CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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Central banks holding back the tide on rate cuts

Following the ECB decision in January, last week saw the US Federal Reserve and Bank of England announce their decisions on rates, with both opting to hold for now. While it was widely expected that monetary policy would remain on pause, central bank watchers were parsing the press conferences for subtle signs that both central banks would move soon. In the aftermath of the meetings, main markets had moved little, with investors having already digested incoming data and comments by key central bankers over the New Year period, and adjusted rate expectations accordingly.

The expected pivot signalled by the Fed was in dropping its tightening bias by subtly changing the language in its statement. The market still expects a first US rate cut at its May meeting, followed by circa 140 basis points (bps) of cuts by year-end, which is considerably more aggressive than the current guidance by the Fed. However, these expectations could yet converge when the Fed publishes new economic forecasts after its next meeting on March 20th, which take into account recent weaker inflation and labour market data.

For his part, Bank of England Governor Bailey stated that the question for it to ponder is 'no longer how restrictive monetary policy has to be, but how long do we need to keep policy restrictive'. Certainly, the new forecasts published by the Bank of England suggest its inflation expectations have tempered, and further good news in its new economic forecasts supports this theme. However, with uncertainties on the horizon in the form a potential giveaway UK Budget in March and a change of Government thereafter, the Governor remained reticent to provide firmer guidance. For now, the market is buying this reticence and is pricing in considerably less rate cuts by the Bank of England than the Fed or European Central Bank, at 100 bps by the year end.

On the main currency markets over the past week the dollar lost some modest ground. EUR/USD has traded towards the top end of its recent $1.07-1.09 range by Friday, and sterling also gained ground versus the dollar, trading up towards $1.28. EUR/GBP has remained range bound, trading around 85.5p. Bond yields were lower for much of the week on the back of central bank news, with significant movement for long-dated US treasuries driven by re-emerging strains in US regional bank with exposures to commercial real estate (CRE) market losses. These fragilities in US CRE may be an ongoing theme as results season unfolds in the coming weeks.

This week will be a good deal quieter with central bank decisions in the rear view mirror; the key macro data points to watch are the final set of Purchasing Managers Indices for January, which will provide a steer on the strength of the global economy in the early part of the year.

David McNamara
Chief Economist
AIB

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