# Central Banks Not for Turning

The focus of markets is very much on central banks this week, as the US Federal Reserve, Bank of England and European Central Bank all hold their first monetary policy meetings of 2023. All three are set to deliver further increases in interest rates given that inflation remains at very elevated levels. These will come on top of the substantial hikes implemented in 2022, ranging in total from 250-425bps.

The central banks indicated at their meetings in December that a significant amount of additional monetary tightening will be required in the first half of 2023 to help bring inflation back down to 2%. However, with activity losing momentum and inflation now on a downward path, markets have been contemplating whether we may be near the peak in interest rates, with policy easing also seen coming on to the agenda later in the year.

Central bankers, however, have been actively dampening down such speculation in the lead-up to their policy meetings. Futures contracts are pricing in just two further 25bps Fed hikes that would see US rates peak at 4.875% at the end of this quarter. Numerous Fed speakers have been very clear, though, that rates need to rise above 5% and thus hikes will be extended into the second quarter.

Markets are also pricing in that US rates will be cut to 4.5% by end year, but the Fed has been explicit in its guidance that policy easing will not be in play later this year. Senior Fed officials have emphasised recently that they will need to "stay the course" and keep rates on hold for quite a considerable time after they reach a peak to ensure they "get the job done" in terms of pushing inflation back down to 2%.

Meanwhile, ECB President Lagarde has been very direct recently in saying markets should revise their position that the ECB would soon slow down the pace of rate hikes. Numerous ECB Council members have indicated that two 50bps hikes remain on the cards at their February and March policy meetings, with Lagarde commenting "inflation, by all accounts, is still way too high". This would take the deposit rate up to 3.0%.

The ECB could then move to 25bps hikes in the second quarter, but there seems less unanimity about additional tightening. ECB Council member Panetta warned there is too much uncertainty to "unconditionally pre-commit to a specific policy course". However, with the core inflation rate continuing to climb in December, the majority of ECB Council members are likely to want to remain on a tightening path in the second quarter and get the deposit rate up to around 3.5%.

In the UK, despite some very weak data recently, the BoE has not been pushing back on market expectations that rates will rise by a further 100bps to 4.5%. UK inflation remains very high at 10.5%, while wage growth is also stronger than in other major economies, running at circa 6.5%. A 50bps hike seems on the cards at Thursday's meeting, to be followed by at least one further 25bps increase in March. Given the bleak UK economic outlook, though, the BoE seems the most likely of the three central banks not to extend its rate hiking cycle into the second quarter.

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