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Franklin Templeton Fixed Income

Central Bank Watch

Easing on the horizon

The Franklin Templeton Fixed Income (FTFI) Central Bank Watch is a qualitative assessment of the central banks for the Group of Ten (G10) nations plus two additional countries (China and South Korea). See full methodology on page 6.

Key highlights

Cuts are coming: Although most developed market (DM) central banks remain in a holding pattern, most signaled a willingness to cut interest rates. Uncertainty remains regarding timing, but we expect the European Central Bank to cut as early as June, followed by the Federal Reserve and the Bank of England. However, the stickiness of inflation and the resilience of growth will determine easing.

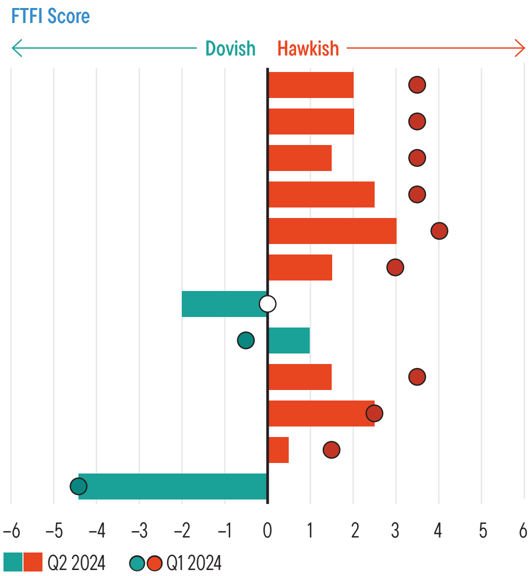
Swiss National Bank leads the charge: A downgraded inflation outlook and a strong currency prompted an unexpected rate cut from the SNB in March. The People's Bank of China should continue to rely on liquidity injections, rather than outright rate cuts in the near-term. The Bank of Japan will likely be the only central bank to proceed on a tightening trajectory as a wage-price virtuous cycle gathers momentum.

Inflation dynamics remain uncertain: Many central banks have attributed slowing inflation to an unkinking in supply chains and, therefore, a fall in goods and energy prices. With labor markets and wages remaining resilient, most central banks will likely want further evidence that inflation is on a sustained downward path.

FTFI Central Bank Dove-Hawk Ranking

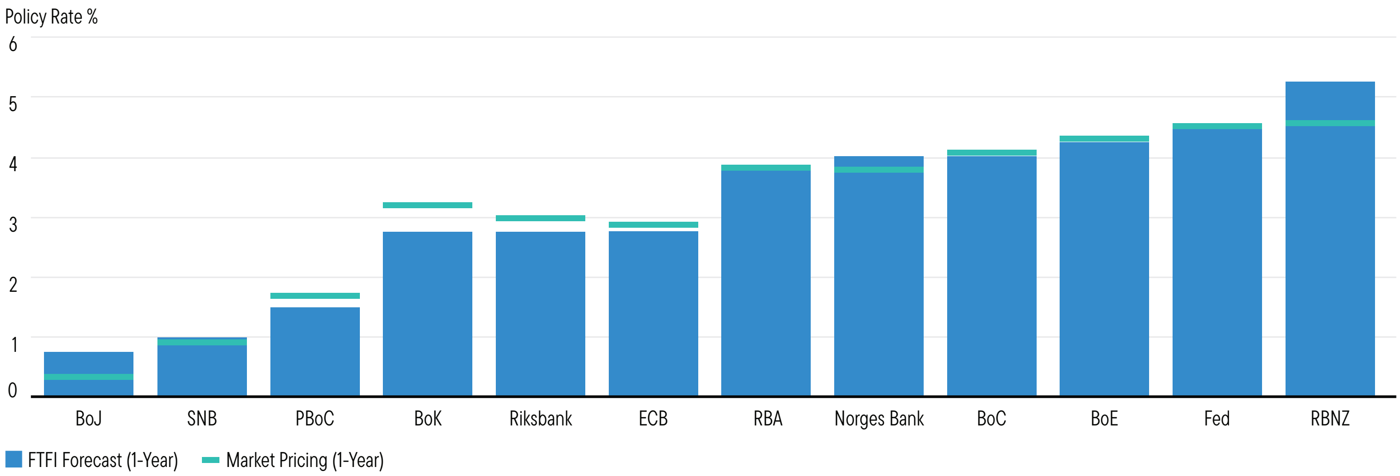
Strategies	Inflation Outlook Perception	QE*/Liquidity Mgmt Programs	Interest-Rate Forward Guidance
Federal Reserve (Fed)	1.0	1.5	–0.5
Bank of Canada (BoC)	1.0	1.5	–0.5
European Central Bank (ECB)	0.5	1.5	–0.5
Bank of England (BoE)	0.5	2.0	0.0
Norges Bank (NB)	1.5	NA	1.5
Sveriges Riksbank	0.0	2.0	–0.5
Swiss National Bank (SNB)	–1.0	NA	–1.0
Bank of Japan (BoJ)	1.5	–1.0	0.5
Reserve Bank of Australia (RBA)	0.5	1.0	0.0
Reserve Bank of New Zealand (RBNZ)	0.5	2.0	0.0
Bank of Korea (BoK)	1.0	NA	–0.5
People's Bank of China (PBoC)	–1.0	–2.0	–1.5

Dovish (–2.0) | Moderately Dovish (–1.0 to –1.5) | Neutral with Dovish Tilt (–0.5) | Neutral (0.0)
Hawkish (2.0) | Moderately Hawkish (1.0 to 1.5) | Neutral with HawkishTilt (0.5)



Notes: *QE = Quantitative Easing. Ranks are based on qualitative judgement based on our interpretation of central banks' forward guidance with overall score of –6 as most dovish and +6 as most hawkish. There is no assurance that any estimate, forecast or projection will be realized.
Source: Franklin Templeton Fixed Income Research. As of April 1, 2024.

Market Implied Policy Rate vs. FTFI Forecasts (Additional Detail on Rates and Forecast Available on Page 6)



Notes: Forecasts represent Franklin Templeton Fixed Income's projected policy rate one year from now. There is no assurance that any estimate, forecast or projection will be realized.
Sources: Franklin Templeton Fixed Income Research, Bloomberg. As of April 1, 2024.

Latest thoughts on global central bank policy

Federal Reserve (Fed)

Next expected move	Sep 2024 (–25bp)
FTFI policy rate 1-yr forecast	4.50
FTFI score	2.0

An unwavering focus on cutting rates

The key message from Fed Chair Jerome Powell at the March Federal Open Market Committee (FOMC) meeting was that the Fed is committed to cutting rates at "some point this year." He downplayed recent inflation data and suggested that strong hiring by itself wasn't enough to delay easing. With the Fed also prepared to see inflation fall "over time," the Fed is telling us it wants to cut and is willing to tolerate a higher level of inflation to do so. Powell's reluctance to directly address the sharp easing in financial conditions led to even looser financial conditions. In contrast, the March Summary of Economic Projections (SEP) offered a more balanced view of policy. The continued projection of three rate cuts for 2024 was dovish, but the 2024 median rate projection could very easily rise if just one FOMC member marked up their expectation. We have maintained that continued economic strength at "restrictive" policy-rate levels and fiscal dominance[1] will force the Fed to reevaluate their long- and short-term neutral interest-rate assessments. Indeed, we saw both occurring in the March SEP. With several Fed members comfortable with the idea that rate assessments have risen from neutral, we expect the long-run dot plot[2] to grind higher. Finally, provided the disinflation story remains intact in the months ahead, the FOMC could get behind Powell for cuts beginning July. However, our base case is increasingly turning toward a September cut and 50 basis points (bps) of cuts this year. Moreover, a few more months of January- and February-like inflation data would certainly make our base case much more likely.

Bank of Canada (BoC)

Next expected move	Jul 2024 (–25bp)
FTFI policy rate 1-yr forecast	4.00
FTFI score	2.0

In a holding pattern

The BoC maintained its policy rate at 5% for the fifth successive meeting in March. Although the minutes of the meeting suggest that deliberations have turned toward what the BoC would consider appropriate conditions for rate cuts, policymakers are split on the timing. The good news is that two consecutive months of cooling Core Consumer Price Index (CPI), leaving it below 3% for the first time in nearly three years, allows for enough of an opening to talk rate relief. Moreover, with population growth outpacing job creation, the unemployment rate has risen to 5.8% and some signs of cooling wage growth have also appeared. In all, the BoC sees the economy in modest excess supply. However, we think the BoC will need to see more than just two months of slower Core CPI. Meanwhile, with the share of CPI components growing above 3% above the historical average, BoC officials continue to view inflationary pressures as broad-based. Policymakers also remain concerned about significant upside risks to shelter price inflation driven by a potential housing sector rebound in the spring. In addition, wage growth at 5% is still more than double the 10-year trend prior to the pandemic and far from consistent with a return to 2% inflation. Given these concerns, we do not expect any easing before July.

European Central Bank (ECB)

Next expected move	Jun 2024 (–25bp)
FTFI policy rate 1-yr forecast	2.75
FTFI score	1.5

Data-dependent also after a June cut

The ECB keeps navigating its "holding phase," while signaling that the beginning of the easing cycle is approaching. Despite the encouraging disinflation progress achieved on the headline front, sticky core services and uncertainty over inflation persistency are holding up premature moves. Indeed, the ECB is focused on wages, corporate profits growth and falling productivity. While the latter two are harder to track on a real-time basis, further evidence of moderation in the historically high eurozone wage growth is required before embarking on an easing cycle. Thus, we believe more data is needed for the ECB to build trust in a sustainable disinflationary process. A first cut in June, when first-quarter wage data will be available, was strongly telegraphed and hard to walk back unless a quick negative turnaround in growth occurs. This also means that the ECB will likely lead the Fed, in our view, defying historical precedents. Nevertheless, we expect a gradual pace of quarterly cuts at least in the beginning as the ECB will likely seek to carefully calibrate its policy as new information will help to resolve inflation persistency uncertainty.

1. Fiscal dominance is an economic condition that occurs when a country's debt and deficit levels are sufficiently high that monetary policy ceases to be an effective tool for controlling inflation.
2. The Fed dot plot is a chart that shows you where each FOMC member thinks interest rates will be by the end of the current year, two or three (depending on the time of year) consecutive years after, and the more ambiguous "longer run." Each "dot" represents a member's individual view.

Bank of England (BoE)

Next expected move	Aug 2024 (–25bp)
FTFI policy rate 1-yr forecast	4.25
FTFI score	2.5

Lowering the easing bar

The BoE took some dovish steps in its March meeting. Recent inflation data is set on an improving trend and there was some recognition of a gradually loosening job market despite a low unemployment rate. Another dovish element was the Monetary Policy Committee (MPC) vote split, which showed that "hawk" members dropped the case for additional hikes in more than two years, although pushing back against market pricing in post-meeting remarks. Lastly, the monetary statement included a comment that policy would remain restrictive even if rates were to be cut. All in all, the MPC is contemplating easing its stance, and if data will not deviate from its forecasts, cuts will be delivered even with still high—although descending—levels of wage growth and services inflation. A first cut in August looks the most probable scenario, slightly earlier than what we anticipated before, and without excluding surprising twists (e.g. a June move) in case of further data improvements. A gradual pace from thereon remains the base case, until further clarity on the normalization of internal inflationary drivers will be made.

Norges Bank (NB)

Next expected move	Sep 2024 (–25bp)
FTFI policy rate 1-yr forecast	4.00
FTFI score	3.0

Consistently hawkish

NB kept its longstanding hawkish bias despite the relatively benign inflation developments since its December meeting. Indeed, inflation fell faster than its own December forecasts. Core inflation measures surprised on the downside in February and led to meaningful downward revisions to the March projections. Nevertheless, NB concerns over inflation persistence remain clear. High wage growth is expected to normalize only gradually, and the prolonged Norwegian kroner weakness continues to be seen as a clear inflationary risk. The hawkish rate path was confirmed and even raised at the margin in the medium term. No cuts are foreseen until autumn as Governor Ida Wolden Bache pointed to a first move in September. We expect another cut in December and a gradual easing thereon, especially if the currency weakness persists for longer.

Sveriges Riksbank

Next expected move	Jun 2024 (–25bp)
FTFI policy rate 1-yr forecast	2.75
FTFI score	1.5

Flying doves

Since the last Central Bank Watch, the Riksbank swung from a midly hawkish stance in November to openly guiding for anticipated rate cuts. Indeed, the January meeting already announced the possibility of easing coming before summer, something that has been reinforced by an explicit forward guidance in March of a cut "in May or June if inflation prospects remain favorable," in line with our expectations. A May cut is highly likely and priced in by the markets, although a selloff of Swedish krona or an uptick in core inflation versus forecasts could push it back to June. The currency's weakness has been a concern for quite sometime, given its relatively high inflation sensitivity to external developments. The rate path was significantly revised by pricing in almost three cuts in 2024 and a terminal rate close to 2.5%, from no cuts and 3.5% in the (extreme) November forecast. We expect at least 75 bps of easing this year and a terminal rate of 2.25% to be reached in the third quarter of 2025.

Swiss National Bank (SNB)

Next expected move	Jun 2024 (–25bp)
FTFI policy rate 1-yr forecast	1.00
FTFI score	–2.0

A strong franc forces a genuine surprise

The SNB—known for its sometimes unexpected moves—surprised markets with a 25 bp cut in March, making it the first among the G10 central banks to ease policy. Although we expected the bank to remain on hold 'til the second half of 2024 and turn to currency interventions before considering rate cuts, the SNB judged that the latest downside surprises in the CPI data were sufficient to bring forward its easing cycle. The SNB's new inflation projections were also lowered by a sharp 0.5–0.6 percentage points relative to December, providing ample justification to begin easing. The bank also made references to the strength of the inflation-adjusted Swiss franc (CHF)—up roughly 7% year-over-year—to justify the rate cut. The SNB actively sought a stronger CHF (via currency interventions) to counteract inflation in 2022–2023, but that story has changed with the strong CHF beginning to weigh heavily on Swiss firms' competitiveness, and in turn, on economic growth. Given the significant downward shift in the Swiss inflation profile and the SNB's references to the strong CHF, we expect a quarter-point reduction in June and September. However, since Swiss inflation and the subsequent policy tightening was not nearly as aggressive as those of its DM peers, the easing cycle should be shallow, with policy rates likely settling at 1%.

Bank of Japan (BoJ)	
Next expected move	Jul 2024 (+15bp)
FTFI policy rate 1-yr forecast	0.75
FTFI score	1.0

Outlier again, this time is different!

After months of speculation, the BoJ finally exited both the yield-curve control framework and negative interest rates at its March policy meeting. The central bank acknowledged that the very strong first round results of the Shunto annual wage negotiations for 2024 underlined the central bank's move, hinting that the elusive wage-price virtuous cycle was now in the works. The second round of negotiations also showed a solid 5.25% hike, well above the 3.60% average in 2023. Although subsequent rounds should further drag the average lower, a close to 5% gain will still be the highest since 1991. BoJ Governor Kazuo Ueda has said that future hikes are contingent on inflation. Given that recent inflation prints continue to show sufficient services-backed increases (impact of base effects from energy and travel aside), strong wage gains should add to the BoJ's tightening ammunition. We expect two more hikes in the remainder of 2024. Japan's legacy of easy policy, risks of deflation and heightened debt will make further policy action gradual, but not absent, in our view. This makes the BoJ the lone central bank to embark on rate hikes in our analysis this year, making it an outlier, again!

Reserve Bank of Australia (RBA)	
Next expected move	Nov 2024 (–25bp)
FTFI policy rate 1-yr forecast	3.85
FTFI score	1.5

Neutral rather than dovish

The RBA turned less hawkish at its March 19 meeting but maintained that it is "not ruling anything in or out," which we view as not dropping its tightening bias altogether. RBA's meeting minutes indicated the same. Growth has slowed, as evidenced in gross domestic product (GDP) reports with the RBA confirming that private consumption remains particularly weak. But additional fiscal easing in the May 14 federal budget on cost-of-living pressures as well as the Stage III tax cuts, which will be implemented from July 1, should lift spending in the second half of 2024, in our view. Labor data continues to show signs of tightness, with the unemployment rate crawling back to 3.7% from 4.1% previously, despite stable participation rates. This will give credence to the RBA's view that labor-market trends lend support to the goal of reaching the inflation target by the end of 2024 (we expect the unemployment rate to stabilize close to 4% levels). Inflation has consistently moderated, but as is the case elsewhere, goods disinflation has led to this decline, whereas non-tradeable inflation remains sticky. So, the battle is not entirely won, which is what the RBA will continue to reiterate through the coming months. We expect a move only in the fourth quarter once the impact of fiscal easing on growth is ascertained, and inflation and labor trends are more stabilized. A quicker loosening of the labor market could bring forward cuts, but that is not our baseline view.

Reserve Bank of New Zealand (RBNZ)	
Next expected move	Q1 2025 (–25bp)
FTFI policy rate 1-yr forecast	5.25
FTFI score	2.5

Hard pause, encore

We had called for a hard pause by the RBNZ in the last edition of our publication in January despite the growing market clamor for cuts. Since then, the data picture has been mixed—the economy has officially entered a technical recession and the property market has broadly weakened with low sales and home prices. However, the labor market continues to be resilient, largely owing to excess supply (the economy has roughly seen a population growth of 2.8% over the year due to a post-COVID-19 immigration surge) and inflation remains too sticky for comfort. The RBNZ seemingly took the side of weak activity and/or GDP (only third quarter GDP was out ahead of the meeting in February, which was weaker than expected at –0.3% quarter-over-quarter seasonally adjusted) and coupled with moderating inflation (although it is more goods led), kept rates on a hold, lowering the peak policy rate to 5.60% from 5.69% previously. Market adjustment toward cuts followed suit. But even by the RBNZ's own admission, peak rates need to be sufficiently restrictive for inflation to move within the 1%–3% target band. This was accompanied by the need to be data dependent of course, which in our view will likely point to a case of higher rates for longer. The last mile of disinflation can prove arduous. We therefore hold on to our view of a hard pause by the RBNZ through 2024.

Bank of Korea (BoK)	
Next expected move	Aug 2024 (–25bp)
FTFI policy rate 1-yr forecast	2.75
FTFI score	0.5

Not in a hurry

The BoK kept its policy rate unchanged at 3.50% at its February meeting, in a unanimous decision, although one member signaled an openness to ease rates in the months ahead. This was widely expected and based on evolving data that pushes back on the need for immediate rate cuts, in our view. Growth remains broadly on track, supported by a recovering semiconductor cycle as exports have held up. The global growth outlook seems to be in a better place although risks remain, as the BoK highlighted. The central bank kept its growth forecasts unchanged, at 2.6% for 2024. On inflation too, the trajectory has been in line with the BoK's expectations. The central bank expects headline CPI to ease to 2.6% in 2024, with core pressures more moderate at 2.2%. Headline CPI could be impacted by volatility from higher agricultural prices in the coming months, keeping the first half of the year numbers on the higher side. In his post-meeting press conference, BoK Governor Rhee Chang-yong mentioned that a rate cut was unlikely in the first half of 2024 and that any moves in second half would be dependent on data. We expect the BoK to turn more dovish in the upcoming meetings, with the first rate cut in third quarter. We do not expect a protracted easing cycle with the terminal rate close to 2.75%. We believe this should be sufficient and supportive of growth and inflation at the 2% levels.

People's Bank of China (PBoC)	
Next expected move	H2 2024 (–30bp)
FTFI policy rate 1-yr forecast	1.50
FTFI score	–4.5

Liquidity injections over rate cuts for the foreseeable future

China's National People's Congress (NPC) once again set a growth target of around 5% for 2024—an ambitious goal this time given the higher base in 2023. However, it also signals a more proactive policy stance. The much-needed tailwinds from fiscal policy already appear to be on the way with China's January-February fiscal deficit rising to its highest in more than 30 years. The PBoC too has surprised with an easier policy stance—cutting the Reserve Requirement Ratio (RRR) by a larger-than-anticipated 50 bps in January and lowering the five-year Loan Prime Rate (a key lending rate) by 25 bps to 3.95% in February. The PBoC will continue to rely on quantitate tools such as RRR cuts (possibly two more 25 bp cuts) to keep liquidity loose through the first half of 2024. This will also aid markets in absorbing an upcoming 1 trillion yuan issuance of special ultra-long sovereign bonds as part of the 2024 fiscal stimulus plan. However, the PBoC has cautioned against any immediate rate cuts. With net interest margins at Chinese commercial banks dropping to a record low at the end of 2023, any further lending-rate cuts will need to be preceded by deposit-rate cuts. Moreover, we think policy rate cuts are more likely in the second half of 2024 as other major central banks will have moved toward easing by then.

Franklin Templeton Fixed Income (FTFI) Policy Rate Forecasts vs. Market Pricing

As of April 1, 2024

Country	Inflation (Latest % Y/Y)	Official Rate	Current Rate (% pa)	Last Change	Next Change (FTFI Forecast)	Market Implied Policy Rate** (%)		FTFI Policy Rate Forecast (%)	
						1-Year	2-Year	1-Year	2-Year
United States	3.2	Fed Funds*	5.50	Jul 2023 (+25bp)	Sep 2024 (–25bp)	4.49	3.82	4.50	4.00
Canada	2.8	O/N Rate	5.00	Jul 2023 (+25bp)	Jul 2024 (–25bp)	4.08	3.43	4.00	3.50
Euro Area	2.6	Deposit Rate	4.00	Sep 2023 (+25bp)	Jun 2024 (–25bp)	2.85	2.30	2.75	2.25
United Kingdom	3.4	Bank Rate	5.25	Aug 2023 (+25bp)	Aug 2024 (–25bp)	4.31	3.64	4.25	3.25
Norway	4.5	Deposit Rate	4.50	Dec 2023 (+25bp)	Sep 2024 (–25bp)	3.81	3.31	4.00	3.25
Sweden	4.5	Repo Rate	4.00	Sep 2023 (+25bp)	Jun 2024 (–25bp)	2.98	2.41	2.75	2.25
Switzerland	1.2	Policy Rate	1.50	Mar 2024 (–25bp)	Jun 2024 (–25bp)	0.91	0.96	1.00	1.00
Japan***	2.8	Policy Rate	0.10	Mar 2024 (+20bp)	Jul 2024 (+15bp)	0.33	0.50	0.75	1.25
Australia	3.4	Cash Rate	4.35	Nov 2023 (+25bp)	Nov 2024 (–25bp)	3.83	3.51	3.85	3.60
New Zealand	4.7	Cash Rate	5.50	May 2023 (+25bp)	Q1 2025 (–25bp)	4.54	3.92	5.25	4.75
South Korea	3.1	7D Repo Rate	3.50	Jan 2023 (+25bp)	Aug 2024 (–25bp)	3.19	2.96	2.75	2.75
China	0.7	7D Rev Repo Rate	1.80	Aug 2023 (–10bp)	H2 2024 (–30bp)	1.69	1.76	1.50	1.80

*For the United States, the rate considered is the upper bound of the fed funds target range. **Market implied rates are based on Bloomberg's MIPR rates. ***Japan's CPI is official core, CPI excluding fresh food. Japan's policy rate is the upper bound of the BoJ's target rate.

Sources: Franklin Templeton Fixed Income Research, Bloomberg, each country's respective national sources. There is no assurance that any estimate, forecast or projection will be realized.

Editorial review

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Our global reach through Franklin Templeton Investments provides access to additional research, trading, and risk management resources. Portfolio managers have opportunities to exchange insights with other investment groups, and collaborate with an independent risk team that regularly examines risk analytics to help identify and address areas of excessive risk exposure within our portfolios.

Franklin Templeton Fixed Income (FTFI) Central Bank ranking methodology
Each central bank is scored on three parameters: Inflation Outlook Perception, Quantitative Easing/Liquidity Management Programs, and Interest Rate Forward Guidance. Each parameter can be scored from a range with a minimum of –2 (dovish) and a maximum of +2 (hawkish). The methodology for scoring compares the latest monetary policy statement/press statements with prior ones to see how the language and tone regarding each of these parameters may have changed over time. The scores are ultimately aggregated for each central bank, with a final FTFI score ranking each from –6 (for most dovish) to +6 (for most hawkish). We also provide our one-year ahead policy rate expectations and compare our rankings and expectations with market implied policy rates to evaluate how the difference between our expectations/rankings and market expectations/rankings.

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The government's participation in the economy is still high and, therefore, investments in **China** will be subject to larger regulatory risk levels compared to many other countries.

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