CIO thinks investors should consider deploying cash into high-quality corporate and government bonds as part of a diversified allocation to fixed income. (UBS)

The Fed looks set to signal a pivot later this month

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The European Central Bank (ECB) kept its deposit facility rate unchanged at 3.75% on Thursday, in line with market expectations. The euro was little changed against the US dollar at 1.09. The decision followed the final reading for Eurozone inflation for June, which stood at 2.5% year over year, down from 2.6% in May.

CIO sees room for the ECB to cut rates again in September, following the first reduction in June. Markets are now pricing in a 65% probability of a September rate cut. With the Federal Reserve also likely to start easing policy in September, and the Bank of England potentially in August, the global rate-cutting cycle remains on track despite inflation jitters in some parts of the world.

Economic activity in the Eurozone remains weak, with decelerating core inflation. Eurozone GDP growth was just 0.3% in the first quarter of 2024. While that is better than the 0.1% contraction in the last quarter of 2023, it follows five quarters of economic stagnation. Weak economic activity and decelerating core inflation should allow the ECB to cut rates again this year. We expect the ECB to ease by a further 50 basis points in 2024.

The Fed looks set to signal a pivot later this month, paving the way for a first cut in September. June's retail sales, housing starts, and industrial production data all surpassed market expectations. Yet they were not so resilient as to dampen hopes for a Fed cut in September, which the futures market currently estimates at a 96% likelihood. Fed Chair Jerome Powell this week said recent inflation figures "add somewhat to confidence" that the pace of price increases is returning to the central bank's target sustainably, after describing the US economy as "no longer overheated" during his congressional testimony last week. We maintain the view that the US central bank will cut rates by 50 basis points this year, starting in September.

So, with current returns on cash likely to diminish, we believe investors holding cash or money market funds and those with expiring fixed-term deposits should consider managing their liquidity via bond ladders or structured investment strategies. We also think investors should consider deploying cash into high-quality corporate and government bonds as part of a diversified allocation to fixed income.

Main contributors: Solita Marcelli, Mark Haefele, Daisy Tseng, Vincent Heaney, Jon Gordon

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