

## Our view on the major central banks

We now expect the Federal Reserve to begin rate cuts in the first quarter of 2024, with the European Central Bank and Bank of England following shortly thereafter

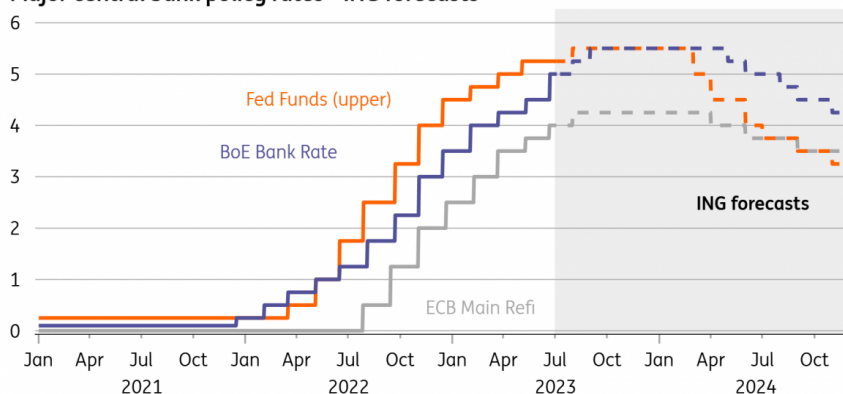


Governor of the Bank of England Andrew Bailey, ECB President Christine Lagarde, US Federal Reserve Board Chairman Jerome Powell

Source: Shutterstock

## Our projections for the major central banks

Major central bank policy rates - ING forecasts



Source: Macrobond, ING calculations

## Federal Reserve

Comments from Federal Reserve officials indicate that while progress has been made, there is more work to do to return inflation to target. The June no-change decision was merely a slowing in

the pace of hikes, with the Fed signalling that it sees the need for two additional 25bp interest rate increases before the end of the year.

A July rate rise looks virtually certain given inflation is above target and the jobs market remains tight, but we are not convinced the Bank will carry through with the second hike. The Fed acknowledges that goods price inflation is under control and housing costs will slow rapidly through the second half of 2023, but policymakers are focused on core services excluding housing, which remains hot. There are tentative encouraging signs, which we suspect will intensify as the lagged effects of previously implemented policy rate increases and tighter lending conditions bite.

With core CPI likely to be in the 2%-2.5% region by the first quarter of next year, the Fed may well be inclined to move policy from restrictive territory in the direction of neutral by March as the economy weakens.

## European Central Bank

The message from the ECB since the June meeting has been clear: the job is still not done and more rate hikes will follow.

Despite a weakening growth outlook and headline inflation coming down, the ECB doesn't want to take any chances. The Bank has to be sure that it has slayed the inflation dragon before considering a policy change. This is why it is putting more emphasis on actual inflation developments, and why it will rely less on forecasts than in the past. This is a big risk as we still think the ECB is too optimistic about the eurozone's growth outlook. Historic evidence suggests that core inflation normally lags headline inflation while services inflation lags that of goods. Against this backdrop, further rate hikes increase the risk of a more significant slowing of the economy further down the road.

If we are right and the economy remains weak, the disinflationary process gains momentum and core inflation starts to drop after the summer, the ECB's hiking cycle should end with the September meeting, though the Bank might wait until the December meeting to officially declare it over.

## Bank of England

Financial markets expect Bank Rate to peak at 6.25% by the end of this year or early next. For context that would be the highest since 2001, but far from pushing back against these lofty expectations, the Bank of England opted to double down with a surprise 50bp rate hike last month. That was a strong statement of intent, and we now expect at least two more 25bp moves this year and don't rule out more. It's clear that the committee has lost confidence and patience in its models, and policy will be heavily determined by actual inflation outcomes over the summer.

We're hopeful that some better news on inflation means Bank Rate doesn't need to go quite as high as investors think. But even if we're right, the current level of mortgage rates will exert the most significant squeeze on households for decades, with the exception of a short period in the early 1990s. The greater prevalence of fixed-rate mortgages means the impact is gradual, but the higher loan-to-income multiples on home lending seen over recent years mean that as households refinance over coming quarters there will be a material impact on growth. That suggests rates can't go much above 5% on a sustained basis, and we still expect rate cuts to arrive by mid-2024.

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