EACH CENTRAL BANK HAS ITS OWN PACE

2024 should be the year of the start of the easing cycle by the Federal Reserve, the ECB, and the Bank of England, primarily to accompany the easing of inflation. However, the timing of the first cut remains uncertain, as does the number of expected cuts. Conditions for a first rate cut in June seem to be in place for the ECB, which, according to our forecasts, would thus act before the Fed, whose first rate cut is expected in July (instead of June previously). The possibility is rising that the Fed will not cut rates at all this year because of the resilience of growth and inflation. Such a prolonged Fed monetary status quo could have more negative than positive consequences.

Until early April, our expectations of policy rate cuts[1] converged on a first synchronous move by the Federal Reserve, the European Central Bank and the Bank of England in June (depending on the meeting dates, 6 for the ECB, 12 for the Fed, and 20 for the BoE). Such a synchronicity, though unsurprising, was, however, uncertain given the higher-than-expected January and February 2024 US inflation figures, some desynchronization of business cycles, and the uncertainty inherent in any forecast. Developments during the week of 8 April led us to revise our Fed and ECB call and the BoE scenario may have to be adjusted too in the near future. With US inflation (as measured by the CPI) surprising again on the upside in March[2], we now expect only two rate cuts by the Fed this year, the first one in July and the second one in December (instead of three previously). For the ECB, we keep our forecast of a first rate cut in June, but we have ruled out our back-to-back cuts forecast (i.e. June, July and September), favouring a more gradual easing of one cut per quarter (in June, September and December), more in line with the ECB's cautious stance so far.

WHY CUT POLICY RATES?

For the United States, the main argument for lower policy rates – to accompany lower inflation – is becoming more difficult to advocate, owing to limited disinflation progress, if at all. The argument that the Fed could cut rates despite the current resilience of growth – on the grounds that this strength would primarily benefit from a non-inflationary supply-side recovery (supported by investment efforts, productivity gains, and an immigration-induced boost to labour force) – also seems to be weakened. Monetary easing can however respond to more negative signs which are emerging in the labour market, that put into perspective the robustness of non-farm payrolls gains until March. But these warning signs remain limited for now. Looking ahead to 2025, the US economy's expected soft landing scenario (which combines a return to potential growth and a continued slow decline in inflation to the 2% target) does not require nor permit rapid rate cuts.

The situation in the euro area is different and the case for rate cuts from June onwards is more compelling. True, on an annual average basis, we see Eurozone growth significantly increase between 2024 (0.7%) and 2025 (1.7%), while US growth would decrease also significantly (1.8% after 2.8%[3]). But Eurozone starting position is much less favourable than the US one. The recovery remains to be confirmed on this side of the Atlantic while growth is stronger footed in the US. In other words, Eurozone growth needs support, while US growth needs to be restrained.

ECB interest rate cuts would thus be helpful in this recovery process, against a background of falling inflation. These cuts would facilitate the necessary fiscal consolidation efforts too. Italian Governor Piero Cipollone, who recently joined the ECB Board, also recently delivered a very dovish speech. Instead of highlighting the inflationary fears linked to the combination of strong wage increases and weak productivity gains, he warned of the risk of a too rapid slowdown in wages (due to monetary policy being too restrictive for too long[4]). He points out that wages still have room for catching up and that their dynamism is one of the key factors in strengthening the nascent recovery in the euro area. Without the economic recovery, there will also be no cyclical rebound in productivity, which is, yet, crucial in returning inflation to its 2% target.

All in all, and as Christine Lagarde heralded it during her press conference early March[5], the ECB knew a little more at its meeting on 11 April about the data conducive to starting its monetary easing cycle, but not enough to act and cut. It should have gathered enough information and therefore "*know a lot more*" by the next meeting on 6 June to make the first rate cut. However, according to our forecasts, the economic conditions would allow only a very gradual easing of monetary policy. It will be a matter of accompanying the recovery without triggering a rebound in inflation, while the stickiness of some of its components prevent it from falling more significantly, not to mention the possible inflationary effects of the recent tensions on oil and gas prices. If it claims to be independent of the Fed, the ECB cannot completely ignore another possible source of imported inflation, if acting before and possibly with more cuts than the Fed led to a marked depreciation of the euro-dollar.

WHAT IF THE FED DOES NOT CUT AT ALL?

While the conditions for the ECB to cut rates seem about to be achieved, the possibility is rising that the Fed will not cut them at all – or even that it will have to raise them again – given the resilience of growth and inflation[6].

What could be the consequences? On the one hand, this could shake financial markets and economic agents, whose current risk-on mood and upturn in confidence are partly driven by rate cuts expectations. If the latter were to be disappointed, this could precipitate a correction in the financial markets and a business cycle downturn. Existing vulnerabilities (residential and commercial real estate markets, business failures, large debt refinancing needs, delinquency rates on credit cards) could expand and spread, driving the economy into recession.

1 All expected cuts are 25 bp.
2 For more details, see INFLATION TRACKER - APRIL 2024 | INFLATION REMAINS ON A DOWNWARD TREND, EXCEPT FOR THE UNITED STATES (bnpparibas.com), 12 April 2024.
3 This elevated figure for 2024 GDP growth benefits from a very positive carryover effect.
4 The confidence to act: monetary policy and the role of wages during the disinflation process (europa.eu), 27 March 2024.
5 Christine Lagarde said that, if the ECB was on track to meet its inflation target, more statistics would be needed before it could be sure: "we will know a little more in April, but we will know a lot more in June" (source: ECB, Monetary policy statement and press conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, 7 March 2024).
6 It should be borne in mind, though, that from the point of view of the Fed's preferred measure of inflation, namely the consumption deflator (PCE), the picture is not as negative as that depicted by CPI figures. Until February 2024 (last available point), the fall in PCE inflation was more pronounced and its level significantly lower (by 0.7 percentage points for headline inflation, which stands at 2.5% y/y, and by 1 pp for core inflation, which reaches 2.8% y/y). According to this PCE measure, inflation is thus less far off the 2% target.

In a recent analysis, the IMF highlights the wide diversity of situations across countries, which could mitigate the risk of such a spill-over[7] . And for the US in particular, the good news is that the characteristics of its residential housing market and the evolution of these characteristics since the 2008 financial crisis and the Covid-19 shock suggest a weakening of this monetary policy transmission channel. On the other hand, a Fed's monetary status quo would not necessarily be bad news if it is, partly, the result of the solid performance of the US economy: if the real world is doing well, it is a good sign for the financial world too. On balance, between the negative and the positive scenario, it is difficult to assess which one would prevail, but, in our view, the risks seem to be tilted to the downside.

To conclude, if we go back to the ECB's point of view, in our scenario, it would end up cutting rates before the Fed, which would be noteworthy news and a well-founded move according to our forecasts. It should be noted that several emerging market central banks have already started cutting rates and that the Swiss National Bank (SNB) paved the way for developed country central banks in March. The BoJ continues however to stand out from its peers, starting only to embark on a process of monetary tightening. As can be seen from the «heatmap» below showing policy rate changes since 2020, after the "big tightening" in 2022, when rate hikes were the rule, the time for a synchronous "big easing" has not yet come. Starting in 2023, the rate cuts would remain scattered in 2024.

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7 *Housing is One Reason Not All Countries Feel Same Pinch of Higher Interest Rates (imf.org), 8 April 2024.*

POLICY RATE CHANGES