Market View
Setting the tone

Coming off a multi-year rapid interest rate hiking cycle, we are now transitioning to an environment where setting the tone is key. This will help households and businesses make economic decisions based on future interest rate expectations. As such, central bankers are exceedingly careful about what they say, given the importance of their tone and language.

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It appears markets got ahead of themselves by pricing in the first rate cut in March, something we referenced in The First Cut is the Deepest. The Federal Reserve (Fed) said three rate cuts were more

realistic, as they want further evidence that the job market is cooling and service inflation is moderating before it starts its rate cutting cycle.

Most market participants expected Chairman of the Fed Jerome Powell to toe a fine line and not reveal too much at the Federal Open Market Committee (FOMC) meeting earlier this week. He did provide slight pushback that rate cuts are imminent during his prepared speech when he said the Fed "does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2%". During the Q&A session of the press conference, Powell provided the strongest pushback yet, reiterating the Fed needed "greater confidence" that the economy is well on the way towards disinflation before it cuts rates, later saying explicitly that a March cut "is probably not the most likely case." It now looks like the first cut won't come until May at the earliest.

Taken together with its projection for three 0.25% cuts this year, it implies the rate cutting cycle could start a pace of one cut each quarter.

By contrast, markets are now pricing in a rate cut every meeting this year starting in May, reducing rates by 1.5% in total by the end of 2024. However, the hurdle rate for the first rate cut remains high, as evidenced by Powell's recent pushback.

The Bank of England (BoE) also met this week. Given the subdued growth outlook in the UK, it made for a much livelier debate amongst Committee members. For the first time since 2008, votes were split between hold, raise and cut.

Six of the nine Monetary Policy Committee (MPC) members backed keeping rates unchanged, while two voted for an increase and one for a cut.

The split vote highlights concerns surrounding domestic inflation and sluggish growth forecasts. For now, it seems the BoE favours the so-called Table Mountain approach (A Rocky Expedition), meaning interest rates will stay at current levels for some time.

It's worth taking a closer look at the make-up of the MPC. Jonathan Haskel and Catherine Mann, the two notable hawks who voted to raise rates by 0.25% at the meeting on Thursday, are due to have their terms expire in August this year, although only Mann's can be extended. This could see the MPC leaning more dovish come autumn.

Usually, central bank meetings are the main market moving event of the week. But challenges facing New York Community Bancorp underscored that last year's issues surrounding regional banks and commercial real estate are not yet fully addressed. Indeed, this bank is particularly noteworthy as it bailed out Signature Bank, one of the regional banks that went under in 2023.

Over in Asia, Japan's Aozora Bank slumped over 30% after they announced significant losses for the year connected to US commercial property.

Bond markets largely shrugged off the Fed and BoE meetings, with the focus shifting to US banks and the increased likelihood of credit tightening as concerns mount over commercial real estate and US regional banks' exposure to the sector. It seems likely we will be in a tug and pull environment for financial conditions with central banks playing a pivotal role in readjusting these given the prevailing economic climate.

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