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Economist's Weekly Market View

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Generally dovish outlook expected from Central Banks

The recent ECB Forum on Central Banking saw the heads of the main central banks espousing similar musings on the economic outlook and the elevated level of uncertainty that currently prevails. However, looking back over the first half of the year, we saw differing postures adopted by some of these respective 'banks' as they deliberated on policy decisions against this unpredictable macro backdrop.

With a large degree of this uncertainty originating from the US, especially in relation to tariffs and trade, the US Federal Reserve (Fed) adopted a wait-and-see approach. In contrast, both the European Central Bank (ECB) and Bank of England (BoE) implemented further cuts in their rate cutting cycle during the first six months of the year, albeit while easing at different paces.

Indeed, for the fourth consecutive meeting, the ECB cut rates by 25bps in June. The Depo rate was lowered to 2.00%, marking the eighth 25bps rate cut since it started its easing cycle in June'24. It continued to state that it will follow a "data-dependent" and "meeting-by-meeting" approach in June. President Lagarde noted though that it was nearing the end of its easing cycle and that it viewed its policy setting to be in a good position to deal with "uncertainty" over the coming months. These comments suggest that another near-term cut is unlikely, and the extent of further easing may be limited.

In terms of the BoE, having cut rates in May, it maintained its official interest rate at 4.25% in June. Once again, there was no unanimity within the BoE, with three members voting for a 25bps rate cut in June. Its current easing cycle, which began in Aug'24, has seen a total of 100bps of cuts (including 50bps year-to-date). The BoE retains an easing bias, and it repeated that it favours a gradual approach to rate cuts.

Meanwhile, the US Fed left rates on hold again in June, in a 4.25-4.50% range. The updated rate projections (i.e. 'dot plot') remained for 50bps of cuts this year, but there was a more hawkish dispersion to the dots. Chair Powell re-stated that the FOMC believes its policy is "well positioned" and is in 'wait-and-see' mode over the summer to assess the impact from tariffs. His subsequent semi-annual testimony and comments at the ECB forum reiterated the Fed's patient stance. This conflicts with President Trump's preference and pressure for more immediate easing. Furthermore, some members of the Fed's policy setting committee have also sounded more dovish in recent remarks.

Assessing the monetary policy outlook for the second half of the year, the market is anticipating the ECB Deposit rate falling to 1.75% by year end. However, the ECB could decide to maintain the Deposit rate at its current 2% level through to the end of the year.

Meanwhile, UK futures contracts are not fully pricing in the next 25bps rate reduction until September. However, we would not be surprised to see this cut occur in August when the BoE will have its updated macro forecasts. We envisage the UK official rate of 3.75% by year end.

In the US, amid the recent dovish comments from some Fed officials combined with the White House's explicit policy preference, rate expectations have ebbed and flowed. There is around 60bps of Fed easing now expected for this year. The first US rate cut of 2025 is projected for September by markets, which is a view we share. We anticipate 50bps of Fed easing by year end.

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