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OCBC Group Research

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Interest Rates Focus

Central banks outlook

- *September FOMC decision is a close call. Our base-case remains for a hold, but the risk of a hike being delivered has risen. August CPI is key to watch.*

- *We have brought forward our expected BoJ rate hike to the September meeting from the October meeting. Question is whether there will be a third hike this year.*

- *We maintain our call for the BoE to keep Bank Rate unchanged at 3.75% this year; RBA is still likely to stay in a pause mode; we expect a 25bp hike by the ECB at September meeting.*

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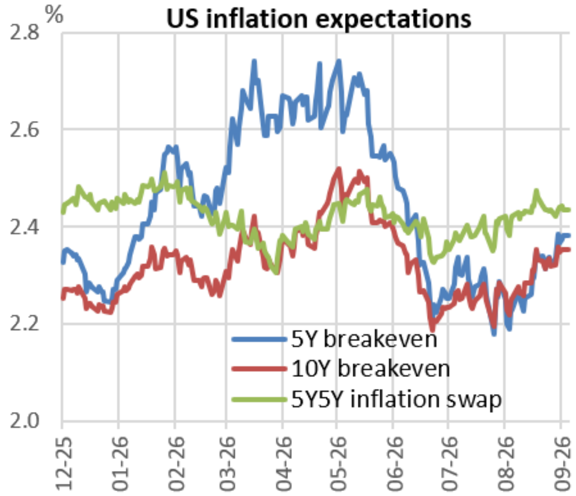
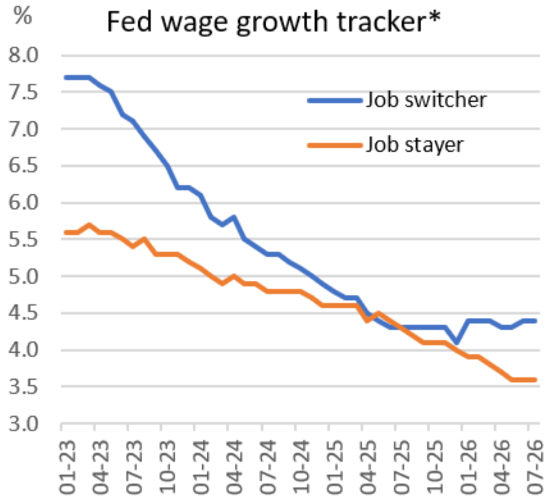
Fed

Our base-case remains for the FOMC to keep Fed funds rate unchanged this year, partly based on contained inflation pass-through thus far, while there has been no re-acceleration in wage growth. We acknowledge the risk for a hike being delivered has risen, given recent hawkish comments from Warsh and the prospects of renewed inflation pressure. Warsh opined the broad financial conditions are not restrictive, the 2% target as measured by the PCE price index is a firm, fixed target, and short-term interest rates are the predominant tool to achieve the Fed's dual mandate. In relation to the reaction function, Warsh commented the standard is: "we must be confident that underlying inflation is moving to our objective clearly and at sufficient speed. Otherwise, we have work to do". The bar for delivering a rate hike seems to have been lowered. Nevertheless, Warsh said he is committed to a discipline, not to a decision. Fed Governor Waller, on the other hand, has opined that underlying inflation is better than core numbers suggest and he would support keeping interest rates steady at this month's FOMC meeting if this week's inflation shows continued progress toward their 2% goal.

Policy decisions remain highly data dependent. Market reaction to Friday's strong payrolls was muted, precisely reflecting the view that it is inflation data, instead of labour market data, that would affect monetary policy direction. Hence, this week's CPI would be key to watch. YoY inflation may have eased somewhat partly due to base effect; focus is on the month-on-month change in core CPI. We previously mentioned if a hike was delivered this year, then it would likely be reversed in 2027 – we still hold this view. In this regard, market pricing of a total of 60bps of hikes by mid-2027 appears overly hawkish to us. As for the September decision, market last priced a 60% chance of a 25bp hike, seeing it as a close call.





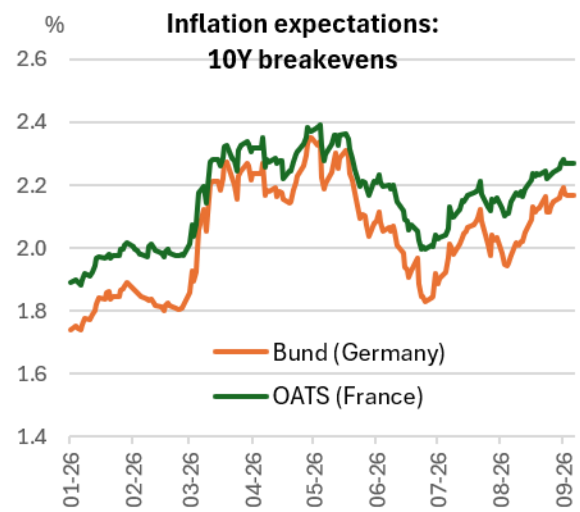
Source: Bloomberg, OCBC Group Research
*nominal wage growth - median percent change in the hourly wage of individuals observed 12 months apart, three-month moving average

BoE

We maintain our call for the BoE to keep Bank Rate unchanged at 3.75% this year. Bank rate being at a restrictive level is one of the reasons for our call, while a softening labour market is another. The pick-up in July CPI inflation had been expected, primarily due to the higher energy cap set by Ofgem for the July-September period which had been well telegraphed. We forecast 2026 and 2027 CPI inflation at 3.1% and 2.3% respectively. Bailey at Jackson Hole commented second-round inflation effects are subdued, and the labour market has been softening for some time. He opined the BoE could watch the situation for the moment. Mann, who voted for a 25bp hike at the last meeting, unsurprisingly sounded hawkish; she opined "it's better to be a little bit too high and then course correct if necessary". GBP OIS is pricing in a status quo decision for the September meeting, but a total of three hikes being priced by July 2027 appears overly hawkish.

ECB

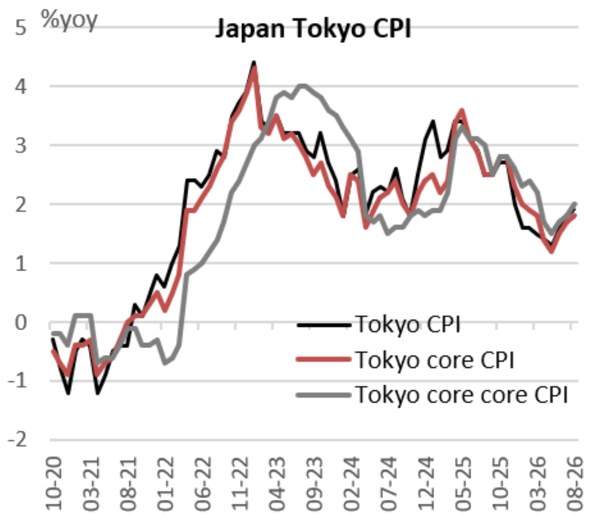
We expect the ECB to raise the deposit rate by 25bps to 2.50% at its September meeting; the main refinancing rate and marginal lending facility rate are expected to be adjusted accordingly. Thereafter, we expect ECB to be on an extended pause. We do not anticipate a more aggressive tightening cycle at this juncture. While economic activities shown some signs of recovering, growth remains soft and uneven. That said, inflation expectations have been sensitive to oil prices and geopolitical developments. Inflation bond breakeven has been rising steadily since pointing to upside risks to our policy rate forecast profile. Lagarde is likely to refrain from giving a firm guidance, as decision-making remains in a meeting-by-meeting approach. Again, the size and persistence of the supply shock are crucial factors affecting ECB's decision making. EUR OIS is fully pricing in a 25bp hike at September meeting, and an additional two more hikes by mid-2027.

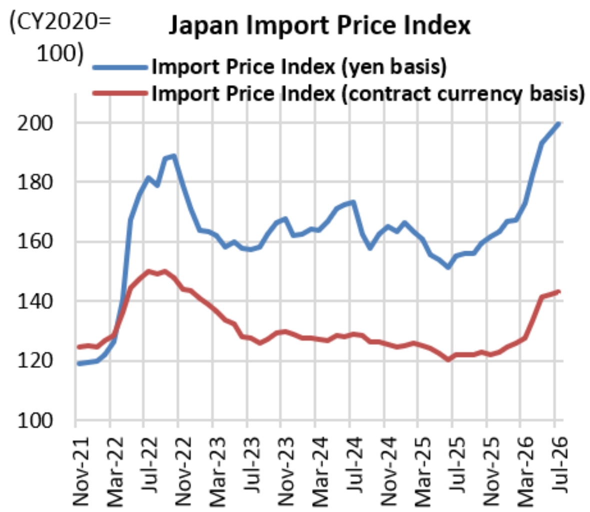


Source: Bloomberg, OCBC Group Research

BoJ

We have brought forward our expected 25bp BoJ policy rate hike to the September meeting from the October meeting previously anticipated. July CPI and August Tokyo CPI YoY inflation accelerated as expected. While monetary policy does not target exchange rate, a weak yen does have an impact on prices. BoJ opined the pass-through from exchange rate to prices seems to be getting stronger. Key question is whether the BoJ will deliver a third hike within this year, thereby quickening the pace of tightening that the twice-a-year pace. Policy normalization is likely to continue given a tight labour market, pro-active firms' price-setting behaviour, and imported inflation pressure. BoJ raises rates to normalise monetary policy, as the policy rate has stayed negative in real term. We expect a total of 50bps of hikes in 2027. There is room for more hikes than what are on our current forecast profile.





Source: Bank of Japan, Bloomberg, OCBC Group Research

RBA

The RBA kept its cash rate target unchanged at 4.35% at its August meeting. The meeting minutes retained a slightly hawkish tone, with members considering either holding rates steady or delivering a 25bp hike. The Board judged that the cumulative 75bp of tightening this year have made financial conditions somewhat restrictive. The Board remains “attentive to the data and the evolving assessment of the outlook and risks when making its decisions”. Incoming data since then have been mixed. Unemployment rose to 4.5% in July, pointing to some easing in labour market conditions, while trimmed mean inflation recorded its strongest month-on-month increase this year. 2Q26 GDP exceeded RBA’s expectations. However, the composition of growth provided little evidence of a broad-based reacceleration in activity.

We expect the RBA to keep policy cash rate unchanged in September. While the risk of further tightening has increased, we expect the Board to remain patient and require clearer evidence of renewed demand or inflationary pressures to hike policy rate further. Market pricing has turned more hawkish over the past couple of weeks. Cash rate futures priced a 68% chance of a September rate hike, while a full 25bp hike is priced in by November.

RBNZ

The RBNZ raised the Official Cash Rate (OCR) by 25bps to 2.75% at its September meeting, its second consecutive hike. The decision was unanimous, with the Committee judging that “gradually removing monetary stimulus” would help guard against the recent oil-price shock feeding into more persistent inflation, while reducing the risk of having to raise rates more aggressively later. The Committee nevertheless acknowledged that the domestic recovery remains uneven, with weak household spending, elevated unemployment and falling house prices continuing to weigh on activity. They also stressed that the future OCR path is "not pre-determined" and would depend on incoming data.

We expect the RBNZ to keep the OCR unchanged at its October meeting and we maintain our view that the next hike will be in 1Q2027. Most measures of core inflation remain within the RBNZ's 1-3% target band, while labour market conditions remain soft, wage pressures contained and inflation expectations broadly anchored. These conditions should allow the Committee to pause and assess whether the recent rise in headline inflation is translating into more persistent domestic price pressures. However, we acknowledge the upside risk that the next hike could be brought forward should inflation prove more persistent than expected. Market pricing moderated slightly following the September meeting, with investors now pricing around one further 25bp hike by year end. This suggests expectations for further policy tightening remain intact, although the RBNZ's relatively cautious guidance has tempered expectations of a more aggressive hiking cycle.

Interest rates forecasts	Current	Q326	Q426	Q127	Q227	Q327
Fed Funds Rate (upper)	3.75	3.75	3.75	3.75	3.75	3.75
BoE Bank Rate	3.75	3.75	3.75	3.50	3.50	3.50
ECB Depo Rate	2.25	2.50	2.50	2.50	2.50	2.50
BoJ Policy Rate	1.00	1.25	1.25	1.25	1.50	1.50
RBA Cash Rate	4.35	4.35	4.35	4.35	4.10	4.10
RBNZ OCR	2.75	2.75	2.75	3.00	3.00	3.00

Source: OCBC Group Research

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