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Did the global easing cycle begin this week?

Most central banks confirmed their easing bias

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FLASH NOTE

SUMMARY

- Most developed central banks unambiguously confirmed their easing bias this week. The Swiss National Bank became the first to deliver a 25bp cut in this cycle. Against trend, the Bank of Japan hiked rates for the first time since 2007.
- We continue to expect the Federal Reserve, the European Central Bank and the Bank of England to start cutting rates in June. More importantly, the debate has started over the pace and extent of the easing cycle.
- The US economy stands out as the outlier in terms of labour market resilience and stickier inflation, raising the risk that the Fed does not deliver the five cuts we forecast for this year. However, we believe that a further normalisation of inflation to an acceptable level of "two point something" would be enough for the Fed to start dialling back policy tightening in June.
- Central bankers could now target a more neutral stance so as not to ease too much and risk a resurgence of inflation. But the neutral rate is an elusive concept and almost impossible to estimate in real time. Moreover, the new macro environment facing central banks will likely be characterised by the prominence of supply shocks as well as fiscal and geopolitical risks, resulting in greater uncertainty and macroeconomic volatility.

CENTRAL BANKS TRY DIFFERENT DANCE STEPS, BUT EASING BIAS DOMINATES

A busy week for central banks saw asymmetrical moves in monetary policy. Alongside rate rises in Japan and Turkey, the Swiss National Bank was the first major central bank in developed markets to cut rates in this cycle. While keeping the exceptions of Japan and Turkey in mind, we see growing evidence that **major central banks are on track to embark on a global easing cycle by the summer**. We summarise their recent decisions in the table below.

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Chart 1: summary of central banks' decisions over the past week

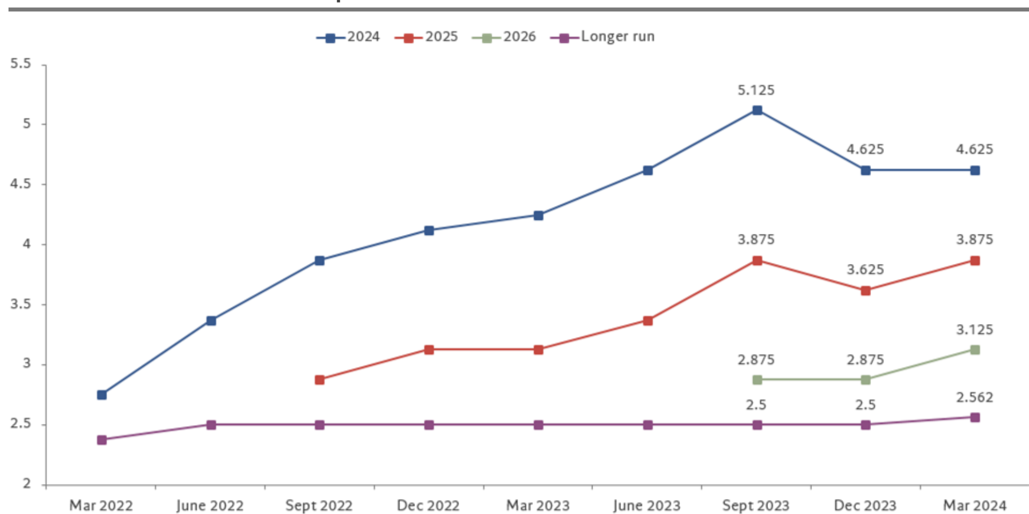
Country	Decision	Comment
Australia (RBA)	on hold at at 4.35%	Shift to a neutral policy stance "not ruling anything in or out"
Japan (BoJ)	**10bp hike to 0.0-0.1%**	**YCC abolished. Flexible JGB purchases. ETFs & REITs purchases ended.**
Indonesia (BI)	on hold at 6.0%	On hold
China (PBoC)	on hold at 3.45% (1Y)	On hold
Czech Republic (CNB)	50bp cut to 5.75%	Dovish vote but hawkish guidance
US (Fed)	**on hold at 5.25-5.5%**	**Easing bias confirmed. Three cuts in the 2024 dots.**
Brazil (BCB)	50bp cut to 10.75%	More flexible forward guidance still consistent with easing bias
Norway (Norges)	on hold at 4.50%	Guidance for September rate cut
Switzerland (SNB)	**25bp cut to 1.50%**	**Easing bias. Large downward revision to inflation forecasts (1.1% in 2026)**
UK (BoE)	**on hold at 5.25%**	**Dovish vote split (8-1) and guidance. Rate cuts "in play".**
Taiwan (CBRC)	12.5bp hike to 2.0%	Hawkish surprise. First change since March 2023.
Turkey (CBRT)	500bp hike to 50.0%	Hawkish surprise. Tightening bias.
Mexico (Banxico)	25bp cut to 11.0%	First change since March 2023. Split 4-1 decision.
Colombia (Banrep)	50bp cut expected to 12.25%	Acceleration of the easing pace expected

Source: Pictet Wealth Management, as of 22 March 2024

The **Federal Reserve (Fed)** left the fed funds rate unchanged this week but **reaffirmed its easing bias**. The Federal Open Market Committee (FOMC) boosted its growth and inflation projections but, crucially, **the median 'dot plot' for 2024 stayed at three rate cuts for this year**. The margin was thin, with 10 FOMC members forecast three cuts or more (vs.11 last time), and nine forecasting two or less. For 2024, the FOMC forecasts significantly higher GDP growth (2.1%, up from 0.7%, mostly due to an expansion of labour supply, including immigration) and slightly higher core inflation (2.6%, up from 2.4%).

Importantly, the median dots for 2025 and 2026 were each revised 25bp higher, to 3.875% and 3.125%, respectively, consistent with three cuts each year. The longer-run median moved slightly higher, to 2.6% from 2.5%, suggesting that **the FOMC is slowly coming around to the view that the neutral rate is likely higher**.

Chart 2: FOMC median dot plot evolution



Source: Pictet Wealth Management, Federal Reserve, as of 22 March 2024

Fed chairman Jerome Powell repeated his previous comment that a rate cut would likely be appropriate at some point this year, with two more consumer price index (CPI) reports before the June Fed meeting carrying significant importance. Powell

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said the strong inflation numbers in January and February had not changed the broader path of gradual disinflation on a sometimes-bumpy road toward 2%, stressing the role of seasonal factors in the numbers.

The risks to our Fed call of a first cut in June and 125bp of cumulative easing are tilted towards a later start and fewer cuts, yet we believe that the Fed's reaction function remains consistent with a cautious easing cycle starting by the summer. Looking ahead, we have a less constructive view than the Fed on growth and the labour market. Powell mentioned at multiple points the risk of employment unexpectedly weakening, a risk the committee is very much sensitive to.

Finally, Powell noted that the tapering of quantitative tightening (QT) is coming "fairly soon". We expect QT tapering to be announced in May, with the FOMC targeting a gradual approach to the ultimate balance sheet level, i.e. slower for longer.

In **Canada**, the surprise decline in CPI inflation in February to 2.8% (vs. a consensus expectation for a rise to 3.1%) has fuelled speculation of an earlier-than-expected rate cut from the **Bank of Canada** (BoC) from the current level of 5%.

The **Reserve Bank of Australia** (RBA) left its cash rate target unchanged at 4.35% this week but dropped its tightening bias. The March statement noted that "the Board is not ruling anything in or out", consistent with a neutral stance. RBA governor Michele Bullock justified the communication change as a response to some data that made them "more confident about the path [they] we are on".

SWITZERLAND SHOWING THE WAY

Moving on to Europe, the **Swiss National Bank** (SNB) surprised the market with a 25bp cut to its policy rate, lowering it to 1.50%. We and the market had expected the SNB to cut rates in June, although large downside surprises to CPI inflation in January and February had raised the risk of an earlier move. In its monetary policy statement, the SNB argued that the decision to ease was made possible "because the fight against inflation over the past two and a half years has been effective".

Moreover, the SNB took into account "**the appreciation of the Swiss franc** in real terms over the past year", a sign of growing concerns over Switzerland's growth outlook.

The biggest surprise came from the very large downward revisions to the SNB's inflation forecasts, to the tune of around 50bp. The medium-term inflation forecast point (to end-2026) was revised to 1.1%, compared with 1.6% three months ago, on the back of "lower second-round effects". Inflation would average 1.2% in 2025 and 1.1% in 2026, based on the assumption of no change to the SNB rate.

The SNB's definition of price stability is "less than 2%", but we believe that 1.1% inflation is too low to its own taste. These large downward revisions to inflation forecasts along with dovish guidance suggest that the SNB will deliver additional easing. **We expect the SNB to cut policy rates again in June, to 1.25%, with a risk of another move later this year.**

One reason why the SNB may still move cautiously after the summer is the uncertain level of the neutral rate. Chairman Jordan mentioned some academic estimates

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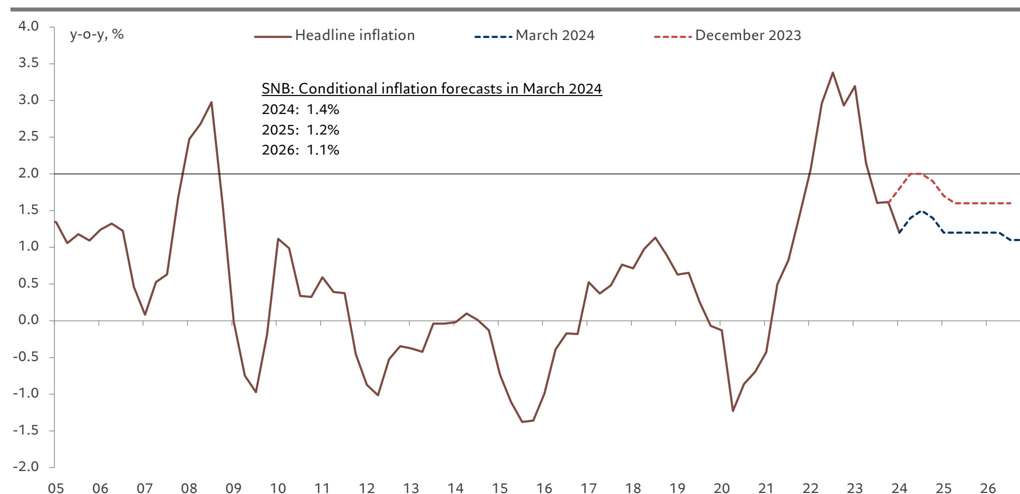
of the Swiss real neutral rate somewhere between 0% and 0.5%, although the SNB never took an official view on the subject. Assuming long-term inflation around 1%, these estimates of the neutral rate would be consistent with a nominal policy rate close to 1.25%. That said, the SNB may eventually want to ease below neutral, if only temporarily, if growth were to weaken or inflation to undershoot their projections.

Chart 3: SNB conditional inflation forecasts



Source: Pictet Wealth Management, Swiss National Bank, as of 21 March 2024

HEY JUNE, DON'T MAKE IT BAD

The **European Central Bank** (ECB) held its annual Watchers Conference in Frankfurt. Several officials confirmed that June would be the most likely timing for a first rate cut, but without pre-committing to a specific rate path. ECB president Christine Lagarde discussed the criteria to be met for the ECB to ease, including "two important pieces of evidence": Q1 negotiated wage growth to be released at the end of May, and the macroeconomic staff projections in June.

Forward-leading indicators remain broadly consistent with the ECB's assessment of price stability, including the most recent wage trackers that their chief economist presented at the conference. If the upcoming data reveal "a sufficient degree of alignment" between underlying inflation and the ECB's projections, a June rate cut looks baked in. **We expect the ECB to cut rates by 25 bps in June, pause in July (although the doves will push harder), and to resume cutting at every meeting from September.**

Looking ahead, both Lagarde argued that the ECB will have to reassess the outlook on an ongoing basis. There is still a lot of uncertainty in terms of the path for wage growth, profits margins and productivity. **Sensitivity analysis** mentioned by Lagarde suggests that there were a "full catch-up" of real wages up to pre-pandemic levels by the end of this year (instead of the assumed catch-up over the next three years), inflation would rise to 3% in 2025 and only fall to 2.5% in 2026 (instead of 1.9% in the March projections). On the corporate side, if profit margins were to rise by 1% more than expected by the ECB until the end of 2026, the study shows that inflation would be 2.7% in 2025 and 2.4% in 2026.

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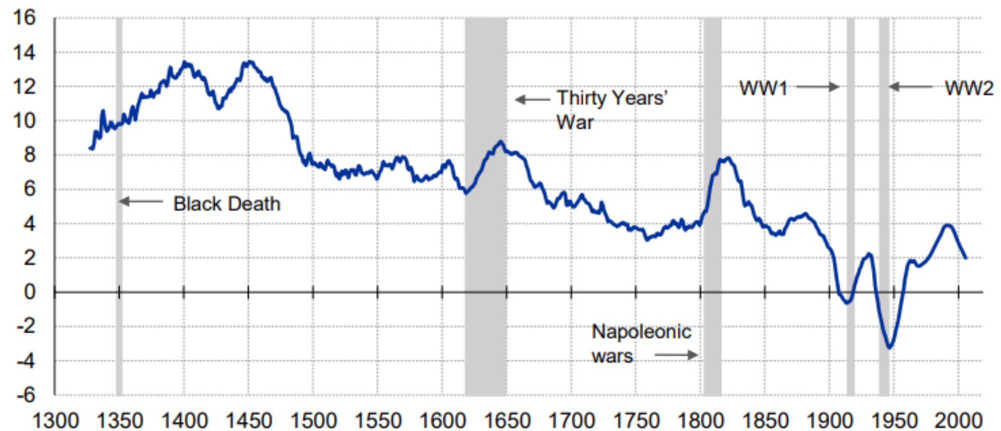
Lastly, Executive Board member Schnabel argued that the ECB needs to take into account a potential shift higher in the natural rate of interest, or r*. Beyond structural factors linked to demographics or productivity, Schnabel argued that the central bank itself may influence long-term interest rates with their forward guidance. She mentioned new ECB research showing that a 100bp monetary policy shock in the US had historically been associated with a 30bp increase in r*.

Chart 4: ECB's estimate of the global real interest rate (percent)



Source: Pictet Wealth Management, ECB (Rogoff, Rossi and Schmelzing, 2022)

Last but not least, the **Bank of England** (BoE) this week left rates unchanged at 5.25%, but shifted to a more neutral stance as well. It was the first time since September 2021 that no Monetary Policy Committee (MPC) member voted for a hike after the two hawkish dissenters, Jonathan Haskel and Catherine Mann, abandoned their call for additional tightening. The statement repeated that policy needs "to remain restrictive for sufficiently long", but the minutes added that the monetary stance "could remain restrictive even if the Bank Rate were to be reduced", adding that high policy rates were ultimately "bearing down on inflationary pressures".

Governor Andrew Bailey added that **the BoE was "not yet at the point to cut rates"**, suggesting that it is actually getting closer to this point. He was more explicit in an interview published this morning, saying that (several) **rate cuts are "in play"**, adding that "credibility can also be affected by waiting too long".

The change in the MPC vote and guidance were backed by more encouraging data. CPI inflation surprised to the downside, falling to 3.4% in February, and is expected to ease further "to slightly below the 2% target in Q2". The MPC stressed that the labour market continued to ease, supporting a further decline in "most indicators of pay growth". As regards growth, the MPC continues to forecast an improvement in H1 following the contraction recorded in H2 2023. The measures announced in the UK government's Spring Budget were described as a net positive, including the 2% cut in national insurance contributions, but no game-changer.

We continue to expect the BoE to cut rates in June, and to ease by 100bp in total this year, bringing the bank rate down to 4.25%. There is still a risk that the BoE wants to play it safe and waits until August. Either way, we continue to believe that once it starts cutting, the BoE will have some room to go given a relatively high starting point, with an easing cycle that could extend well into 2025.

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