Market Watch. Blackfort.

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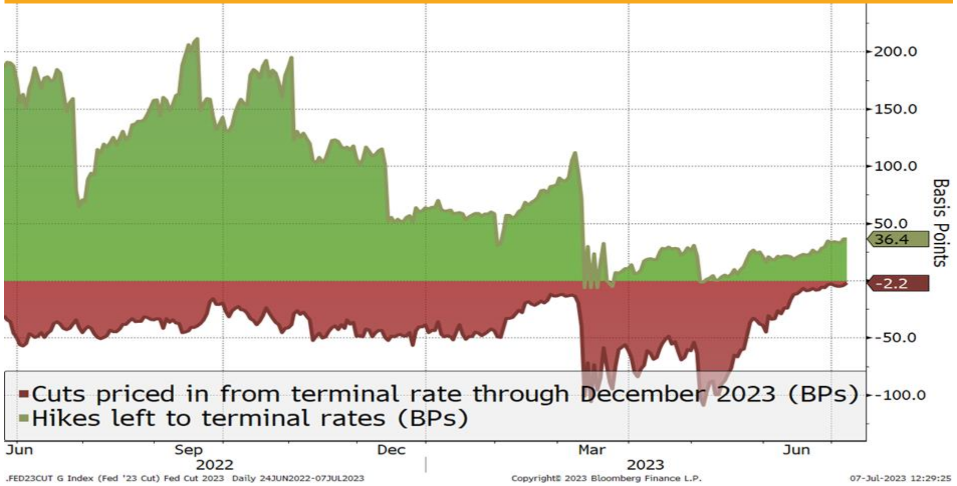
The Fed and ECB will raise rates at their next meeting while the economy cools down

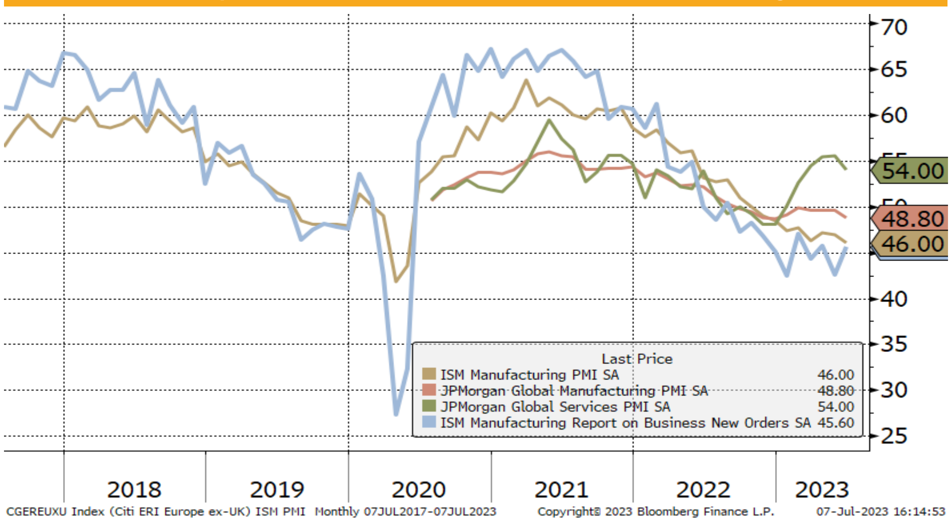
- Central banks find themselves in a difficult situation where the economy is experiencing a slowdown, yet core inflation is not falling as much as anticipated. In the light of this, both the ECB and the Fed have declared during the central conference in Portugal that they will proceed with raising their policy rates at the upcoming meetings, despite the weakening state of the economy.
- However, in the United States, the situation appears relatively better compared to the Eurozone. Inflation has decreased to 4%, and although the job market indicates signs of cooling down, it continues to grow sufficiently to suggest that the country might only experience a mild recession.
- In Europe, inflation remains at a consistently high level, and the largest economy, Germany, is already experiencing a recession. However, the ECB has communicated its preference to continue its efforts to combat inflation, even if it means pushing the economy further into a recession. Despite this, the recent PMI data in Europe was exceptionally weak. As a result, we still anticipate that the ECB will take steps to stimulate the economy over the next 12 months, even if inflation does not reach the 2% target.
- Due to Germany's strong reliance on global industrial production, the pressure from workers to safeguard their jobs is expected to increase significantly and nudge the ECB to cut rates.

The market expects that the Fed will raise its policy rate once more



- At first glance, the situation in the US may appear similar to Europe. However, upon closer examination, when we consider details such as the new orders sub-index, we believe that the lowest point of this slowdown may be already behind us. This is evident as the index has experienced a consecutive increase for the second time.
- In contrast to Europe, the US is also benefiting from a robust and continuously expanding service sector.
- This puts the Federal Reserve in a favorable position to consider cutting rates more decisively and from a higher level during 2024. In hindsight, this helps to explain why US equity markets have continued to rise while yields on longer-maturity bonds have recently also experienced a significant rally.
- On the other hand, Europe is also confronting a slowdown in the service sector, which further complicates the situation for the ECB. As a result, our expectation is that inflation in 2024 and 2025 will not reach the ECB's or Fed's 2% target. However, both central banks might still consider cutting rates, even if their inflation targets have not been met.

Global industrial production contracts while services continue to grow



Source: Bloomberg, Blackfort Analytics

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