CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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Summer interest cut signalled by European Central Bank

After around two years of aggressive interest rate hikes from the main central banks, monetary policy makers are still on hold and currently deploying a "data-dependent" approach in setting monetary policy. Overall, central banks are waiting for further signs that underlying inflation is on a sustained downward trajectory to give them confidence that it will fall back towards 2% before they will contemplate cutting rates. Amid some upside surprises on the data front, and on-going hawkish central bank rhetoric, market rate expectations have hardened since late January. There is around 50 basis points (bps) less of rate cuts now being anticipated for this year, compared to futures contracts pricing at the end of January.

In the past week, we have seen further evidence of the cautious approach that central banks are taking in determining when is the right time to start to ease interest rates. In the US, Fed Chair Powell gave his semi-annual testimony to Congress. He emphasised that while the Fed believes it will be appropriate to "begin dialling back policy restraint at some point this year" he stated that they are "waiting to become more confident that inflation is moving sustainably at 2%".

There was a similar message coming last Thursday's ECB Governing Council meeting for March. For a fourth consecutive meeting, the central bank maintained its key deposit rate at 4%. Furthermore, the central bank continued to emphasise that it will ensure that rates are sufficiently restrictive for as long as required to reach its 2% inflation target on a sustained basis. However, the ECB did indicate that a rate cut in June was a possibility. President Lagarde commented that the ECB will have a "little" data in April, but will have "a lot more" for the June meeting and "it matters because we are data dependent". The ECB will be looking for more progress on reaching their inflation target.

Meanwhile, during the post meeting press conference, President Lagarde was asked about the re-pricing of market expectations since January, and how it aligned with her own view. She responded by saying that they "seem to be converging better". This suggests that current market expectations for around 100 bps of rate cuts this year are broadly aligned with the ECB's rate outlook. However, with central banks no longer providing specific forward guidance on the rate outlook, whilst at the same time being in data dependent mode, market rate expectations will remain very reactive to key data releases and remarks from central bank officials.

In this context, the main data highlight this week will be US CPI inflation for February. Having fallen sharply in the first half of last year, headline CPI inflation has been range bound since mid-2023, printing in a 3.1-3.7% corridor. Headline CPI stood at the bottom of this range, at 3.1%, in January. Meantime, the downward trend in core-CPI inflation has stalled in recent months. Core-CPI declined from 5.6% at the start of 2023 to 4% in October, before edging lower to 3.9% in December, and remaining at that level in January.

David McNamara

Chief Economist

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