TO CUT OR NOT TO CUT (SIMULTANEOUSLY)?

US inflation March figure, again higher than expected, put an end to our scenario of a simultaneous first rate cut by the Fed, the ECB, and the BoE in June. We now expect only two rate cuts by the Fed this year, the first in July and the second one in December. The possibility is even rising that the Fed will not cut rates at all this year. On the ECB's side, we maintain our expectation that the first cut will occur 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). The ECB would end up cutting rates before the Fed.

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 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) again surprising 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.

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 lower 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[3].

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%[4]). 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 help support the recovery of the economy against a background of falling inflation. These cuts would also facilitate the necessary fiscal consolidation efforts.

All in all, and as Christine Lagarde heralded it during the 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. Then, 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.

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. What could be the consequences? On the one hand, this could undermine 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. 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.

In our scenario, the ECB 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. 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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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 For more details on our analysis and forecasts per country, see the April issue of EcoPerspectives, coming soon
4 This elevated figure for 2024 GDP growth benefits from a vey positive carryover effect.
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).