



R&R Weekly Column  
By Brunello Rosa



## 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 13<sup>th</sup>, [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).



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**Abbreviations, Acronyms and Definitions**

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	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

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