

**BLOG**

One Hike, Three Hints, and a Surprise Rate Cut

Recent signals from major central banks suggest challenges ahead with easing monetary policy amid above-target inflation.

BY **RICHARD CLARIDA** | 26 MARCH 2024

Last week, five of the world's major central banks made news. The Bank of Japan (BOJ) and the Swiss National Bank (SNB) announced important changes to monetary policy, and officials at the U.S. Federal Reserve, the European Central Bank (ECB), and the Bank of England (BOE) dropped meaningful hints about the likely road ahead for interest rates. Taken together, these moves and signals offer insights into future monetary policy and in particular, the challenges the Fed, the BOE, and the ECB may face in execution and communication as they begin to cut policy rates with inflation in their countries projected to be running above target in 2024 and into 2025.

BOJ and SNB each turn the page after key objectives achieved

The BOJ decision on 19 March to end its negative interest rate policy (NIRP) and to hike rates for the first time since 2007 was widely expected but nonetheless significant. It signaled the bank's confidence that the extraordinary policies of NIRP, yield curve control, and quantitative and qualitative easing have at long last achieved their elusive goal: ending Japan's secular deflation equilibrium and shifting into a "1-point-something" inflation regime, with inflation expectations firmly anchored in positive territory. (We would note that alongside BOJ policy, the post-pandemic inflation spike along with the sharp contrast in rate policy versus other major regions played a significant role in reflation of Japan's economy. For details, please see our blog post, ["Bank of Japan's Policy Shift Ushers in a New Era for Investors."](#))

The SNB's decision on 21 March to cut its policy rate by 25 basis points was a bit of a surprise relative to market pricing. Nonetheless, the move confirmed that in SNB officials' judgment, the rate hikes enacted in 2022 and 2023 to counter the post-pandemic inflation surge have achieved the objective of returning Swiss inflation to somewhat below 2%.

In sum, both central banks changed policy last week because officials believed that the previous policies they put in place had achieved their long-run objectives.

ECB, Fed, and BOE fortify hints about planned rate cuts

At [a speech in Frankfurt on 20 March](#), ECB President Christine Lagarde reinforced what I took to be the intended signal from her 7 March post-meeting press conference, namely that the bank will likely have enough information by its June meeting to consider cutting rates. (See our blog post, ["ECB: Next Stop, June."](#)) Lagarde's speech last week was also noteworthy for its thoughtful and rigorous discussion of how the ECB seeks to balance the risk of considering rate cuts with inflation still projected to run above the bank's 2% target this year and most of next year (though it has slowed recently) versus the risk of constraining a eurozone economy in which growth is expected to remain sluggish.

Following its 20 March meeting, the Fed conveyed clear signs that a rate cut is likely this summer. At the press conference, Chair Jerome Powell engaged in a lively discussion with reporters, making the case that when the Fed has more information later this year, it will likely make sense to cut rates perhaps three times by December – even with core PCE (personal consumption expenditures) inflation projected to finish 2024 at 2.6%. (See our blog post, ["Fed](#)

[Readies for Rate Cuts: Back Toward Neutral, or Mid-Cycle Adjustment?"\)](#)

After a quiet meeting last week, BOE Governor Andrew Bailey published an op-ed piece in the Financial Times on 22 March that conveyed much the same message regarding the BOE's policy outlook – suggesting markets are right to expect more than one rate cut this year.

Threading the needle: rate cuts amid inflation

If rate cuts do commence this summer as telegraphed by Lagarde, Powell, and Bailey last week, it's likely these leaders at that time will not attempt to justify the policy change because they are content with "2-point-something" as a provisional inflation target. Rather, we expect they will reiterate that monetary policy is already restrictive, and therefore that gradual rate cuts in tandem with declining inflation are simply a means to prevent policy from getting even more restrictive, given they project inflation should decline over time to the 2% long-run target.

But what if inflation in these economies does not follow the forecasts and becomes entrenched at a plausible 2.5%? In this scenario, the central banks would likely pause their rate cut cycles. However, they would likely be very reluctant to restart rate hikes, relying instead on their belief that by keeping policy restrictive long enough, they can credibly forecast inflation returning (eventually) to the 2% target. In other words, in policymakers' view, rates would remain elevated relative to current estimates of long-run neutral (i.e., a policy rate level that neither hinders nor stimulates growth) not because neutral has risen, but because instead inflation is stuck at "2-point-something," at least until the next recession – a recession that they are trying to avoid.

"Opportunistic disinflation," anyone? In this strategy, a shortfall in aggregate demand during a future recession could help return inflation to target. But central bankers are hoping inflation won't be too deeply embedded, and that restrictive-enough interest rates (and not a future recession) can tame it back to 2%.

DISCLOSURES

London

PIMCO Europe Ltd
11 Baker Street
London W1U 3AH, England
+44 (0) 20 3640 1000

Dublin

PIMCO Europe GmbH Irish Branch,
PIMCO Global Advisors (Ireland)
Limited
3rd Floor, Harcourt Building 57B Harcourt Street
Dublin D02 F721, Ireland
+353 (0) 1592 2000

Munich

PIMCO Europe GmbH
Seidlstraße 24-24a
80335 Munich, Germany
+49 (0) 89 26209 6000

Milan

PIMCO Europe GmbH - Italy
Via Turati nn. 25/27
20121 Milan, Italy
+39 02 9475 5400

Zurich

PIMCO (Schweiz) GmbH
Brandschenkestrasse 41
8002 Zurich, Switzerland
Tel: + 41 44 512 49 10

Madrid

PIMCO Europe GmbH - Spain
Paseo de la Castellana, 43
28046 Madrid, Spain
Tel: +34 810 809 912

Paris

PIMCO Europe GmbH - France
50-52 Boulevard Haussmann,
75009 Paris

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CMR2024-0325-3470955