Weekly round up (Week 38)

It was a busy week for central banks, with a total of nine meetings. Five monetary policy committees left rates unchanged, while the others cut them by 25 basis points.

The main surprises came from Asia, where the Bank of Indonesia (BI) caught economists off guard by cutting its policy rate by 25 bp to 4.75%, contrary to expectations of no change. Economists had leaned toward caution, citing the need to maintain monetary stability, but the central bank appears more focused on aligning with President Prabowo Subianto's goal of stronger growth. This latest move brings the total easing to 150 bp over the past 12 months. BI now expects growth in 2025 to exceed the midpoint of its forecast range of 4.6% to 5.4%, supported by stronger momentum in the second half of the year.

Elsewhere in Asia, the Bank of Japan (BoJ) signaled its intention to pursue a restrictive monetary policy despite an unstable political environment. The central bank kept its key rate at 0.5%, in line with economists' expectations. The decision was taken by 7 votes to 2, with Hajime Takata and Naoki Tamura opposing it in favor of a rise to 0.75%, in line with their reputation as “hawkish” members.

However, in a surprise decision, the BoJ announced its intention to begin selling its holdings in ETFs and J-REITs at an annual pace equivalent to approximately 0.05% of market trading volume. Don't panic! At this pace, it would take more than 100 years to liquidate its holdings entirely, underscoring the BoJ's desire to minimize disruption. Nevertheless, this decision clearly demonstrates the BoJ's confidence in the Japanese economy and its financial markets.

One of the main difficulties encountered in the context of monetary policy tightening has been concern over US tariffs. Governor Ueda addressed the issue directly, emphasizing that the Japanese economy remains resilient, with employment and investment largely spared from tariff pressures so far. This makes the BoJ's next meeting uncertain. The September Tankan survey will be closely scrutinized as confirmation of underlying economic strength and a possible green light for action. This opens up the possibility of a rate hike on October 30, just one day after the US Federal Open Market Committee (FOMC) considers a rate cut on October 29, hinting at a radical policy shift between the world's first and fourth largest economies, which would be moving in opposite directions.

The major event in Europe was the Bank of England (BoE), where the Monetary Policy Committee (MPC) kept its key rate at 4%, with a 7-2 split in the vote. The MPC reaffirmed that a gradual and cautious approach to easing remains appropriate. It also voted in favor of slowing the sale of its gilt holdings on its balance sheet, which will fall from £100 billion to £70 billion between October 2025 and September 2026. With £49 billion expected to come from buybacks, this implies around £21 billion of active sales. The BoE emphasized that quantitative tightening

(QT) should not become a source of market volatility and specified in the minutes that sales would be geared towards shorter maturities.

Perhaps the BoE also had an eye on the storm brewing in UK public finances. Public borrowing in August was much higher than expected: £18 billion against a forecast of £12.5 billion, the highest level for August in five years. This brought the deficit for the fiscal year beginning in April to £83.8 billion, the second highest since records began in 1993, surpassed only by the pandemic in 2020. At this stage of the fiscal year, revenues are £6.1 billion below forecast, while spending is broadly in line, jeopardizing Chancellor Reeves' budget commitments and complicating the preparation of the November 26 budget. Net public sector debt now stands at 96.4% of GDP.

Meanwhile, as President Trump dined with British royalty, the FOMC—for the first time in Trump's second term—announced a rate cut, reducing the federal funds rate by 25 bp to 4.00–4.25%, in line with expectations. There was only one dissenting vote, from new Governor Miran (appointed by Trump), who favored a 50 bp cut. The lack of further opposition showed broad unity among the remaining 11 voting members.

Chair Powell described the decision as a “risk management” cut, reflecting slightly less concern about inflationary risks and greater sensitivity to downside risks in the labor market. The median dot plot indicated two further 25 bp cuts this year, although the balance remains fragile: nine participants anticipated one or fewer, while ten anticipated two or more. At the press conference, Powell emphasized that the dot plot should not be seen as a policy signal, noting that participants do not seek to agree on these projections.

In the new staff projections released since June, growth has been revised upward across the entire forecast horizon. Expectations for 2025 and 2026 were raised by 0.2 percentage points to 1.6% and 1.8% respectively, while the forecast for 2027 was increased by 0.1 pp to 1.9%, and a new forecast for 2028 was introduced at 1.8%. Employment and inflation forecasts remained virtually unchanged, with unemployment expected to peak at 4.5% this year, while inflation is not expected to reach the Committee's 2% target before 2028.

Two important points emerged from the press conference. First, Chairman Powell emphasized that the combination of a decline in labor supply, due to demographic changes, post-COVID effects, and changes in immigration patterns, and a slowdown in labor demand, influenced by AI-related productivity gains, will likely keep labor market conditions tight for some time. and changes in immigration patterns, and a slowdown in labor demand, influenced by AI-related productivity gains and uncertainty surrounding tariffs, has created an unusual balance in the labor market. As a result, the threshold for monthly job creation needed to keep the unemployment rate stable is now minimal, perhaps between 0 and 50,000.

After last week's political tsunami, marked by negative headlines in the press, it was reassuring to see central banks reaffirm their common sense and stability. The common thread running through their decisions was confidence in robust growth prospects and broadly contained inflation. Each committee is at a different stage in the process, but the common goal is to steer monetary policy toward neutral levels, a destination they expect to reach over the next 12 to 18 months.