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# EcoFlash

## Central banks: a pause while waiting for more information

**As expected, the Fed, the ECB, and the BoJ left their rates unchanged this week. This pause, however, does not mark the end of the cycle. The ECB's tone is becoming more balanced, weighing inflationary risks against tightening financial conditions, but one final rate hike in December remains our base case. Across the Atlantic, Kevin Warsh describes an environment conducive to further tightening, while remaining cautious about the risk of a credit shock. In Japan, the lasting exit from the deflationary cycle is taking shape, and monetary policy adjustment is expected to continue gradually. We anticipate two rate hikes by the Fed by January and four by the BoJ by the second half of 2028.**

**Eurozone: A more balanced tone, but the course remains unchanged.** The ECB's statement marks a shift from September. It now explicitly acknowledges both upside risks to inflation (the magnitude and persistence of the energy shock) and downside pressures (tightening financial conditions). The statement that inflation would remain "well above target for an extended period" no longer appears. In essence, however, there is little change. A rate hike in December remains our base case scenario, widely anticipated and implicitly signaled by Christine Lagarde during the Q&A ("If the current situation is not called into question by the next set of economic data, the path is clear"). Lagarde presented the rise in sovereign yields as a global phenomenon that is tightening financial conditions; regarding the TPI, she stuck to the usual stance: the ECB will intervene if monetary policy transmission were to be hampered "by disorderly movements not justified by fundamentals". By December, the indirect and second-round effects of the energy shock will be closely scrutinised. From our perspective, September's producer prices offer clearer signals, but the increase remains limited to a few sectors: energy, electricity-intensive industries and electrical equipment, driven by IA[1]. For now, companies in the Eurozone, particularly in the services sector, appear to be absorbing the shock. The European Commission's survey released this Thursday indicates a rise in the sales price index in October, which remains in line with recent months.

**United States: The Fed navigates between risks.** The FOMC pauses after September's rate hike and maintains the federal funds target at 3.75%-4.0%. However, Fed Chairman Kevin Warsh outlined a landscape conducive to further tightening: stronger growth, "rather positive" labor market conditions, and, above all, inflation that is "too high." As a result, two dissenting votes (out of 12) were cast in favor of a 25bps hike. But the committee also appears to fear the adverse consequences of tightening too quickly, which is why it is waiting to "accumulate more information." AI is increasingly at the heart of monetary policymaking. In particular, K. Warsh warned against the risks of an abrupt tightening of interest rate conditions, including for the AI investment cycle - which triggered a steepening of the yield curve. He also announced that he would soon (on November 16) attend a hearing of the "Productivity and Employment" task force to "refine his views" on the implications of AI for the dual mandate. Governor Lisa Cook, who voted for a 25bps hike, had noted ahead of the committee meeting "ongoing inflationary pressures" and a risk that they might not "subside quickly". In addition, K. Warsh announced that there would be fewer meetings resulting in rate decisions: 7 in 2027 and 6 in 2028, compared with 8 today. The change is expected to take effect starting in the fall of 2027. The meetings freed up by this change would allow the committee to focus on "strategic deliberations" and long-term issues.

**Japan: A *status quo*, but a tightening cycle set to continue as the economy emerges from deflation.** The Bank of Japan decided, in line with our forecasts and the consensus, to keep its policy rate target steady at 1.25% at its October 29-30 meeting. One dissenting vote called for a rate hike (25bps), contrasting with the two dovish dissenting votes (opposed to a rate hike) at the previous meeting. As in the US, the decision is justified by the need to further analyse risks to economic activity, prices, and financial conditions. Above all, the central bank's outlook for economic activity and prices marks a turning point: it explicitly states that "core inflation has reached a level generally in line with price stability" and that it is "expected to remain there." Governor Ueda refined this by noting that it is now necessary to "anchor" inflation at this level before declaring the target achieved. Furthermore, the emphasis on "upside risks to prices" and the fact that any rise in core inflation is now deemed "undesirable" indicate that monetary tightening will continue.

**The monetary tightening cycle continues.** The next steps are likely to be more significant in the United States, where inflation has exceeded the target for nearly six years and coexists with a favorable outlook for growth and employment. In the Eurozone, the rise in inflation is primarily due to a supply shock in energy costs (though it is also fueled by demand in the United States). It continues to have little impact on measures of core inflation, including those tracked by the ECB, such as the HICP; and households' long-term inflation expectations remain anchored. The degree of monetary tightening also differs. In real terms, the ECB's current rates (the deposit facility rate deflated by the core CPI) hover around 0%, a level that more or less corresponds to estimates of the natural rate. The Fed, meanwhile, remains in accommodative territory: the real rate (*Fed Funds* deflated by Core

[1] This is a point underscored by the first PPI releases for September (Spain, Italy).

PCE) is at around 0.8%, 40bps below the committee's implied long-term level (1.2%). Japan remains an outlier: the rise in rates preceded the inflationary shock and, until now, has been more a matter of normalization. It is therefore more extensive and spread out over time. The central bank is adjusting to the new inflation regime and remains cautious in its exit from accommodative policies. The starting point is significantly lower, with real rates still negative, but the adjustment cycle should ultimately bring it to the upper end of the neutral range estimated by the BoJ (1.1%-2.5%). We therefore anticipate one final rate hike by the ECB in December, two more hikes by the Fed, first in December and then in January, and four spaced-out hikes by the BoJ through the second half of 2028.

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