CAPITAL ECONOMICS

GLOBAL ECONOMICS UPDATE

Hawkish tone at Sintra forum, particularly in Europe

- **Central bankers have struck a hawkish tone at the ECB's forum in Sintra this week, suggesting that rates haven't yet peaked and cuts are not on the cards for some time. But there were some interesting differences in tone. Most notably, the ECB and BoE sounded more concerned about wage-price spirals than the Fed, supporting our view that rates in Europe will stay higher for longer than those in the US.**

- The ECB Forum on Central Banking is an annual event held in Sintra, Portugal and attended by central bankers from major economies. The Forum has only been running since 2015, but policymakers (especially ex-ECB President Mario Draghi) have given some market-moving speeches over that time such that the conference now vies with Jackson Hole for investors' attention. This year, it was attended by the heads of the ECB, US Fed, Bank of England and Bank of Japan who all sat on the same panel yesterday.

- We think there were five key messages. **The first is that policy tightening is still very much the order of the day.** The ECB, US Fed and Bank of England all indicated that they are not yet done, which won't have surprised markets. But there was perhaps an outside chance of hints that the cycle might be drawing to a close and they did not see fit to oblige. **Indeed, President Lagarde reiterated that there was "still ground to cover" while Powell said that despite the Fed's latest pause, more rate hikes (plural) were likely to be appropriate and that he wouldn't rule out *successive* hikes rather than every other meeting.**

- **Second, central bankers conceded that some economic hardship is inevitable and indicated that moderate weakness in the economic data will not change their path.** None responded directly to a question about whether they were prepared to tolerate recessions, but Governor Bailey highlighted that the Bank of England had been forecasting one not so long ago and continued to tighten policy nonetheless. Both Chair Powell and President Lagarde conceded that recessions were certainly possible and hinted that they were a price worth paying to bring inflation down.

- **Third, central banks are very unsure about how much tightening is needed.** Such things are never certain, but their tone regarding recent surprises in inflation and in activity was particularly humble and they all stressed the need to be data-driven due to the uncertainty. **This suggests that they could change their tone relatively quickly if inflation (especially in services) shows clear evidence of falling.**

- **Fourth, the Fed seems closer to a peak than either the ECB or the Bank of England.** Although all three sounded distinctly hawkish, Powell highlighted early signs of loosening in the labour market while neither Lagarde nor Bailey had seen any such cause for relief. **What's more, Powell was keener to stress that interest rates are in restrictive territory and that the closer they come to the peak, the higher the risk of doing too much. In our view, both Lagarde and Bailey seemed more concerned about the risk of doing too little and allowing inflation expectations to become unanchored.**

- **Finally, the Bank of Japan is still in a very different camp.** Governor Ueda argued that while core inflation had risen, key indicators of underlying price pressure such as wage growth were still too low to be consistent with the BoJ's target. He argued that inflation was likely to fall in the near term and then rise again in 2024. Only once he had seen clear evidence of the latter would he feel comfortable removing any policy accommodation. He conceded that Japan's position as an outlier had put downward pressure on the yen, which the BoJ is monitoring closely, but he reiterated that any intervention would be a matter for the Finance Ministry to decide.

- **In all, the hawkish tone of this week's comments has increased the risk that interest rates will rise somewhat further than our forecasts of one or two more hikes in Europe. But in the US at least, we still think that underlying inflation will fall faster than anticipated as a recession takes hold.** If the banks are as data-driven as they suggested today, this should lead to a change of tack. Our forecast is that the Fed will be the first to cut, perhaps as soon as Q1 next year, but that the ECB and Bank of England are likely to lag some way behind. See our Central Bank Hub for more detail.

Jennifer McKeown, Chief Global Economist, +44 (0)20 7811 3910, jennifer.mckeown@capitaleconomics.com

Disclaimer: While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Capital Economics Limited and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or investments.

Distribution: Subscribers are free to make copies of our publications for their own use, and for the use of members of the subscribing team at their business location. No other form of copying or distribution of our publications is permitted without our explicit permission. This includes but is not limited to internal distribution to non-subscribing employees or teams.

TORONTO NEW YORK LONDON SINGAPORE

Email **sales@capitaleconomics.com** Visit **www.capitaleconomics.com**