Source: UBS

Central banks: June is the new March

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Central bank chiefs in both the US and the Eurozone have recently made it clear that they require more evidence that inflation is under control before they start cutting interest rates. For the Swiss National Bank as well, this means interest rate cuts are not likely to be on the agenda until June instead of March.

It is that long since the markets were wondering whether the Federal Reserve or the European Central Bank (ECB) would be the first to cut their policy rate in the first quarter of the new year. In the second half of 2023, inflation had fallen from high single-digit figures toward the central bank target range. The Eurozone economy had been struggling since the summer, while initial signs of weakening were making themselves felt in the US economy, which had previously been unexpectedly resilient. However, since the start of this year, the point when the major central banks on either side of the Atlantic were expected to make their first interest rate cut has been abruptly put back. June is now the new March, to put it simply.

On the one hand, indicators in Europe show some light at the end of the tunnel for the industrial economy. US figures for the real economy have also surprised on the upside recently. On the other hand, the decline in inflation has come to a standstill since the beginning of the year. It has become doubtful whether inflation will actually continue to quickly fall below the 2% target mark as hoped. Meanwhile, the central bank chiefs have also made it clear that they would like to see more evidence that inflation can actually be brought under control. Accordingly, market expectations regarding the starting point for a cycle of interest rate cuts have been put back, and we now expect that both the Fed and the ECB will start reducing rates in June.

This means that it would be something of a surprise if the Swiss National Bank (SNB) forged ahead with a March interest rate cut at its monetary policy assessment next week. For one thing, the Swiss franc has fallen off somewhat from its highs against the euro and US dollar since the start of the year. Although an early interest rate cut could drive the Swiss franc to depreciate further, the imported inflation as a result would reignite rising prices. It therefore seems more likely that the SNB will not make an interest rate move until June, thus acting pretty much in step with the Fed and the ECB.

Because in our baseline scenario we anticipate that the global economy will gradually weaken and achieve a soft landing, we expect around three interest rate cuts of 25 basis points each by the end of the year. If the major central banks are able to reduce their policy rates more or less in harmony and in a controlled manner, we expect no major fluctuations for the USD-EUR-CHF currency trio. In this scenario, we expect the USDCHF and EURCHF rates to tread water in a trading range of between 0.85 and 0.90 and between 0.95 and parity respectively.

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