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Our view on the major central banks

The Fed and Bank of England are closing in on the end of their respective tightening cycles, while the ECB still has more work to do. Greater potential for an inflation pullback in the US suggests the Fed will be much earlier to cut rates than its European counterparts. Bank of Japan tightening is likely to be a gradual process

ECB President, Christine Lagarde with Croatia's Economy Minister at the World Economic Forum last month

Federal Reserve

After the most aggressive series of policy rate increases seen in more than 40 years, unsurprisingly, the US economy is now experiencing slower growth. Markets are now pricing recession, but Federal Reserve officials are concerned that lower Treasury yields and a softer dollar have loosened financial conditions, thereby undermining the Fed's policy stance.

They continue to warn that "unacceptably high" inflation means the economy needs to experience a "sustained period of below trend growth" for them to be confident price pressures will fade. Hence the latest 25bp hike with a further 25bp expected in March.

However, job loss announcements are becoming more prevalent, and weakening price intentions, falling car prices and a clear topping out in housing rents offer encouragement that inflation will fall sharply. This should open the door to significant interest rate cuts from late in the third quarter of this year, with the Fed funds target rate potentially falling back to 2.5% next year.

European Central Bank

It took the ECB a while, but it seems to have got the hang of it: hiking interest rates. And as long as core inflation remains stubbornly high and core inflation forecasts remain above 2%, the ECB will continue hiking rates. The increasing probability that a recession will be avoided in the first half of the year also gives companies more pricing power, showing that selling price expectations remain elevated.

The celebrated fiscal stimulus, which has eased recession fears, is an additional concern for the ECB as it could transform a supply-side inflation issue into demand-side inflation. These are two factors that could extend inflationary pressures in the eurozone, albeit at a lower level than we see at the moment. As a consequence, we expect the ECB not only to continue hiking into late spring but also to keep interest rates high for longer than markets have currently pencilled in.

Bank of England

The Bank of England has given its strongest hint yet that the tightening cycle is nearing an end - and perhaps even that February's 50bp hike was the last. In practice we're probably not quite there yet. UK headline CPI may have peaked, but the same can't yet be said for wage growth or service-sector inflation. We therefore expect the BoE to pivot back to a 25bp rate hike in March but that's likely to be it.

However unlike the Fed, it's unlikely that the BoE will begin cutting rates later this year. The Bank's Chief Economist, Huw Pill, recently noted that the UK has the worst bits of the US inflation story (structural labour shortages) and the eurozone (energy crisis), arguing that core inflation could stay stickier as a result. That's a line we're likely to hear a lot of over the coming months and suggests a rate cut is unlikely for at least a year.

Bank of Japan

The Bank of Japan attracted the attention of market participants around the world after it surprised with an unexpected adjustment in the yield curve control policy in December. Governor Kuroda reiterated at the January meeting that the economy still needs easy monetary policy, and the BoJ's sustainable inflation target of 2% has yet to be achieved.

We think that it is highly unlikely that Kuroda will make another move in March, just before his retirement in early April. Indeed, markets are paying more attention to who will be the next governor, hoping the new leader may change the BoJ's policy stance. We agree, but "Shunto", the spring wage negotiations, will be key to watch. If wage growth is not strong enough to offset recent inflation, it will take longer than expected to normalise policy.

We predict that the BoJ will keep its negative policy rate and yield curve control policy until the end of 2023 for now.

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