobs market is also noticeably cooling. We're likely to see more evidence of this over the next couple of months. We're erring on the side of a pause in November, but we don't rule out another hike.

Bigger picture, the BoE is clear that it wants to keep rates high for a prolonged period. We've pencilled in the first cut for the second quarter of next year but we acknowledge that may end up being delayed.

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