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Bank of Japan (BOJ)

The BOJ's decision to end negative interest rates is turning out to be a "best possible scenario," in my view, representing a vote of confidence in the Japanese economy but with extremely gentle normalization in the offing.

Swiss National Bank (SNB)

SNB became the first developed central bank to cut rates in this rate cycle, which I think makes it easier for the Bank of England, US Federal Reserve, and European Central Bank to begin rate cuts.

Market impact

Gentle rate cuts could create a mildly supportive environment for risk assets, which could also be helped by a high level of cash on the sidelines.

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For some time now, I've contended that monetary policy has had an outsized impact on markets. This started when major central banks implemented extraordinarily accommodative and experimental monetary policy to combat the Global Financial Crisis. But it's continued in the last several years when we saw a massive amount of tightening to combat pandemic-era inflation, which had a dramatic impact on markets in 2022. Given the importance of monetary policy in driving markets, last week was a momentous one with five developed market central banks and seven emerging market central banks meeting - leading to two historical decisions being made.

Let's start with the central banks that voted to alter policy last week: the Bank of Japan (BOJ) and the Swiss National Bank (SNB).

Bank of Japan raises rates for the first time in 17 years

The BOJ raised its policy rate for the first time since 2007, ending negative interest rates. The vote was 7-2 to move the policy rate range to between 0% and 0.1%, up from a -0.1% short-term rate. Emboldened by the large wage increases in the recent shunto negotiations between unions and employers, the BOJ also ended purchases of exchange-traded funds (ETFs) and real estate investment trusts (REITs). Finally, the BOJ announced the end of its formal yield curve control policy, although it said that it would purchase Japanese government bonds (JGBs) at broadly the same pace as before and, if long-term rates were to experience a sharp increase, they would suppress them through JGB purchases.

The key message from the BOJ was that conditions will remain very accommodative. BOJ Governor Kazuo Ueda explained, "We have ended our extraordinary monetary easing scheme. But we still hold massive amount of JGBs purchased during the extraordinary monetary easing. The same goes for our ETF holdings. These will remain as remnants of the extraordinary monetary easing scheme."¹ The BOJ suggested that financial conditions would stay accommodative for now and did not provide guidance on future rate hikes, which was interpreted as a sign that another rate hike would likely not be entertained until the fall.

The BOJ's decision is thus far turning out to be a "best possible scenario," in my view, because the very act of starting to normalize represents a vote of confidence in the Japanese economy and indicates that Japan has finally made a transition from a deflationary economy to an inflationary economy, which has positive implications for Japan equities. However, Ueda's dovish statements at the BOJ press conference and the lack of guidance on future rate hikes resulted in JGB yields edging lower and the yen weakening further - which is also supportive of Japanese equities. Looked at in this context, it is unsurprising that the Nikkei 225 Index finished the week at a record 40,888.²

Swiss National Bank unexpectedly cuts rates

The Swiss National Bank surprised markets last week by cutting rates by 25 basis points. Now, it's worth noting that the SNB has kept us on our toes in the last several years. In June 2022, it surprised markets with a rate hike of 75 basis points, followed by another 75 basis point increase three months later. Its rationale for last week's small cut is simple - SNB's forecasts for inflation in 2024 and 2025 were revised downward (from 1.9% to 1.4% for 2024 and from 1.6% to 1.2% in 2025). Policymakers also shared that they've gained greater confidence that inflation will be able to sustainably stay within the SNB's acceptable range of 0% to 2%.

The SNB's decision is history-making because it's the first developed central bank to cut rates in this rate cycle. It's symbolic of what I expect to be a small cascade of developed central banks that will begin to enact rate cuts in 2024.

Bank of England holds rates steady

The Bank of England (BOE) also met last week but, as with the majority of banks that met last week, there were no policy changes. However, there were small psychological gains for those rooting for rate cuts to start soon: No Monetary Policy Committee (MPC) members voted for a rate hike at this meeting - this was the first time since September 2021 that there were no votes in favor of a rate hike. And we saw some similarities to the views of the SNB coming from the BOE. The BOE's policy statement suggests that the MPC is gaining confidence that inflation is on track to reach its target - and sustainably so. BOE Governor Andrew Bailey explained that "we are not yet at the point we can cut rates, but things are moving in the right direction."³ This was evidenced by the February UK inflation reading, which fell to 3.4% year/year from 4.0% year/year in January. This was the weakest rate of inflation since September 2021 and a downside surprise versus market expectations.⁴

The BOE continued to have a significant amount of hawkish language in its statement - warning that policy will need to "remain restrictive for sufficiently long" and be "restrictive for an extended period of time."⁵ However, just as with the hawkish statements from Fed officials, I believe it is intended to keep a lid on financial conditions and prevent them from easing prematurely.

What was more important, in my view, was the follow-up interview that Bailey gave with the Financial Times. He stated that "all our meetings are in play" - which suggested a May rate cut is a very real possibility.⁶

The reality is that, even though rates remain at 16-year highs of 5.25%, I believe the future of rate cuts is in close sight for the Bank of England.

The US Federal Reserve takes a dovish tone

As expected, the Federal Reserve (Fed) made no change to the fed funds rate. However, the tone of the Fed decision, "dot plot," and press conference was quite dovish.

There had been whispers that the March dot plot would show two expected rate cuts for 2024, but in fact median expectations remained three rate cuts this year - albeit just barely. But it mattered to markets, especially in the context of other revisions to the dot plot - namely a significant upward revision to growth expectations for 2024, improvement in unemployment expectations for this year, and also an

upward revision to core inflation expectations. More specifically, expected growth for 2024 was revised to a far stronger 2.1% from 1.4% in the December dot plot, unemployment was nudged down to 4% for 2024 from 4.1% in the December dot plot, and the projection for core Consumer Price Index inflation in 2024 was increased to 2.6% from 2.4% in the December dot plot.⁷ Taken all together, it suggests a more patient Fed.

This was reiterated in the press conference. Fed Chair Jay Powell recognized it would take time to get to the Fed's inflation target and said he wouldn't overreact to recent inflation data that was higher than expected. Powell also said that the US labor market wouldn't have to weaken in order for rate cuts to begin - a message he has shared multiple times in the past several months.

It's worth noting that expectations for rate cuts in 2025 and 2026 were lowered, which caused a steepening of the yield curve. Having said that, I put very little stock in the Fed's projections, especially that far out. When asked about longer-run expectations for rates, Powell said we don't know if rates are going to be higher in the long run. He suspects they won't be ultra-low in the long run but admitted that there is tremendous uncertainty around that.

Powell also said the Fed is getting close to slowing the pace of quantitative tightening. This is good news as it is part of the normalization process for the Fed.

What does this all mean?

We're seeing developed economies in general proving to be more resilient than expected. This is good news for markets. And we're seeing disinflationary progress continuing, albeit imperfectly, in Western developed economies. This in turn is resulting in the start of gentle rate cuts for 2024, which is also good news for markets.

The Swiss National Bank may be the first developed central bank to cut rates, but I believe it will not be the last this year. I think of it as a trend setter, and I think the very act of its small rate cut will help encourage other developed central banks to follow suit sooner rather than later. For example, I think the SNB's decision makes it easier for the BOE, the Fed, the European Central Bank (ECB), and other developed central banks to begin rate cuts in the next several months.

What happened last week in terms of monetary policy will matter this year for markets. I think we could be entering a period that is very different than 2022, when the World Bank warned that "central banks around the world have been raising interest rates this year with a degree of synchronicity not seen over the past five decades..."⁸; that was a period when dramatic rate hikes created an *annus horribilis* for many asset classes. Gentle rate cuts by a number of central banks this year could create a mildly supportive environment for risk assets.

For those who believe that such cuts are already priced into stocks and fixed income, I would argue that there are other catalysts that could support equities - and fixed income - this year. Keep in mind there is a high level of cash (I would call it an overweighting) sitting on the sidelines, some of which could rotate into equities and fixed income, especially if rates begin to fall and/or more investors develop FOMO (a fear of missing out). For example, money market assets peaked in the fourth quarter of 2008 before dropping significantly.⁹ It seems no coincidence that cash started to move off the sidelines just as stocks began a strong and lengthy multi-year rally in March of 2009.

Dates to watch

The most critical data release this week is the US Personal Consumption Expenditures Price Index, given it is the Fed's preferred gauge of inflation. There is likely to be some anxiety and possible volatility around this data release. However, there is far more on the docket for this week:

Date	Report	What does it tell us?
Mar 25	ECB President Lagarde speaks	Offers insights into central bank thinking
	US New Home Sales	Measures the health of the housing market
Mar 26	US Durable Goods Orders	Tracks new orders placed with manufacturers for long-lasting goods
	S&P/Case Shiller Home Price Index	Measures the health of the housing market
Mar 27	Crude Oil Inventories	Indicates state of energy supply and demand
	Fed Governor Waller speaks	Offers insights into central bank thinking
Mar 28	UK Gross Domestic Product	Measures a region's economic activity
	Germany Retail Sales	Measures consumer demand
	Germany Unemployment	Measures health of the job market
	US Gross Domestic Product	Measures a region's economic activity
	Canada Gross Domestic Product	Measures a region's economic activity
	University of Michigan Consumer Sentiment	Assesses US consumers' expectations for the economy and their personal spending
	University of Michigan Consumer Inflation Expectations	Measures consumers' expectations of future inflation
	Korea Industrial Production	Indicates the economic health of the industrial sector

Notes

- ¹Source: Reuters, Quotes from BOJ Governor Ueda's comments at news conference, March 19, 2024
- ²Source: Bloomberg, as of March 22, 2024
- ³Source: Reuters, "UK inflation 'moving in right direction' for rate cuts, Bank of England says," March 21, 2024
- ⁴Source: UK Office for National Statistics, March 20, 2024
- ⁵Source: Bank of England, March 21, 2024
- ⁶Source: Financial Times, "Bank of England's Andrew Bailey says rate cuts 'in play' in upbeat take on UK economy"
- ⁷Source: Federal Reserve Board of Governors, March 20, 2024
- ⁸Source: The World Bank, Sept. 15, 2022
- ⁹Source: Board of Governors of the Federal Reserve System through Dec. 31, 2023, as of March 7, 2024

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Fixed income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

The Nikkei 225 Index is a price-weighted average of 225 top-rated Japanese companies listed in the first section of the Tokyo Stock Exchange.

The US Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics. Core CPI excludes food and energy prices while headline CPI includes them.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Expenditures included in the index are actual US household expenditures.

Shunto refers to the annual wage negotiations between unions and employers in Japan.

The Federal Reserve's "dot plot" is a chart that the central bank uses to illustrate its outlook for the path of interest rates.

Quantitative tightening (QT) is a monetary policy used by central banks to normalize balance sheets.

A policy rate is the rate used by central banks to implement or signal its monetary policy stance.

The yield curve plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates to project future interest rate changes and economic activity.

Yield curve control is a monetary policy tool used by central banks to manage interest rates along the yield curve.

The federal funds rate (or fed funds rate) is the rate at which banks lend balances to each other overnight.

A basis point is one hundredth of a percentage point.

The opinions referenced above are those of the author as of **March 25, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.