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Economist's Weekly Market View

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Big Week for Major Central Banks

Three of the world's main central banks, the Fed, BoE and ECB, are holding key policy meetings this week amidst considerable uncertainty and concerns about the prospects for the global economy. It calls to mind the famous opening scene of Shakespeare's great play Macbeth, with its ominous sense of foreboding … "When shall we three meet again? In thunder, lightning, or in rain? When the hurly-burly's done, When the battle's lost and won".

There are certainly battles ahead in terms of combating a new variant of Covid-19 and rising inflationary pressures that could be lost and won in 2022, and in-turn, greatly impact the stance of monetary policy. Indeed, we are already seeing an impact on the BoE's plans to hike rates soon. Markets had priced in that UK rates would be increased by 40bps to 0.5% by end year. However, the BoE surprised markets by not hiking in November and seems set to keep policy on hold again this week.

Indeed, one BoE rate setter, Michael Saunders, who had voted for a rate hike in November, has indicated that there could now be particular advantages in waiting to see more evidence on the effects of the new Omicron variant on public health and the economy before making decisions on changing monetary policy. Markets now think that the BoE will wait until February to start to hike rates, with a modest 12.5bps increase expected then. They now see rates rising to just 0.9% by end 2022 compared to 1.25% previously.

Meanwhile, the ECB was expected to provide a clear long-term framework at this week's Council meeting on its plans for QE post the wind down in March of its pandemic emergency bond purchase programme. However, ECB President Lagarde recently hinted that the ECB may decide to avoid giving a long term commitment at the meeting given the current heightened uncertainty, but may instead set policy for a relatively short period of time. Nonetheless, the ECB can be expected to reaffirm its view that interest rate rises are very unlikely next year and that it will continue with some form of enhanced asset purchase programme during 2022.

The Fed, though, is expected to announce an acceleration in the pace of tapering its asset purchase programme. The US economic recovery is more advanced, its labour market tighter and inflation higher than elsewhere, pushing the Fed towards an earlier start date for rate hikes following a quicker conclusion to QE.

There has been plenty 'hurly-burly' on financial markets in recent weeks as sentiment ebbs and flows in relation to the future path of the coronavirus and monetary policy. Central banks are struggling to maintain a consistent message in the face of new developments on Covid, a rapid acceleration in inflation and increasing uncertainty about the economic outlook.

Volatile markets will be looking for clear guidance on monetary policy when the various central banks meet this week, but they may be disappointed. Like the foretelling in Macbeth, that "Fair is foul, and foul is fair, Hover through the fog and filthy air", things may turn out to be very different to what is expected in 2022. In such circumstances, a cautious approach and not offering too many hostages to fortune may be the best route for central banks to take, as they wait for the heavy fog to clear.

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