

## FX Pulse

FICC Research Dept.

## Pricing in of rate cuts in major nations disappears

- ECB to discuss rate hike in April
- BOE delivers surprise with no votes for rate cut
- BOJ signaling that its stance is to continue with rate hikes, but ...

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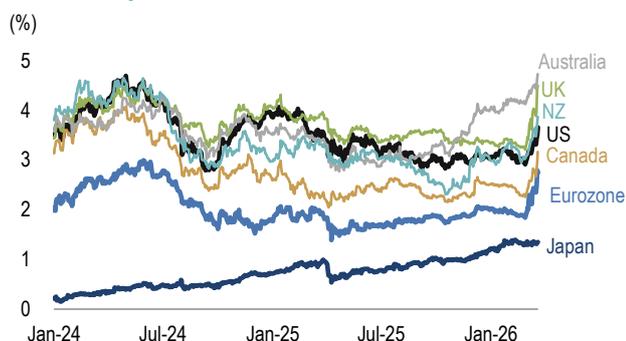
## Significant repricing in the Eurozone and the UK

Last week, major central banks held a series of monetary policy meetings, the first since the start of large-scale military action against Iran. In addition to the Fed, both [the ECB and the BOE](#) decided to keep their policy rates on hold. However, expectations of rate hikes are rising in the market amid growing concerns about energy supply disruptions. Notably, the Reserve Bank of Australia (RBA), which had already shifted toward a rate-hiking path ahead of other major central banks, decided on a second consecutive rate hike at its board meeting on 17 March.

The repricing of policy rate paths has been particularly pronounced in the Eurozone and the UK, with markets already pricing in three or more rate hikes by both the ECB and the BOE within the year (Chart 1). For both central banks, an April rate hike is priced in with a probability of about 80%. As CBS reported on 20 March that the Trump administration was considering deploying ground troops to Iran, and with President Trump stating that he does “not want a ceasefire with Iran,” the market has also begun to more clearly price in rate hikes by the Fed.

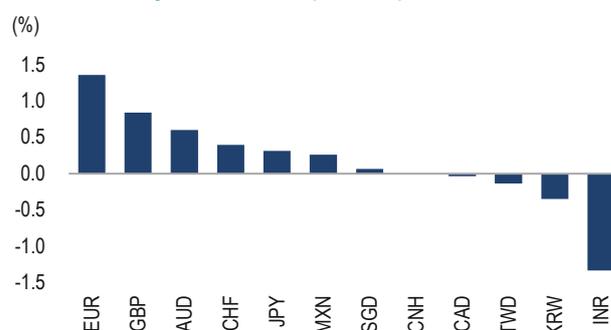
Looking at currency performance against the US dollar in this environment, the appreciation of the euro and British pound was notable last week, while the Australian Dollar, Swiss Franc, and Japanese Yen also rose overall (Chart 2). However, as mentioned earlier, an April rate hike by the ECB and BOE is largely priced in by the market, and about three rate hikes within the year have already become the consensus. From the standpoint of additional room for monetary-policy repricing, the Fed and other central banks appear to have relatively more room, suggesting that further upside in the euro and British pound could be limited.

Chart 1: Policy Rate Paths in Various Countries



Source: Bloomberg; compiled by Daiwa.  
Note: 1yr-forward 1mo OIS rate.

Chart 2: Currency Performance (vs. USD)



Source: Bloomberg; compiled by Daiwa.

## **ECB to discuss rate hike in April**

At its meeting on 19 March, the ECB Governing Council unanimously decided to keep its major policy rates on hold, maintaining the deposit facility rate at 2.00%, in line with market expectations. Stressing the significantly greater uncertainty created by escalating tensions in the Middle East, the ECB indicated its stance would be to assess the impact on inflation and the economy.

The statement noted, "The war in the Middle East has made the outlook significantly more uncertain, creating upside risks for inflation and downside risks for economic growth. It will have a material impact on near-term inflation through higher energy prices. Its medium-term implications will depend both on the intensity and duration of the conflict and on how energy prices affect consumer prices and the economy." Furthermore, it stated, "The scenario analysis suggests that a prolonged disruption in the supply of oil and gas would result in inflation being above, and growth being below, the baseline projections" and "The Governing Council stands ready to adjust all of its instruments within its mandate."

In a press conference, ECB President Christine Lagarde stated, "We are well positioned to navigate this uncertainty." However, she did not use the wording that she has often employed recently in which she stated that "we continue to be in a good place." She also clarified that, in determining the appropriate monetary policy stance, the ECB would continue to follow a data-dependent, meeting-by-meeting approach, and that rate decisions in particular would be based on its assessment of the inflation outlook and the risks surrounding it, taking into account incoming economic and financial data as well as developments in underlying inflation.

According to sources, the ECB might begin discussing rate hikes at its next meeting in April and could decide to actually raise rates at its June meeting. The sources also indicated that the ECB would be prepared to move forward with rate hikes as early as the next meeting in April if the inflation rate significantly exceeded the 2% target.

Indeed, on 20 March, Bundesbank President Joachim Nagel expressed the view that the ECB would need to consider a rate hike as early as April if inflationary pressures were to further intensify due to the impact of the war in Iran. On the same day, Governor Gabriel Makhlouf of the Central Bank of Ireland also made it clear that he would not rule out a rate hike next month if the data indicated a need for it.

On the other hand, Governor Olli Rehn of the Bank of Finland stated, "We must keep a cool head and keep our eyes on the entire playing field," explaining that policymakers needed to separate short-term volatility from the long-term economic impact. Governor François Villeroy de Galhau of the Bank of France said that the ECB would not be inactive nor overreact to oil and gas price volatility, stating that it was ready to act to stabilize inflation at its target of 2%. Governor José Luis Escrivá of the Bank of Spain indicated a cautious stance, stating that it was very difficult to assess the impact of rising energy prices on inflation trends, and that the ECB should adhere to its established practice of making decisions on a meeting-by-meeting basis.

## **BOE delivers surprise with no votes for rate cut**

At its Monetary Policy Committee (MPC) meeting on the 19th, the BOE decided to hold its policy rate at 3.75%. However, the fact that even the two dovish members did not vote for a rate cut came as a surprise, and resulted in a unanimous decision for the first time since September 2021. The statement and meeting minutes also had a more hawkish tone than expected.

While the BOE statement from the previous meeting had explicitly stated, "Bank Rate is likely to be reduced further," that wording was removed this time. Instead, the BOE stated the following. "The Committee will continue to monitor closely the situation in the Middle East and its impact on global energy supply and energy prices. It stands ready to act as necessary to ensure that CPI inflation remains on track to meet the 2% target in the medium term."

BOE Governor Andrew Bailey pointed out that the impact from the situation in the Middle East was already showing up in gasoline prices, and that, if the situation continued, it would also lead to higher energy bills for households in the latter half of the year. He stated that the policy rate was being held steady in order to assess future developments, and that “Whatever happens, our job is to make sure inflation gets back to its 2% target.”

An assessment of the views of MPC members suggests that Deputy Governor Clare Lombardelli, Chief Economist How Pill, and committee member Catherine Mann are leaning towards supporting a rate hike. Although Governor Bailey has indicated a cautious stance, saying that there was no need to rush to conclusions regarding the future rate path, if tensions in the Strait of Hormuz and pressure on energy markets do not abate, it is entirely realistic that the BOE could decide to raise rates as early as its next meeting in April, when it updates its macroeconomic projections.

### **BOJ signaling that its stance is to continue with rate hikes, but ...**

[At its Monetary Policy Meeting \(MPM\) on 18-19 March, the BOJ decided to keep its policy rate on hold.](#) Similar to the January meeting, board member Hajime Takata proposed a rate hike, arguing that the price stability target had been more or less achieved, but this was rejected by a majority vote. Notably, Takata changed his reason for advocating a rate hike, from his previous assertion that it was because overseas economies were in a recovery phase to stating that it was because there were risks to prices in Japan due to the second-round effects of price rises stemming from overseas developments. [This suggests an awareness that inflation risks should be given greater consideration, even during a time when the economy may experience a downturn to a certain degree due to the tense situation in the Middle East.](#)

Board member Takata dissented regarding the price outlook, asserting that the level of the rate of increase in the CPI, including underlying CPI inflation, had already generally reached the price stability target. Board member Naoki Tamura also dissented, asserting that underlying CPI inflation would likely be at a level that was generally consistent with the price stability target from the beginning of fiscal 2026 onwards.

At a press conference, Governor Kazuo Ueda stated that, while opinions were divided on whether greater consideration should be given to the upside or downside risks to the underlying inflation rate from the Middle East situation, there were more opinions pointing to the upside risks. Expressing his own views, Ueda said that he wanted to decide on the matter after monitoring the situation a bit more, and added that it would be difficult to make a precise decision, but that the BOJ might know in a short period of time in which direction things are likely to go and how much volatility there will be, arguably leaving the door open for an April rate hike. There was likely a temporary increase in yen buying in the forex market in response to these remarks.

He also added that, with there possibly being an increased pass-through from exchange rate fluctuations to domestic prices and a greater impact on underlying inflation than what was seen in the past, the BOJ wanted to analyze the situation carefully. Furthermore, at the beginning of the press conference, he revealed that the BOJ is considering expanding and publishing CPI indicators to better capture underlying inflation, and that it is also considering using the latest data to publish a re-estimate of the natural rate of interest—which does not affect the economy or prices.

While Ueda's stance of continuing with rate hikes is expected to provide some support for the yen exchange rate, with central banks in other countries now shifting towards a rate hike path, curbing yen depreciation is becoming more difficult. Furthermore, with PM Sanae Takaichi having been firmly intent on demanding considerations be made for the economy even before the situation in Iran deteriorated, a government official has stated that she might not give her approval (for a hike in April). The Prime Minister's concerns that any further rate hikes would lead to a return to deflation appear to be what was behind the recent selection of BOJ policy board members. The recent measures against soaring crude oil prices also seem to reveal her determination to tackle inflationary pressures with fiscal policy.

At the House of Councillors Budget Committee on the 16th, Finance Minister Satsuki Katayama declined to comment on the level of the exchange rate, but then stated that her stance was to exercise maximum vigilance, and take decisive measures. By employing the strong wording “decisive measures,” she was engaging in verbal intervention. While caution about intervention is likely to weigh on the upside for the USD/JPY rate, concerns about yen depreciation are likely to persist unless the situation in the Middle East improves quickly.

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