

## 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.

## Authors

### James Knightley

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

### James Smith

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

### Min Joo Kang

Senior Economist, South Korea and Japan

[min.joo.kang@asia.ing.com](mailto:min.joo.kang@asia.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 <http://www.ing.com>.