AE monetary policy tracker

July 11, 2024

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Key takeaways

- The year 2024 marked a change from the restrictive stance of monetary policy across most major advanced economies, even as expectations of easing kept getting pushed back due to the persistence of inflation. Some of the advanced economies chose to cut ahead of inflation reaching target, as economic activity showed signs of weakening. However, the extent and pace of easing remains uncertain and data dependent, as the last mile of disinflation process has turned out to be protracted. Core inflation remains above the headline print in many advanced economies due to elevated wages and high services inflation. Financial markets continue to gyrate as they re-price expectations of policy easing based on incoming data. But there are exceptions, with certain central banks tightening due to idiosyncrasies pertaining to their economies or policy objectives.

- In the latest meetings held in June, monetary policies were unchanged in the US, the UK and Japan. But the ECB lowered key policy rates by 25bps, citing progress in disinflation. However, upward revision to its inflation forecasts for 2024 and 2025 indicate that the ECB might adopt a cautious, data dependent approach before cutting rates further. Market is currently pricing another rate cut by the ECB in September, the first cut in the US by September, and a similar timing for the start of easing in the UK.

- In some of the major policy moves this year, the Bank of Japan ended its eight-year long negative interest rate regime by hiking rates for the first time in 17 years. On the other hand, the Swiss National Bank surprised markets with two rate cuts so far this year, one in March and the other in June, as inflation stayed within the bank's target range for months. In May, Sweden's Riksbank cut policy rate for the first time since 2015, as inflation neared target in March and economic activity contracted in 2023. Bank of Canada also cut policy rate in June as inflation eased and growth in the first quarter of 2024 was slower than expected.

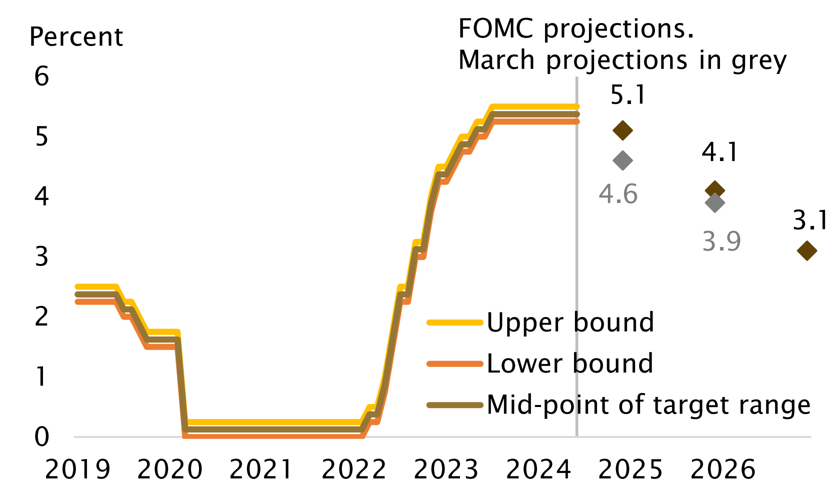
- In addition to Japan, financial market is pricing rate hike in Australia this year. Among other exceptions, Bank Indonesia surprised with a rate hike in April as a pre-emptive move to stabilize its currency against a strengthening USD, and risk-off sentiment due to geopolitical tensions that drove capital outflows from EMs.

Central bank	Latest meeting	Action	Upcoming decision	Market pricing
US Fed	Jun-12	No change	Jul-31	First rate cut by Sep
ECB	Jun-06	25bp rate cut	Jul-18	Another 25bp cut by Sep
BoE	Jun-20	No change	Aug-01	First rate cut in Aug/Sep
BoJ	Jun-14	No change	Jul-31	20bp hike by Dec

Fed FOMC policy unchanged in June; easing likely from September

- At its monetary policy meeting concluded on June 12, the Fed FOMC held target range for the policy rate unchanged at 5.25-5.50 percent for the seventh consecutive meeting. The last time the Fed hiked was in July 2023. While the FOMC noted the "lack of progress" in disinflation in May policy statement, in its latest policy, the committee acknowledged the "modest progress" in disinflation in recent months.
- As per the latest dot plot, median expectation is now for one-two rate cuts in 2024 amounting to less than 50bps, lower than three in March of around 75bps. Median view for 2025 was almost the same in March and June at around three cuts totaling 75bps.
- The next Fed policy outcome is due on July 31. Market is currently pricing the first rate cut in September, with the possibility of two more in November and December.

Fed funds rate projections revised up in June for 2024, 2025



Median estimate of 2.5% policy rate in the longer run masks the divergent views between FOMC members that are aligned towards a higher terminal rate of 3% and above, and away from sub-2.5%. Though inflation is expected to return to the 2% target in 2026, median view of Fed funds rate for the year stayed in the range of 3.00-3.25% in March and June dot plots.

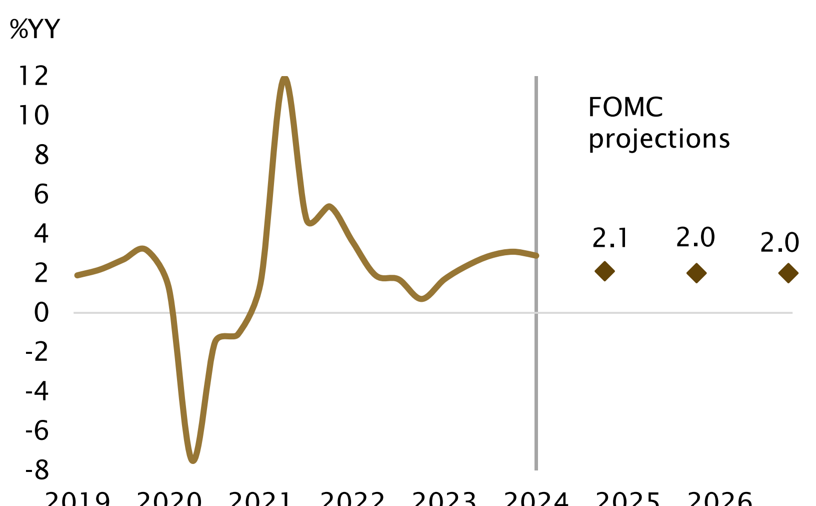
Fed FOMC dot plot: Assessment of federal funds rate in the longer run

Longer run	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
4.00											
3.75								••	•	•	•
						•	•				•
3.50								•	••	••	••
3.25					•	•	•	•			
										•	•
3.00	••	••	••	••	•	•	•	•	•	•••	••••
									•		
2.75							••		•	•	•••
				•	•	•	••	••	•	•	•
2.50	•••••••••	•••••	•••••••	••••••••	•••••••••	••••••••	•••••••	••••••••	••••••••	••••••••	•••••
	•	•	•	•	••	••	•••	•••	•••	•	•
2.25	••••	••••••	••••••	••••••	••••	•••					
2.00	•	•	•								

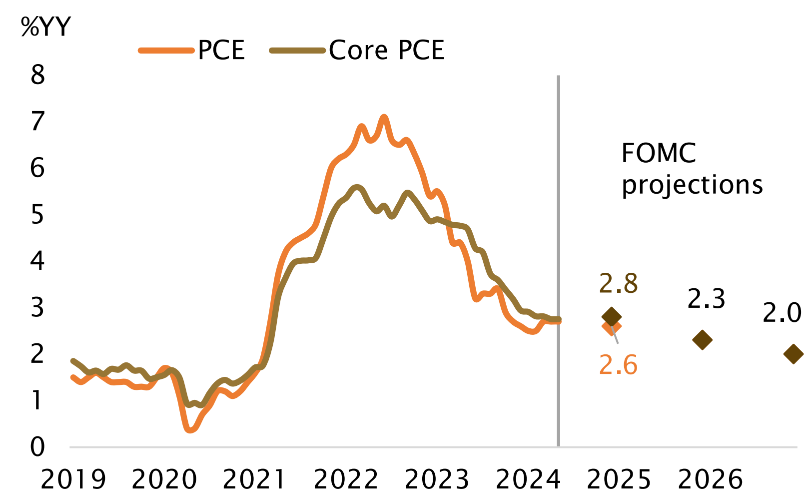
Fed minutes reiterate pockets of weakness in economy

- As per June projections, median view of FOMC members is for real GDP growth to moderate to 2.1% in 2024 from 2.5% in 2023, and then further to 2.0% in 2025 and 2026. These were unchanged from March. In case of PCE and core PCE inflation, members revised up their forecasts from March for each by 20bps for 2025 and by 10bps for 2026. Members continued to expect both headline and core inflation to average 2% in 2026.
- While median projection for unemployment rate was at 4% for 2024 at both March and June meetings, it was revised higher by 10bps for both 2025 and 2026 to 4.2% and 4.1%, respectively. In the Fed's latest Biege book, there were observations around lower employee turnover, increase in employers' bargaining power, while minutes of the June meeting noted moderation in nominal wage growth.
- In addition to softness in labor market indicators, some of the concerns reflected in the minutes of the Fed's June meeting were around increased delinquencies on auto loans and credit cards in Q1, signaling pressure on some households' balance sheets, and credit quality in the commercial real estate market. The minutes also noted the decline in pricing power of firms amid consumers' increased price sensitivity.
- Latest data on nonfarm payrolls indicated a moderation in Q2 with average addition of 177,300 from 267,300 in Q1. The unemployment rate increased to 4.1% in June from 4.0% in May. Both PCE and core PCE eased to 2.6%YY in May from 2.7% and 2.8%, respectively in April. In June, year-ahead inflation expectation moderated to 3.0% from 3.3% in May, as per University of Michigan's consumer survey.

Real GDP growth projections unchanged in June



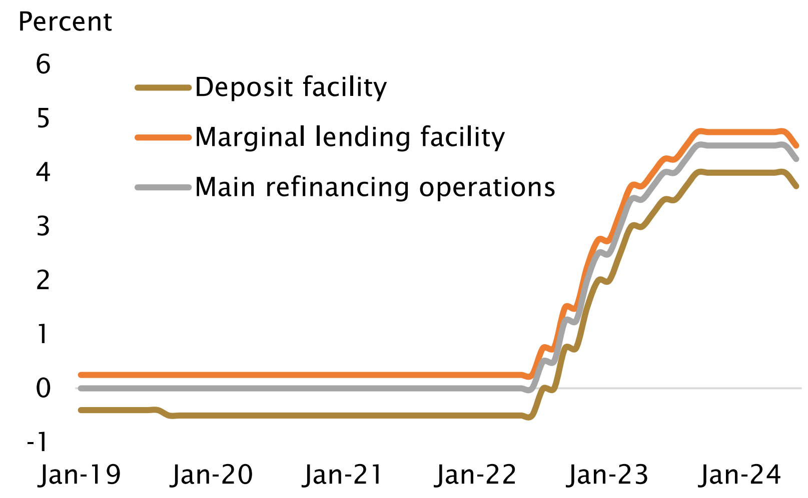
PCE, core PCE projections revised higher by 20bps in June



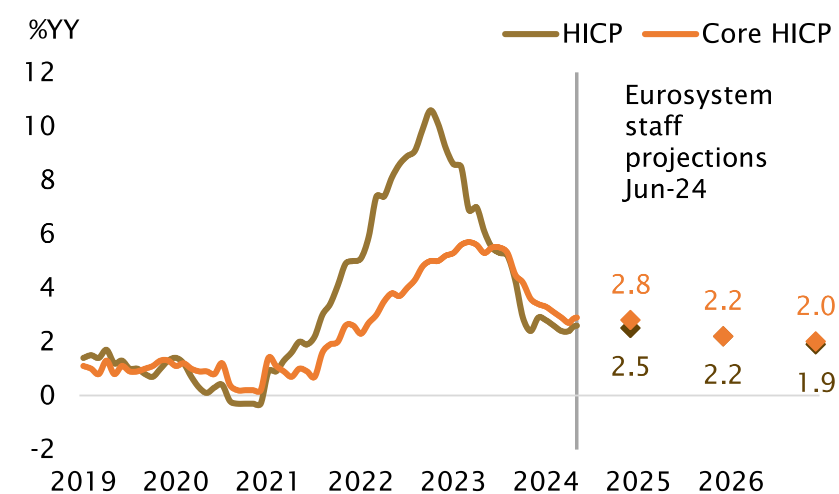
ECB delivered hawkish 25bp cut in policy rates at June meeting

- At its latest monetary policy meeting held on June 6, the ECB's governing council cut key policy rates by 25bps after keeping them unchanged since September 2023. Accordingly, rates on refinancing operations, marginal lending facility and deposit facility were cut to 4.25%, 4.50% and 3.75% respectively, with effect from June 12.
- The Eurosystem staff projection for real GDP growth was raised by 30bps for 2024 and cut by 10bps for 2025 compared with March forecasts. Headline and core inflation forecasts were revised up 10-20bps for 2024 and 2025. Both headline and core inflation are expected to stabilize around the ECB's target of 2% by 2026.
- In the post policy press conference, President Lagarde reiterated the ECB's commitment to attain 2% inflation objective and refrained from pre-committing to a particular rate path, thereby lending a hawkish tone to the ECB decision. The central bank will remain data dependent in its approach to policy making. The objective of a rate cut in June was to lower the degree of policy restrictiveness, and despite the cut, real interest rates remained higher compared to Sep-2023 (when the ECB had last hiked) due to the moderation in inflation achieved since then. President Lagarde noted that the disinflationary path stays bumpy due to elevated wage pressures and services inflation, which are expected to moderate later in the year and in 2025. Flash estimates for June indicate that Eurozone headline inflation eased to 2.5%YY from 2.6% in May, while core inflation was stable at 2.9%. The unemployment rate in May was unchanged from April at 6.4%.
- The next ECB policy decision is due on July 18. Market is currently pricing one 25bp rate cut in September and another 25bp one in December.

ECB cut key policy rates cut after holding for nine months



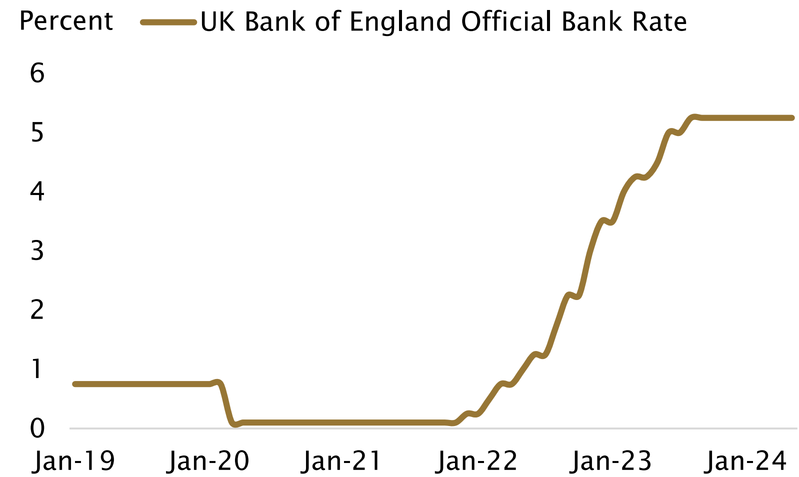
Headline, core inflation projections revised up from March



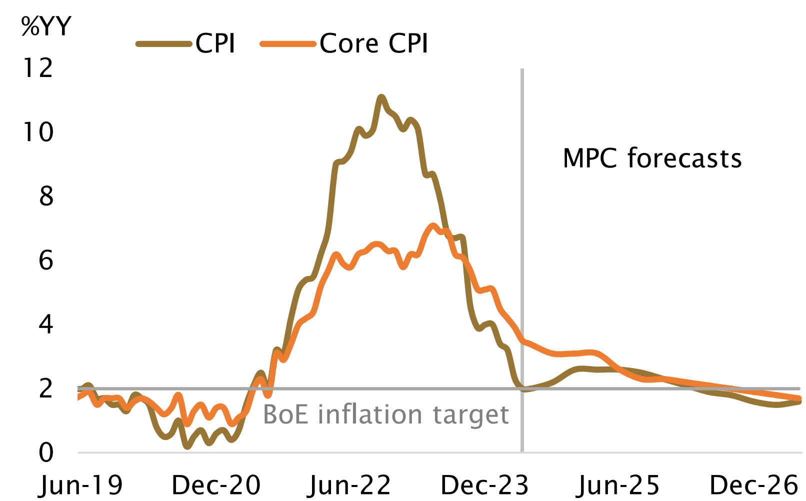
BoE held policy rate at 5.25% in June; easing likely in August

- At its monetary policy meeting decision on June 20, the Bank of England's Monetary Policy Committee (MPC) maintained the Bank rate at 5.25% for the sixth consecutive meeting since September 2023. A majority of seven MPC members voted for status quo, while two voted for a 25bp rate cut.
- Both headline and core inflation continued to moderate. The headline CPI softened to the central bank's 2.0% target in May from the peak of 11.1% in October 2022. Core inflation eased to 3.5% from the peak of 7.1% in May 2023. However, inflation is expected to rebound in H2-2024, as favorable effects from low energy prices in 2023 fade from data. The MPC's forecasts from the latest quarterly monetary policy report (MPR) published in April shows expectations of inflation moderating sub-2% on a sustainable basis only in 2026. Wage growth and services inflation remain high relative to historical trends, so that core inflation continued to trend above the headline print for the eighth successive month.
- The minutes of the latest MPC meeting suggest stronger-than-expected growth momentum.in Q1 and Q2. Consumers remained cautiously optimistic in Q2 amid strong gains in housing and business investments in Q1. Latest MPR note indicates real GDP growth to average 0.4% in 2024 (compared to 0.1% in 2023), 0.9% in 2025 and 1.3% in 2026. Growth in 2024 could be higher due to strong growth momentum in Q2.
- The next BoE MPC decision is due on August 1. Market is currently pricing one 25bp rate cut in August and another 25bp by December.

Bank rate unchanged at 5.25% for sixth straight meeting



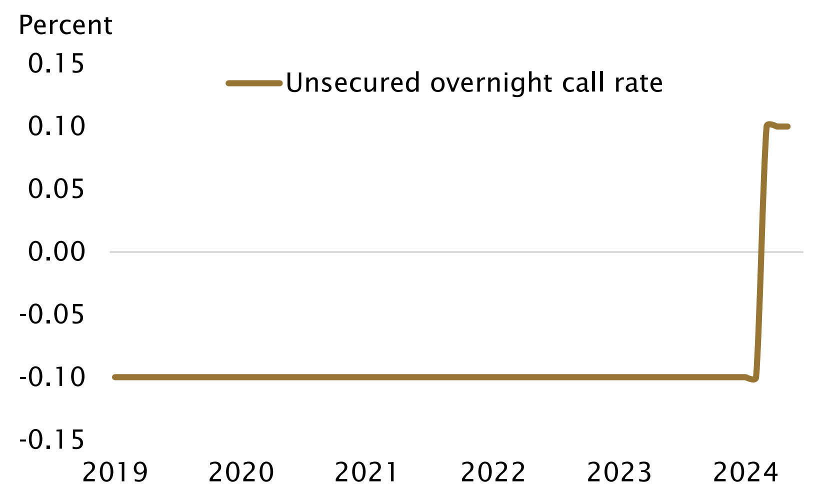
Inflation expected to sustain below 2% only after mid-2026



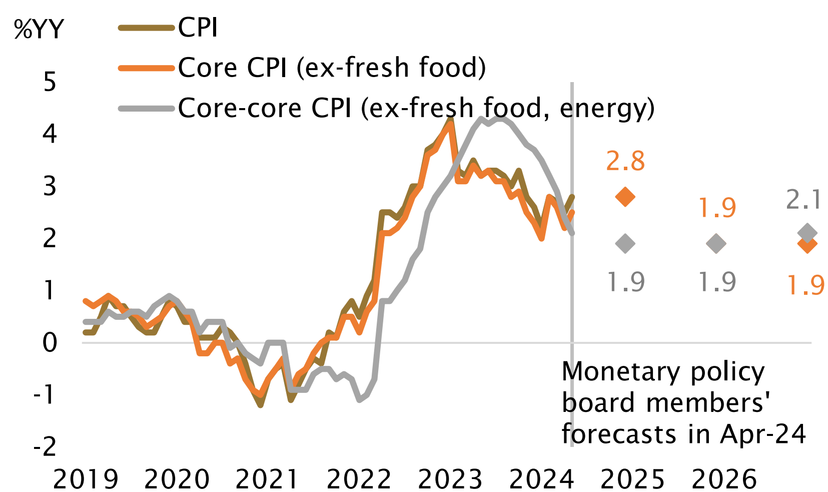
BoJ kept policy rate unchanged in June after hiking in March

- At its latest monetary policy meeting held in June, the Policy Board of the Bank of Japan, by a unanimous vote, decided to maintain the uncollateralized overnight call rate at around 0-0.1 percent for the third consecutive meeting.
- The Board noted, by an 8-1 majority vote, that at the next meeting in July, it will decide on a plan to reduce purchase amount of Japanese Government Bonds (JGBs) over the next one-two years. Currently, the amount of JGB purchases is about 6 trillion yen per month.
- In March, the BoJ ended its eight-year long negative interest rate regime by hiking policy rate for the first time in 17 years. The BoJ moved away from the framework of quantitative and qualitative monetary easing with yield curve control. Going forward, the short-term interest rate will be the BoJ's primary tool to conduct monetary policy. The central bank will discontinue purchases of exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs). It would gradually reduce the amount of purchases of CP and corporate bonds and discontinue the purchases in one year.
- Despite some weakness in recent economic activity, growth is expected to remain above potential with the Policy Board members optimistic about the "virtuous economic cycle expected to be supported from the income side by significantly high levels of corporate profits and by the highest level of wage growth in around three decades, achieved in the annual spring labor-management wage negotiations."
- Core inflation is expected to rise in H2-2024 and moderate to 2% target in 2025. The next BoJ decision is due on July 31. Market is currently pricing another 20bp hike by end-2024.

BoJ kept policy rate unchanged in June



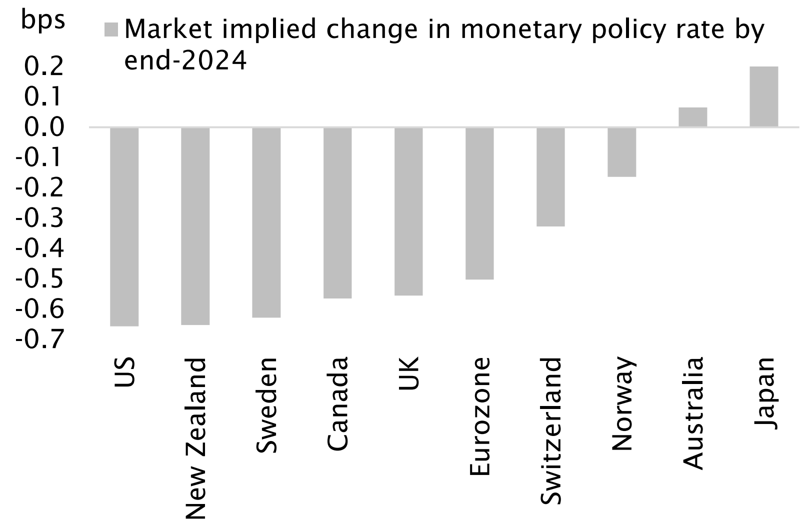
Core CPI expected to moderate to 2% target in 2025



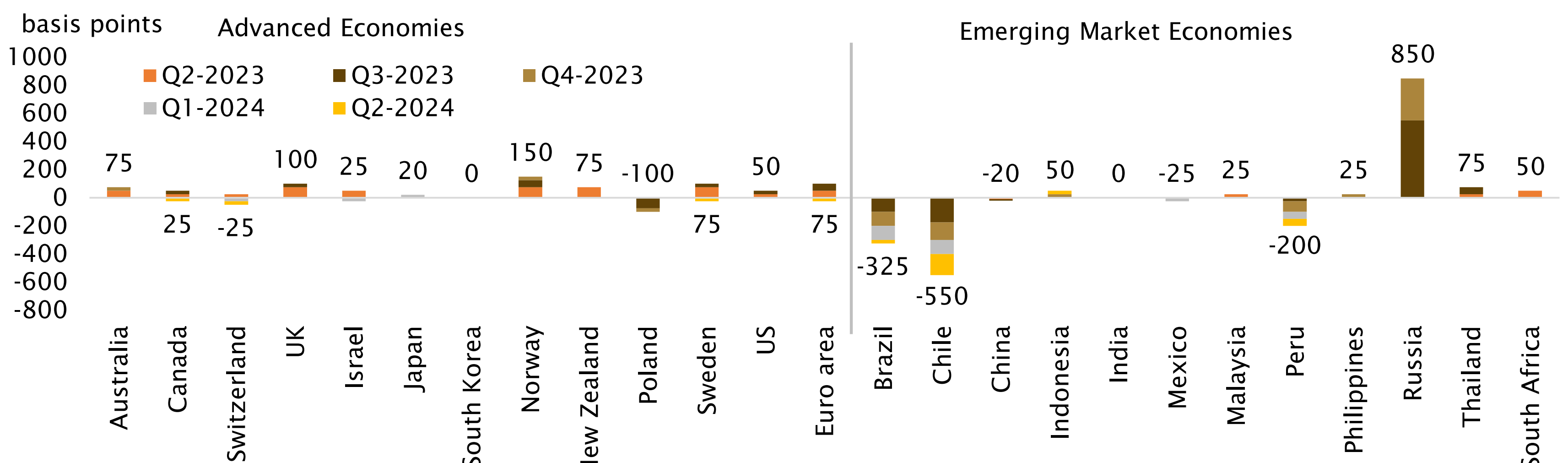
Divergences in monetary policy

- While central banks in some of the major advanced economies have started easing policy by cutting rates, the pace and extent remain uncertain, as economies continue to grapple with the sticky last mile of disinflation amid moderating economic activity.
- In addition to the ECB, Bank of Canada also cut its policy rate in June. The Swiss National Bank has cut twice this year in March and June, while Sweden's Riksbank cut in May. Financial market is pricing rate cuts across major advanced economies, except for the BoJ and RBA. The RBA had last hiked in Nov-2023 due to slower-than-expected progress in disinflation.
- Within emerging markets, central banks in Latin America have continued to ease, but there are exceptions such as Bank Indonesia that unexpectedly raised policy rate in April as a pre-emptive move to stabilize its currency.

Further hikes in 2024 expected in Australia and Japan



Divergences in monetary policy with recent hikes in Australia, Indonesia, and Japan



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