

Interest Rates Focus

Central bank outlook – Fed, BoE, ECB, BoJ, RBA

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- **Fed.** We maintain our base-case for one 25bp Fed funds rate cut in 2026, and we have pencilled in this expected cut for Q1-2026. There are risks to our base-case on both side of the dovish-hawkish spectrum. The phrase “in considering the extent and timing of additional adjustments” in the December FOMC Statement suggests that there may be a longer pause and hence a potential delay to the next rate cut. On the other hand, the Committee’s 2026 PCE inflation and core PCE inflation forecasts are somewhat benign at 2.4% and 2.5% respectively. If inflation trends lower towards the latter part of 2026, that will open room for additional rate cuts. On balance, as the Fed funds rate is now “within a broad range of estimates of its neutral value”, additional rate cuts would probably require inflation move near the 2% target. While FOMC minutes for the December meeting continued to reflect a divided Committee given the downside risk to the labour market and upside risk to inflation, the overall tone was tilted to the dovish side.
- **BoE.** BoE cut its Bank Rate by 25bps to 3.75% at its December MPC meeting by a 5-4 vote (four members voted to keep the rate unchanged). We maintain our call for another 25bp cut in Q1-2026 which will bring the Bank Rate to 3.50%, with a potential pause thereafter. Bank of England noted “the restrictiveness of policy has fallen” since the Bank Rate has already been reduced by 150bps since August 2024. Nevertheless, an easing bias is maintained, with the Bank Rate remaining “on a gradual downward path”. Slack in the labour market and therefore the likelihood of pay growth to continue to slow support some further monetary policy easing.
- **ECB.** ECB is nearing or at the end of the monetary easing, with the key policy Deposit Facility Rate at 2.00% which is seen as a neutral level. Lagarde maintains her stance that the central bank is “in a good place”. From here, the decision to be made is whether to deliver an outright stimulative monetary policy, which may be warranted if downside risk to growth materialises. Our base-case is no additional rate cut is required based on the economic outlook. Tariff related uncertainty has slightly faded, while domestically, the labour market remains resilient.
- **BoJ.** Bank of Japan hiked its Target Rate by 25bps to 0.75% at December meeting. The central bank opined “it is highly likely that the mechanism in which both wages and prices rise moderately will

be maintained”, which has been our long-held view. Enterprises’ short-term (1-year), medium-term (3-year) and long-term (5-year) inflation expectations have stayed firmly above the 2% level (all enterprises-all industries readings), as per *Tankan* surveys. This proactive attitude in price-setting points to a higher likelihood that the increase in wage costs will be partially passed through onto consumer price levels. Next to watch is 2026 *Shunto* outcome. There is room for further, gradual policy normalization, and we keep our expectation for another 25bp hike in Q1-2026 to 1.00% - which, being at the lower end of the estimated range of the neutral rate, is better seen as an interim target.

- **RBA.** RBA’s Cash Rate is likely to stay at 3.60% through 2026. The Monetary Policy Board is worried about persistent inflation, while cash rate futures are pricing in some hikes. Messages at Bullock’s post-meeting press conference were even more hawkish than the MPB Statement. She revealed the RBA board didn’t consider cast for rate cut while rate hikes were discussed. She explicitly closes the door for further easing by saying “the question is, is it just an extended hold from here or is it possibility of a rate rise”. We however consider it as pre-mature to start forecasting hikes at this juncture.

Interest rates forecasts	Current	1Q26	2Q26	3Q26	4Q26
Fed fund rates (upper)	3.75	3.50	3.50	3.50	3.50
BoE Bank Rate	3.75	3.50	3.50	3.50	3.50
ECB Depo Rate	2.00	2.00	2.00	2.00	2.00
BoJ Target Rate	0.75	1.00	1.00	1.00	1.00
RBA OCR	3.60	3.60	3.60	3.60	3.60

Source: OCBC Group Research

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