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REVIEW OF THE WEEK
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AFTER THE FLURRY OF CENTRAL BANK DECISIONS LAST WEEK, WHAT DID WE LEARN ABOUT WHEN (AND HOW MUCH) THE BIG HITTERS PLAN TO CUT RATES?

It's been a big week for central banks, with lots of hints revealed about where monetary policy is headed the world over. The Bank of England (BoE) and the US Federal Reserve (Fed) each laid the groundwork for a shift to interest rate cuts, perhaps around the middle of the year.

The Swiss National Bank probably pulled off the biggest surprise and became the first among its global peers to cut rates, citing progress on inflation. Earlier in the week, the Bank of Japan (BoJ), increased rates for the first time since 2007. **As we explained last week**, Japan has been battling deflation – where prices generally fall rather than rise – for more than 20 years. Its low and negative rate policy finally seems to have paid off. With prices now increasing at around the BoJ's 2% target, it shifted rates to a range of zero to 0.1 per cent.

Here in the UK, the Bank of England (BoE) did what had been expected and held rates at 5.25% for the fifth time in a row. But, unlike the last Monetary Policy Committee (MPC) meeting, not one of the nine MPC members voted to increase rates and one voted for a cut. That's a big turnaround since the end of last year when three voted for rate rises. This striking shift in the BoE's stance brings it closer in line with the Fed and the European Central Bank (ECB), which had each been quicker to signal that rate cuts were on the way.

Following Thursday's decision to hold rates at 5.25%, BoE Governor Andrew Bailey seemed positively itching to cut rates. He announced that the UK's latest inflation data was "very encouraging and good news" and that it signalled that cuts were "on the way". Financial markets responded by raising their bets for a first BoE rate cut of 0.25% in June and are fully pricing in a cut of this size in August – followed by two more this year. That would take rates to 4.5% by December.

Over in the US, the Fed also kept rates unchanged. And policymakers maintained their projections for three 0.25% rate cuts this year if inflation continues to retreat. But after a couple of bumps on the road to lower inflation, is there a chance the Fed could drop one of those cuts?

The Federal Open Market Committee (FOMC) made some interesting changes to the projections that accompanied its rate announcement. It increased its forecasts for both inflation and growth, and lowered its projections for the unemployment rate – essentially delivering a judgement that the US economy is going to run hotter for longer than previously expected.

And while the FOMC continues to telegraph three rate cuts this year, it's projecting one fewer next year (three instead of the four it had previously estimated). At the same time, it slightly upped its median estimate of where the Fed Funds rate is likely to settle in the long run, increasing it from 2.5% to 2.6%.

In his press conference after the announcement, Fed chair Jerome Powell seemed to address the current market zeitgeist: fears that stronger-than-expected US inflation over the last few months could derail the Fed's rate expectations. He insisted that inflation continues to move "gradually on a sometimes bumpy road toward 2%".

Is inflation less sticky 'over here'?

By contrast with the US, most important inflation measures have been falling more than forecast in the UK of late. In February, headline inflation fell to 3.4% from 4.0% the month before. That's the lowest rate since 2021 and slightly below expectations it would fall to 3.5%. After utility bills drop in April, we think headline inflation in the UK could fall below the BoE's target of 2% over the next few months. Core inflation (which excludes volatile food and energy prices) has also provided a positive picture, falling slightly more than anticipated to 4.5% in February. We've also escaped nasty surprises in services inflation, which eased to 6.1% in February – in line with BoE expectations.

As its name suggests, services inflation measures prices driven mainly by the cost of employing people to deliver services. It's stayed high in most advanced economies because wages have risen steeply as tight labour markets have forced companies to pay up to attract and retain staff. But wage growth in the UK now seems to be slowing. Between the third and fourth quarters of last year, regular private earnings grew at an annualised rate of about 3%. That's roughly consistent with inflation at the BoE's 2% target. Such short-run data can be volatile, but even so, this is clear progress.

Also, in contrast to the US, food, goods and energy prices look set to fall further in the UK and continental Europe. And the US latest data indicate that the risks of much greater resilience in services inflation are considerably higher.

The three-month rate of change in US core inflation has been rising since the autumn and is higher than the both the six and 12-month rates of change. It's the services sector that's the key culprit. The annualised three-month rate of change in core services inflation (excluding shelter costs) has been above 6% for two months in a row. This measure had fallen to within a whisker of 2% late last summer so that marks quite a reversal.

All this suggests there's a bigger chance of rates falling further and faster in Britain than in America. That's why we prefer UK government bonds to US ones – government bond prices tend to rise when rates in their home country fall.

You can find out more about our views on the outlook for rates, inflation and economic growth, as well as our insights about what this could mean for financial markets, in our next video update which will be available **here** soon.

If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We'd love to hear from you.

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