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Central Banks Pivot, But Push Back Against Premature Rate Cuts

Three major banks met for their policy meetings last week. All of them have de-facto abandoned their tightening biases in favour of a neutral stance, and are ready to adopt an easing bias in coming weeks. But they had to push back against market expectations that they would prematurely cut policy rates. Let's discuss each of these central banks in the chronological order in which they made their decisions.

On December 13th, the US Federal Reserve announced its decision to keep its policy rates unchanged for the third consecutive time, after the September and November "skips." More than that, the new Summary of Economic Projections (SEP) showed that FOMC participants expect three 25-bps cuts in 2024, four cuts in 2025 and three more in 2027, which would bring Fed funds rate from 5.25-5.50% to 2.75-3.00% at the end of the forecast period. That is still above the longer-term level of 2.5%, which is considered a sort of short-term neutral rate (whose value is likely to be higher, by now). Having said all this, in determining the need and extent of "any additional policy firming", the FOMC will continue to monitor incoming data on economic activity and financial conditions. As Chair Powell explained during the press conference, the inclusion of this sentence was necessary to make sure that the possibility of further rate hikes was not completely removed. In spite of this caveat, financial markets celebrated with a fall in market yields, a weaker dollar, and higher equity prices.

The following day, the Monetary Policy Committee of the Bank of England also announced its decision to keep the Bank Rate unchanged at 5.25%, with a 6-3 split in favour of the decision. Three MPC members (J. Haskel, M. Greene and K.L. Mann) voted for a 0.25% increase in the Bank Rate in consideration of the still-elevated level of headline and core inflation (respectively at 4.6% and 5.7%) and a still-resilient labour market, in spite of the weakening economy. During the press conference, central bank governor Andrew Bailey specifically had to say that it was too early for the MPC to start contemplating possible rate cuts, even if the market is pricing them in starting from May/June 2024. Of the three major central banks, this was the strongest pushback against market expectations of rate cuts, taken in consideration of the still-elevated level of inflation.

Also on Thursday, the European Central Bank announced its unchanged policy stance. With its updated forecasts, it revised its growth and inflation forecasts lower. The ECB, the descendant of the German Bundesbank, also said that rates will have to remain at "sufficiently restrictive levels for a sufficiently long period of time", to allow inflation to fall to target levels over the forecast horizon. Given the deceleration of Eurozone economy, the ECB could have indicated more clearly that rate cuts are on the horizon, as the Fed did, but instead it decided to send a relatively hawkish signal. Actually, the ECB also decided to taper, from H2 2024, the reinvestment of the principal proceeding of PEPP bonds, which in itself is a tightening move. In spite of this, markets were still digesting the news from the Fed and continued to celebrate the perceived pivot by central banks.

While all three central banks have remained on hold in December, they all reiterated that it is too early to declare victory against inflation. In spite of this, market participants are now looking at incoming easing cycles, which they expect to begin in the first half of 2024. The skirmishes between markets and central banks are set to continue for a few more weeks.

Our Recent Publications

- *Review: ECB on Hold on Rates, But Announces Tapering of PEPP Reinvestment, by Brunello Rosa and Nato Balavadze, 14 December 2023*
- *Review: BOE Keeps Rates on Holds But Pushed Back on Immediate Rate Cuts, by Brunello Rosa and Nato Balavadze, 14 December 2023*
- *Flash Review: The Fed Keeps Rates on Hold, But SEP signals Three cuts in 2024, by Brunello Rosa and Nato Balavadze, 13 December 2023*
- *Preview: ECB on Hold In December, With First Indications on PEPP Reinvestment, by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 13 December 2023*
- *Preview: Fed to Stay on Hold, "High For Longer" May Be Less Long, by Nouriel Roubini, Brunello Rosa and Nato Balavadze, 12 December 2023*
- *Flash Preview: BoE To Stay on Hold in December, While Warning That Rates Will Need To Remain "High for Longer", by Brunello Rosa and Nato Balavadze, 11 December 2023*

Looking Ahead

The Week Ahead: Headline And Core Inflation To Fall In EZ And UK; Q3 GDP QoQ To Advance In US And To Stall In the UK

In the US, in Q3, according to final estimate, GDP growth is seen advancing by 5.2% q-o-q (*p:* 2.1%). In November, PCE and core PCE price index is likely to decrease to 2.8% y-o-y (*p*: 3.0%) and 3.4% (*p:* 3.5%).

In the EZ, in November, both headline and core inflation rate are expected to fall to 2.4% y-o-y (*p:* 2.9%) and 3.6% y-o-y (*p:* 4.2%). In December, consumer confidence is likely to rise to -16.5 (*p:* -16.9).

In the UK, in November, both headline and core inflation rate are expected to fall to 4.4% y-o-y (*p:* 4.6%) and 5.5% y-o-y (*p:* 5.7%). In Q3, according to final estimate, the economy is likely to stall q-o-q (*p:* 0.2%) and advance by 0.6% y-o-y *(p:* 0.6%). November's retail sales are likely to rise to -1.8% y-o-y (*p:* -2.7%).

The Quarter Ahead: G7 Moves Closer To Seizing Russian Assets For Ukraine; Hungary Blocks Ukraine Aid amid Putin's Statements

G7 advances toward taking control of Russian assets in support of Ukraine. The G7 nations consider seizing Russian central bank assets to support Ukraine amid funding challenges. Talks intensify on utilizing about $300bn of immobilized Russian sovereign assets, marking a significant escalation in the West's financial measures against Moscow. With two key financial aid packages for Ukraine facing setbacks, the move aims to secure an alternative funding source, crucial for postwar reconstruction. Concerns persist among G7 governments about potential repercussions on foreign investors in dollar and euro assets.

The War in Ukraine. Hungary blocks $54 billion EU financial assistance for Ukraine, with the veto occurring shortly after the European Union approved the initiation of membership talks with Ukraine—a decision Hungary opposed. In the meantime, Putin asserts that peace in Ukraine will only be realized when Russia attains its objectives. Putin rejects U.S. assertions that Russia might attack a NATO country, calling it "complete nonsense" and contrary to Russian interests. The statement follows Biden's warning that a Russian victory in Ukraine could lead to a potential attack on a NATO ally, triggering a global conflict.

Last Week's Review

Real Economy: US Headline Inflation Fell; UK Unemployment Was Unchanged; Inflation Edged Down In France And Italy

In the US, in November, headline inflation fell to 3.1% y-o-y (*c:* 3.1%; *p:* 3.2%), while core inflation remained unsteady at 4.0%.

In the EZ, in October, Industrial Production contracted by -6.6% (*c*: -4.6%; *p:* -6.8%). In December, the Economic Sentiment Index rose to 23 (*c:* 11.2; *p*: 13.8)

In the UK, in December, the diffusion index of consumer confidence rose to -22 (*c:* -22; *p:* -24). In October, the unemployment stood at 4.2%. In October, Industrial Production rose by 0.4% (*c*: 1.1%; *p:* 1.5%).

Among the largest EZ economies, in France and Italy, the harmonized inflation edged down to 3.9% y-o-y (*c:* 3.8%; *p:* 4.5%) and 0.6% y-o-y (*c:* 0.7%; *p:* 1.8%) respectively.

Major CBs remained on hold. In the US, the EZ, and the UK, the Fed, the ECB and the BoE held the rates steady in December.

Financial Markets: Stock Prices Increased; US Bond Yields Fell; Dollar Index Is Down, While Gold And Oil Prices Edged Up

Market Drivers: Major stock indexes rose driven by the potential for imminent interest-rate cuts. Long-term UST yields dropped due to inflation data and signals from the Fed, causing the yield on the 10-year U.S. Treasury note to fall below 4% for the first time since the end of July.

Global Equities: increased *w-o-w* (MSCI ACWI, +2.6%, to 716.45). The US S&P 500 index edged up (+2.5% w-o-w, to 4,719.19). In the EZ, share prices were up (Eurostoxx 50, +0.6% w-o-w, to 4,549.55). In EMs, equity prices increased (MSCI EMs, +2.7%, to 1000.89) Volatility rose slightly to 14.65 (VIX S&P 500, 52w avg.: 20.9; 10y avg.: 18.7).

Fixed Income: *w-o-*w, the 10-year US Treasury yields edged down (-31 bps to 3.91%). The 2-year US Treasury yields decreased (-27 bps to 4.72%). The German 10-year bund yield edged down (-24 bps to 2.03%).

FX: *w-o-w,* the US Dollar Index edged down (DXY, -1.4%, to 102.6; EUR/USD +1.2%, to 1.09). In EMs, currencies edged up (MSCI EM Currency Index, +0.7% w-o-w, to 1,726.35).

Commodities: *w-o-w,* oil prices rose (Brent, +1.5% to 76.95 USD/b). Gold prices increased w-o-w (+1.0% to 2,033.80 USD/Oz).

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*Five Star Movement, Italy*
ann.	*annualized*	*m-o-m*	*Month-on-month*
ARS	*Argentinian Peso*	*mb*	*Million barrels*
avg.	*Average*	*mb/d*	*Million barrels per day*
bn	*Billion*	*MENA*	*Middle East and North Africa*
BoC	*Bank of Canada*	*MHP*	*Nationalist Movement Party, Turkey*
BoE	*Bank of England*	*mn*	*Million*
BoJ	*Bank of Japan*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	thousand	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*