Our view on central banks

We think that tightening cycles are now finished across the major economies, and we're expecting the first rate cuts from the likes of the Federal Reserve and the ECB by the middle of next year

Clockwise from top left: Bank of England Governor Andrew Bailey, Governor of the Bank of Japan Kazuo Ueda, US Federal Reserve Board Chairman Jerome Powell, and European Central Bank President Christine Lagarde

Federal Reserve

4.9% annualised third-quarter GDP, unemployment at 3.8% and inflation still well above target mean the Federal Reserve's 'higher for longer' narrative has gained increased traction, with Treasury yields hovering just below the 5% level. This has helped push mortgage rates above 8%, and with personal loan and credit card borrowing costs hitting multidecade highs, we are now seeing a clear tightening of financial conditions and the Fed regarding monetary policy as restrictive. This is giving us greater confidence that the Fed funds policy rate has now indeed peaked.

Consumer spending is key for the outlook for 2024 given it is 70% of economic activity. Real household disposable income has fallen in each of the past four months, savings are being run down, and consumer credit has turned negative with households repaying student loans. As such, the drivers of consumer spending are looking much less supportive and we expect economic activity to moderate. Inflation is moving in the right direction and we see this process continuing given the deteriorating consumer fundamentals. We acknowledge that we were too aggressive in expecting rate cuts – but we still see more scope for policy easing through 2024 than the market is currently pricing. We look for rate cuts to start in the second quarter, with the policy rate ending the year at 4%.

James Knightley

European Central Bank

The European Central Bank has finally realised that its growth optimism might have been too much. While ECB officials had tried to talk up market expectations about further rate hikes after the September meeting, the message at the October meeting was a different one. The central bank has become much more cautious regarding the eurozone's growth outlook. Disappointing sentiment indicators – and most of all, the ongoing impact of the policy rate hikes so far – suggest a further weakening of the eurozone economy. As inflation should also continue to come down, there is very little need for the ECB to consider further rate hikes any time soon. Instead, we think that it has already reached peak interest rates and has now entered the next phase of its tightening cycle: high for longer.

Carsten Brzeski

Bank of Japan

The Bank of Japan is expected to ditch its Yield Curve Control (YCC) policy in the next quarter once global rates stabilise. The BoJ recently decided to allow 10Y JGB to float above 1%, and continuing to ease the reference would make YCC policy meaningless. A weak yen will continue to add to inflationary pressures, and we believe next year's wage growth could be strong enough to convince the BoJ to normalise its policies.

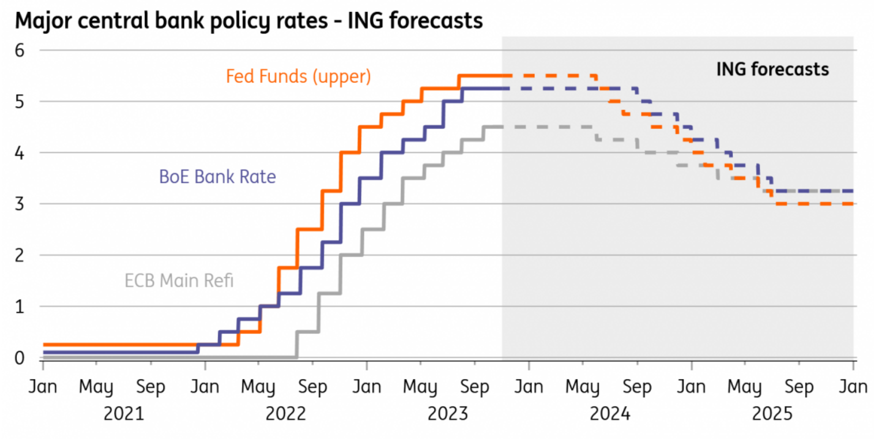
Our call is that we see YCC scrapped in the first quarter of next year and that a rate hike will follow in the second. The risk, however, is that the BoJ believes a sustainable return to the inflation target is not reachable, especially if we only see a slight growth in wages. That could see the central bank maintaining its policy easing for longer.

Min Joo Kang

Bank of England

The Bank of England is keen not to shut the door to further rate hikes, and it would prefer the most recent on-hold decision to be viewed as a pause rather than a definite end to the rate hike cycle. It's true that another hike can't be totally ruled out, especially if we get some unpleasant surprises in either services inflation or private-sector wage growth over the next month or two. But we think that's unlikely, and there are now clear signs of disinflation in the pipeline – not least because the jobs market is weakening. The battle is now keeping rate cut expectations at bay, and initial policy easing is now being priced for next summer. That's our view too, especially if we're right that core inflation will be back below 3% by then. We ultimately expect rate cuts to take us back to the 3% area by mid-2025.

James Smith



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