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Markets Now More Aligned To Central Banks' Likely Policy Moves

Towards the end of 2023, it appeared clear that the world's major central banks were changing their tone. After increasing rates at an unprecedented pace over the previous year, in a *de-facto* coordinated fashion, the US Federal Reserve, the Bank of England, and the Eurozone's ECB started to signal that additional interest rate increases may not necessarily be justified.

The Federal Reserve, for example, "skipped" its rate increases in September and November, thus signalling that its "fast and furious" tightening cycle could afford at least a pause. Similarly, the ECB managed to "slot in" another 25-bps rate increase in September, in a decision that clearly divided the Governing Council, while saying that further hikes would be subject to additional scrutiny. The Bank of England instead skipped September, and in effect began its long pause in its tightening cycle, thus implementing what the Bank's chief economist Huw Pill had labelled a "table mountain approach."

Subsequently, between January and February all three central banks removed their tightening bias, and started to signal that the next move will not necessarily be a rate hike. At the same time, they all warned that rates will need to be kept on hold for quite some time before a rate cut could be considered. As the market tends to get ahead of itself, it has started to price in an aggressive policy easing cycle, for example by suggesting that the Fed may be cutting rates six or even seven times in 2024 – way more than the three cuts suggested by the Fed's dot plot – and the ECB at least five times. We warned that these aggressive expectations were not justified either by data or by central bank communication.

In the last few weeks, the market seems to have come to terms with the reality that central banks will stick to what they had been saying for some time, namely that policy rates will need to be kept "high for longer." In particular, the European Central Bank said last week that it will want to see more data on wage growth before making a decision on cutting rates, and that the bulk of those data will become available after the April meeting, making June the more likely time for the beginning of the easing bias.

The Federal Reserve and the Bank of England will meet this week. As we have written in our preview, the Bank of England will likely take into serious consideration what its Chief Economist Huw Pill has said, i.e. that the beginning of the easing cycle could still be "some way off." The market has interpreted these words by pushing back the time of the first rate cut to August 2024. The Federal Reserve faces a quite persistent inflation pressure deriving from a strong economy and a robust labour market, which could also imply a delay of the first rate cut.

Among the major central banks, the BoJ remains the usual outlier: while all others are thinking to cut rates, it is now preparing the ground for finally exiting its extraordinary easy stance. That might occur as early as in April this year.

Our Recent Publications

- *Preview: MPC Still Split in March, but With an Eye On The Beginning of the Easing Cycle, by Brunello Rosa and Nato Balavadze, 15 March 2024*
- *Key Takeaways from the Munich Security Conference 2024, by Kateryna Anisova, 14 March 2024*
- *Pakistan's Stalemate Election and the Future of The Country's Politics, by Joshua Bowes, 13 March 2024*
- *Insights into the UK General Election: Policies, Polls, and Potential Outcomes, by Lāsma Kokina, 12 March 2024*

Looking Ahead

The Week Ahead: Headline And Core Inflation To Fall In EZ And UK; PMIs To Decrease In US, While Rising In EZ And UK, CBs To Hold

In the US, In March, S&P Global Manufacturing and Services PMIs are likely to decrease to 51.7 (*p:* 52.2) and 52.0 (*p:* 52.3)

In the EZ, in February, headline and core inflation rate is expected to edge down to 2.6% y-o-y (*p:* 2.8%) and 3.1% y-o-y (*p:* 3.3%). In March, consumer confidence is seen rising to -14.7 (p: -15.5). In March, HCOB Manufacturing and Services PMIs are likely to increase to 49.7 (*p:* 49.2) and 47.0 (*p:* 46.5). Composite PMI is seen edging up to 50.5 (*p*: 50.2).

In the UK, in February, headline and core inflation rate is expected to edge down to 3.6% y-o-y (*p:* 4.0%) and 4.6% y-o-y (*p:* 5.1%). In March, S&P Global Manufacturing and Services PMIs are likely to increase to 47.8 (*p:* 47.5) and 54.0 (*p:* 53.8). Composite PMI is seen edging up to 53.3 (*p*: 53.0). In February, retail sales are expected to shrink by -0.8% y-o-y (*p:* 0.7%).

CBs to stay on hold. In the US, the Fed is likely to maintain its Fed funds range at 5.25% - 5.50%. In the UK, the BoE is expected to hold its Bank Rate (BR) at 5.25%. In Japan, the BoJ is seen keeping its policy stance unchanged in March.

The Quarter Ahead: Macron Talks With Scholz In Berlin; Japan Union Announced Record Wage Hikes; US Politics

Ukraine War. During talks in Berlin, Macron emphasized unity among France, Germany, and Poland following a disagreement over Europe's response to Russia's war in Ukraine. Macron warned that Europe's credibility would be severely damaged if Russia succeeds, while German Chancellor Olaf Scholz refrained from deploying Taurus cruise missiles, opting for caution.

Japan Union announced record wage hikes. Japan's largest union group announced that major companies in the country have agreed to a 5.28% wage increase for 2024, marking the highest pay raise in 33 years. This development supports the expectation that BOJ will soon move away from its decade-long stimulus program.

US Politics. Former VP Mike Pence stated that he cannot endorse Donald Trump, the presumptive GOP nominee, due to his conscience, marking a significant rejection of his former running mate and the president he worked alongside. Meanwhile, a judge postponed Donald Trump's hush-money criminal trial until mid-April or later.

Last Week's Review

Real Economy: Headline Inflation Rose, While Core Fell In US; Unemployment Increased In UK

In the US, in February, headline inflation rose to 3.2% y-o-y (*c:* 3.1%; *p:* 3.1%), while core inflation fell to 3.8% y-oy- (*c:* 3.7%; *p*: 3.9%). Michigan Consumer Sentiment decreased to 76.5 (*p:* 76.9) as expected.

In the EZ, in January, IP shrank by -6.7% y-o-y (*c:* -2.9%; *p:* 0.2%).

Among the largest EZ economies, in February *i)* headline inflation fell to 2.5% y-o-y (*c:* 2.5%; *p:* 2.9%) in Germany; *ii)* headline inflation edged down to 3.0% y-o-y (*c:* 2.9%; *p:* 3.1%) in France; and iii) stayed unchanged at 0.8% y-o-y as expected in Italy.

In the UK, in January, the unemployment rate edged up to 3.9% (*c:* 3.9%; *p:* 3.9%). In January, IP decelerated to 0.5% y-o-y (*c:* 0.7%; *p:* 0.6%).

Financial Markets: Stock Prices Were Mixed; Bond Yields Increased; Dollar Index Fell, While Oil And Gold Prices Decreased

Market Drivers: In the US and Europe, yields rose after February US inflation turns out hotter than expected. The yield gap between German and Italian 10-year sovereign bonds narrowed as confidence in Italy's economic growth is outpacing Germany's.

Global Equities: Decreased *w-o-w* (MSCI ACWI, -0.5%, to 767.62). The US S&P 500 index edged up (+0.1% w-o-w, to 5,117.09). In the EZ, share prices rose (Eurostoxx 50, +0.6% w-o-w, to 4,988.95). In EMs, equity prices decreased (MSCI EMs, -0.2%, to 1,034.74). Volatility fell to 14.60 (VIX S&P 500, 52w avg.: 20.9; 10y avg.: 17.6).

Fixed Income: *w-o*-w, the 10-year US Treasury yields rose (+30 bps to 4.31%). The 2-year US Treasury yields increased (+25 bps to 4.73%). The German 10-year bund yields increased (+16 bps to 2.43%).

FX: *w-o-w,* the US Dollar Index increased (DXY, +0.7%, to 103.45; EUR/USD -0.4%, to 1.09). In EMs, currencies edged down (MSCI EM Currency Index, -0.2% w-o-w, to 1,733.09).

Commodities: *w-o-w,* oil prices decreased (Brent, +1.5% to 83.35 USD/b). Gold prices decreased w-o-w (-1.2% to 2,159.4 USD/Oz).

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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*