

# Central banks

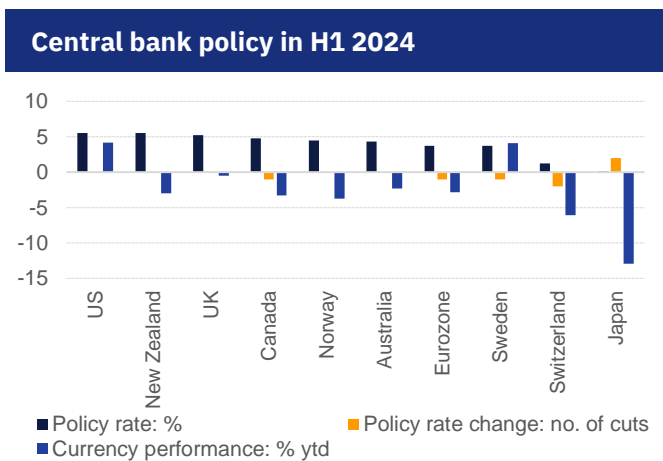
Research | 25 June 2024

- **June was a busy month for developed market central banks, with some beginning their cutting cycle and others maintaining caution**
- **Most central banks look set for rates to be lower by the end of 2024 with the Bank of Japan a notable exception. The Federal Reserve appears set for slow and shallow monetary easing**
- **A hesitant Fed will keep an upward bias to the US dollar while commitment to easing cycles will set the tone for peer currencies**

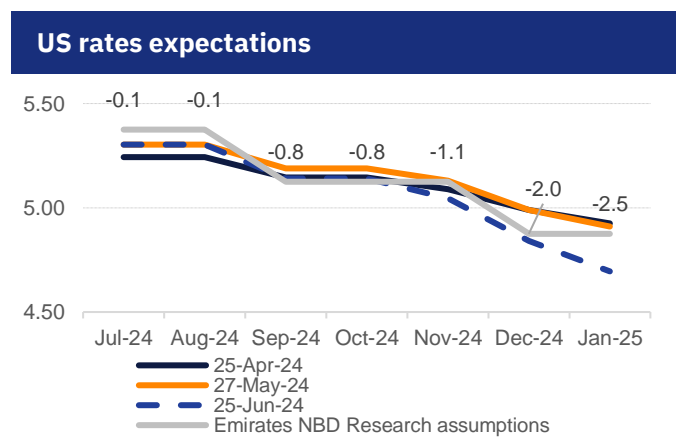
June has been a busy month for G10 currency central banks. Monetary authorities in the US, Eurozone, Japan, UK, Canada, Australia, Norway, and Switzerland have all set policy this month and signs of divergence are growing stronger. Markets had been expecting central banks would adopt varying paces and degrees of monetary easing and actions and statements this month have helped to solidify those differences. The focus for central banks this year has largely been on whether the war on inflation is over and rates can start to move lower. In some economies the disinflationary pull looks strong although it looks as though it has been sparked by weak activity in some markets rather than solely supply-side factors. Elsewhere, the effect of generationally high inflation looks to have scarred policymakers into maintaining a hawkish bias on policy even as economies show sign of cooling.

## The Fed – the hawkish optimist

In the US the Federal Reserve left the Fed Funds rate unchanged at 5.5% where it has been held since July 2023. The hold was widely expected but the Fed tilted hawkish in its projections for the economy over the rest of the year, lowering the median projection for rate cuts to one 25bps cut from three previously. Policymakers from the Fed have pointed to encouraging signs of disinflation in the US economy but note that they don't want to risk moving too early before they have confidence that inflation is on a sustained downward trend to target levels. In its June summary of economic projections the Fed only expects inflation to hit target levels by 2026 though they still expect healthy GDP growth and only moderate labour market cooling.



Source: Bloomberg, Emirates NBD Research.



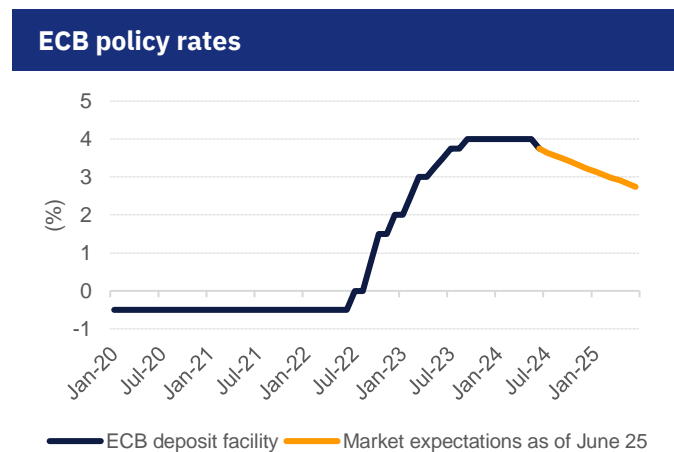
Source: Bloomberg, Emirates NBD Research.

Our own forecast remains for the Fed to cut rates by 25bps twice in the second half of the year. Signals from the US economy remain mixed: the headline jobs report

for May was very strong at 272k jobs added while retail sales for the same month disappointed forecasts. Activity data for June from the ISM survey was better than expected while existing home sales in May dropped for a third month running. That unclear messaging from the economy likely warrants caution as inflation, while moving lower, is still at risk of upward surprises, particularly in the services sectors. For 2025, we are tentatively projecting four 25bps cuts at this time but note that there are risks to the upside to rates as fiscal policy in either a Trump or Biden administration could prove to be inflationary via tax cuts, tariffs or more government spending.

### The ECB – a “reluctant” cutter

The European Central Bank cut policy rates by 25bps at its June meeting, as had been widely expected. That was the first cut in rates in nearly five years and left the deposit rate at 3.75%. However, at the same time as cutting rates the ECB revised up both its inflation forecast and its growth forecast. When announcing the cut, the ECB noted that it was “not pre-committing to a particular rate path” and in the immediate aftermath of the rate cut ECB policymakers have taken a much more equivocal stance on the next steps for policy. Isabel Schnabel, an executive board member of the ECB, said the eurozone economy could face “new price shocks” and backed up the message that the ECB couldn’t be “pre-committed to a fixed rate path.”



Source: Bloomberg, Emirates NBD Research.

Klaas Knot, president of the Dutch central bank and an ECB governing council member, said any decision needed to be bound by data, rather than in anticipation of data improving to target levels while Mario Centeno, his counterpart from Portugal, gave a similar signal that if inflation continues to fall then rates will drop in parallel. Markets aren’t expecting another cut this summer from the ECB and fewer than two more 25bps cuts by the end of the year. The ECB looks to be a “reluctant cutter” for the rest of this year, wary of the risks of inflation reigniting but economic data from the block has cooled in recent prints. The composite PMI for the eurozone dropped to just 50.8 from 52.2 a month earlier. We expect two more cuts from the ECB for the rest of 2024 before four 25bps cuts pencilled in for 2025.

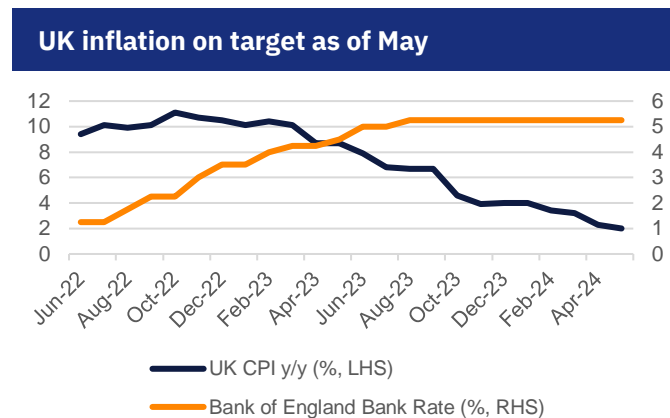
### Bank of Japan to extend hikes, slowly

The Bank of Japan is the standout among major central banks as it contemplates how high rates need to go, rather than how much they can be cut back. Rates in Japan turned positive for the first time since 2015 only in March this year when the BoJ raised the overnight call rate to 0.1%. At the June meeting, the BoJ voted unanimously to keep rates on hold at 0.1% and minutes from the meeting suggest that the bank is balanced about whether to hike or hold at the next meeting. Inflation in Japan rose to more than 4% in early 2023, its fastest pace since the early 1980s and far higher than the pronounced slump in price pressure Japan has endured since the early 1990s. Since then though it has eased back and headline inflation rose by 2.8% y/y as of May, picking up from a year-to-date low of 2.2% in January 2024.

Markets are pricing in around a 60% probability of a 10bps hike at the end of July meeting with two 10bps hikes in total fully priced in by the end of the year. While moving higher, Japanese rates will remain substantially below US rates, even as the Fed contemplates cutting by the end of the year. That wide differential will continue to weigh on the Japanese yen which has been the worst performing major currency this year.

## Bank of England increasingly set on cuts

The Bank of England’s MPC kept rates on hold as expected at 5.25% when it set policy on June 20th, with two members again voting for a cut. For some of the remaining seven MPC members, the decision to hold rates unchanged was “finely balanced” with the strong services inflation for May persuading them to wait longer before starting to ease the policy rate, even as headline inflation reached the 2% target last month. Overall, the statement after the meeting was considered dovish, and the market is pricing a greater than 60% probability of an August cut, with a 25bp cut almost fully priced by September.



Source: Bloomberg, Emirates NBD Research.

Economic activity looks to be turning around in the UK with PMI numbers holding above 50 for the first half of 2024. However, the recovery looks still tentative and consumer relief in the form of lower rates may help to provide more of a tailwind for the UK economy in the second half of the year. Our forecast for the Bank of England is two 25bps cuts spaced out over September and December.

## Switzerland and Canada cut, RBA waits

Among the smaller economies in the G10, Canada kickstarted its easing cycle with a 25bps cut to policy rates at the Bank of Canada’s June meeting, cutting the overnight lending rate to 4.75%. Comments from BoC Governor Tiff Macklem pointed to the likelihood of further easing in coming months, saying that provided inflation continued to fall towards target, it was

“reasonable to expect further cuts”. Inflation in Canada is within the BoC’s target range of 2% ± 1% as of May.

In Australia and New Zealand, however, inflation remains among the highest in G10 economies, prompting central banks there to keep rates on hold and not offering up any potential easing until perhaps as late as 2025. The Reserve Bank of Australia noted in its June decision (where it kept rates on hold at 4.35%) that “the path of interest rates that will best ensure inflation returns to target...remains uncertain and the Board is not ruling anything in or out.” Markets have seized on that equivocal stance as hawkish and are pricing in a modest chance that the next move from the RBA will be a hike. The RBNZ did not meet in June, but at its late-May meeting it also left its benchmark official cash rate on hold (at 5.5%), noting that “domestic inflation has fallen more slowly than expected” and remains above target.

The Swiss National Bank cut rates by 25bps at its June 20 meeting, taking the policy rate to 1.25%. This was the second cut in a row from the SNB after a 25bps cut in March and was something of a surprise to markets. The SNB noted that the “underlying inflationary pressure has decreased again” and the central bank forecast inflation at just 1.3% on average for 2024 before decelerating to 1.1% next year. The Swiss Franc had been on an appreciating trend against the Euro since May, having gained more than 4% versus the single currency, but has pared these gains since the decision. The SNB noted that it was “also willing to be active in the foreign exchange market” to presumably stem any substantial appreciation in the franc.

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