WELLS FARGO

International Commentary — January 30, 2025

G10 Central Banks Start the Year in a Dovish Overall Mood

Summary

- It was a busy week for foreign central banks, with several institutions offering their first monetary policy assessment of 2025. The European Central Bank lowered its policy rate 25 bps to 2.75%, while repeating that inflation should converge to 2% by late this year and that growth remains weak. We expect 25 bps rate cuts in March, April, June and September, for a terminal policy rate of 1.75%.
- The Bank of Canada cut its policy rate 25 bps to 3.00%, but did not offer any future policy guidance amid tariff-related uncertainty. We would not interpret that as a hawkish signal, however, and indeed the central bank's modeling suggested higher tariffs would have a relatively rapid and substantial impact on economic growth, and a somewhat more gradual impact in boosting inflation. Our view remains for 25 bps rate cuts in March, April and June, which would see the policy rate reach a low of 2.25%.
- Sweden's Riksbank cut its policy rate 25 bps to 2.25%, while its accompanying statement was mildly dovish in tone. We think an accumulation of benign inflation and subdued activity data will see the central bank deliver a final 25 bps rate cut by May. In Australia, the latest inflation figures slowed more than forecast and pointed to an easing in domestic price pressures. We now expect the Reserve Bank of Australia to start its easing cycle with a 25 bps rate cut in February, and look for a cumulative 100 bps of policy rate cuts this year, to a low of 3.35%.

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European Central Bank Continues Its Rate Cut Cycle

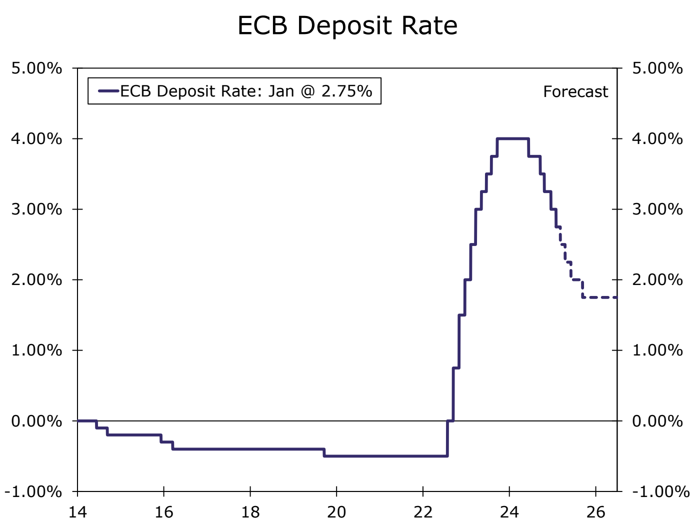
The European Central Bank (ECB) lowered its Deposit Rate by 25 bps to 2.75% at its first monetary policy announcement of 2025 and delivered an accompanying statement that, while not overtly dovish, is in our view consistent with further easing at upcoming meetings. Among the key points, the ECB said:

- The disinflation process is well on track, and that most measures of underlying inflation suggest that inflation will settle around the 2% target on a sustained basis.
- Domestic inflation remains high, but wage growth is moderating as expected and profits are partially buffering the impact on inflation.
- Monetary policy remains restrictive and the economy is still facing headwinds. On a more encouraging note, rising real incomes and the gradually fading effects of restrictive monetary policy should support a pick-up in demand over time.

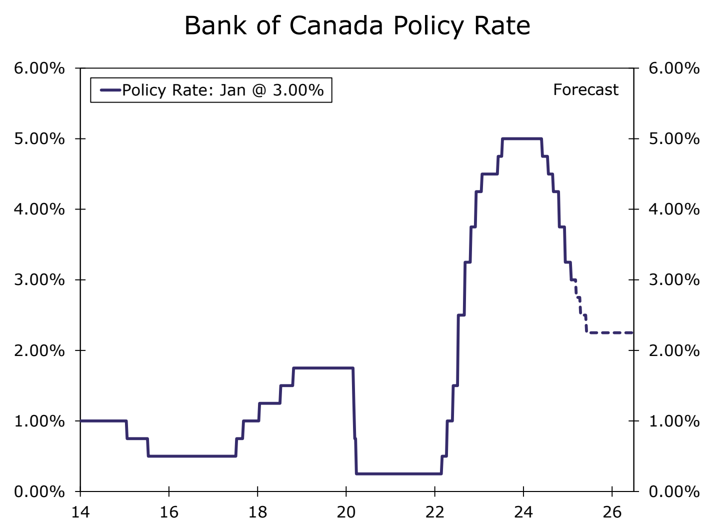
With respect to policy guidance, the ECB said it will follow a data-dependent and meeting-by-meeting approach to its monetary policy decisions, and that it is not pre-committing to a particular rate path.

Comments from ECB President Lagarde at the post-meeting press conference did not deviate significantly from the initial ECB announcement. Lagarde said there were both upside and downside risks to inflation, but that risks to the growth outlook were tilted to the downside. Lagarde said the ECB would publish a report on the neutral policy interest rate in early February, while also adding that discussing where to stop interest rate cuts is premature—the latter an indication that further interest rate cuts should be forthcoming.

Overall, we don't see anything in today's announcement and post-meeting press conference that would prompt us to change our outlook for ECB monetary policy. Eurozone growth remains very sluggish, as evidenced by the flat quarter-over-quarter outcome for Q4 GDP, along with small quarterly declines for German and French Q4 GDP. **Our view remains for further 25 bps rate cuts at the March, April, June and September meetings, which would see the Deposit Rate reach 1.75% by September**, though the later rate cuts in particular would require a further deceleration in wages, services inflation and core inflation in the months ahead. Our view is more aggressive than currently expected by market participants, which anticipates a Deposit Rate of around 2.00% by September.



Source: Datastream and Wells Fargo Economics



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Bank of Canada Eases Monetary Policy Further Amid Increasing Uncertainty

The Bank of Canada (BoC) began 2025 by delivering a 25 bps policy rate cut to 3.00% at its January meeting, but did not offer any guidance on future monetary policy given the increasingly uncertain outlook amid the threat of higher tariffs from the United States. Also on the policy front, the BoC announced an end to quantitative tightening, saying that it would begin asset purchases in March, such that its balance sheet stabilizes and then grows modestly.

The BoC said that with inflation around 2% and the economy in excess supply, it decided to reduced interest rates further. The central bank described the cumulative 200 bps of rate reductions since last June as “substantial”, which could support some strengthening in consumption and housing activity, even as population growth slows given reduced immigration targets. The outlook for business investment remains weak. This overall outlook, notably, is based on economic projections which the Bank of Canada explicitly based on the absence of new tariffs and their economic impact. Those updated economic projections, based on unchanged tariffs, forecast:

- GDP growth of 1.8% in 2025 and 2026, weaker than the prior projections in October, but still stronger than an estimated 1.3% GDP growth in 2024.
- Slightly higher CPI inflation than previously, at 2.3% in 2025 and 2.1% in 2026. Those inflation forecasts are still close to the central bank's target, however. Moreover, the core CPI forecasts of 2.1% for end-2025 and end-2026, we largely unchanged, and also close to the central bank's target.

The BoC said that “setting aside threatened US tariffs, the upside and downside risks around the outlook are reasonably balanced.” But the central bank also said a protracted trade conflict would most likely lead to weaker GDP growth and higher prices, and would test the resilience of Canada's economy. Indeed, the BoC offered some insight into how higher U.S tariffs on Canada (a 25% rate) and an equivalent Canadian tariff retaliation (also a 25% rate) would affect the economic outlook. In this hypothetical scenario, the central bank's benchmark calibration or estimates:

- Envisaged a 2.5 percentage point hit to GDP growth in year one, a 1.5 percentage point hit to GDP growth in year two, and little impact on growth by year three.
- Envisaged a very modest boost to CPI inflation in year one, around a 0.5 percentage point boost to inflation in year two, and around a 1.0 percentage point boost to inflation in year three.

Overall, the Bank of Canada views the impact of tariffs in this scenario as having a relatively rapid and substantial impact on economic growth, and a somewhat more gradual impact in boosting inflation. Accordingly, we would not view the central bank's absence of future policy guidance as a hawkish signal, but simply an unusual lack of certainty about the outlook. Even if higher tariffs do transpire, we believe the BoC would be inclined to continue with its easing cycle. In that context, **our view remains for 25 bps rate cuts at the March, April and June meetings, which would bring the BoC's policy rate to a low of 2.25%.** The risks around that outlook are tilted toward a slightly more truncated easing cycle, with a June rate cut potentially the most at risk.

Riksbank Keeps Rate Cut Door Slightly Ajar

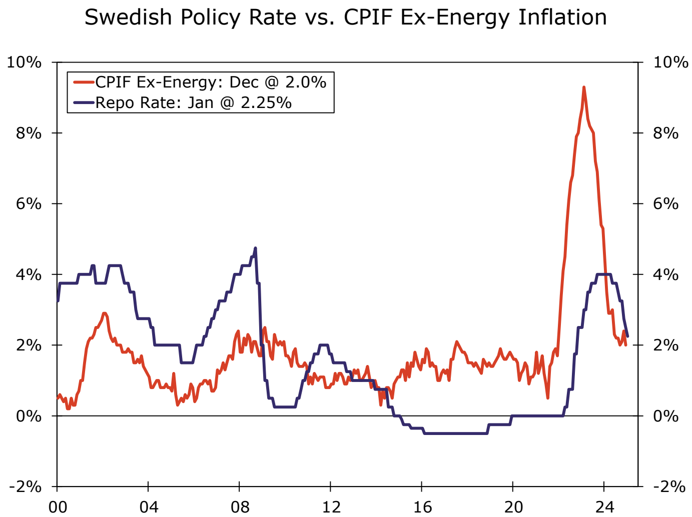
Sweden's central bank, the Riksbank, kicked off 2025 by lowering its policy rate 25 bps to 2.25%, and also offered a mildly dovish accompanying statement. The Riksbank said that inflation pressures are broadly consistent with the 2% target and that economic projections from December essentially still hold, forecasts that anticipated just one rate reduction in the first half of this year.

Still, the Riksbank said the risk of inflation becoming too high is limited at the same time that economic activity is weak (the Q4 GDP indicator rose 0.2% quarter-over-quarter, a bit less than the consensus forecast). The central bank said it “is prepared to act if the outlook for inflation and economic activity changes” and cited an uncertain global environment and geopolitical tensions. Given the mildly dovish statement, we believe an accumulation of evidence will eventually see the Riksbank cut rates further. If inflation remains benign and if economic activity shows a renewed softening, **we expect a final 25 bps policy rate cut to 2.00% at the Riksbank's May meeting.** That said, if economic trends are especially weak, there is a risk that rate cut could come earlier, at the March announcement.

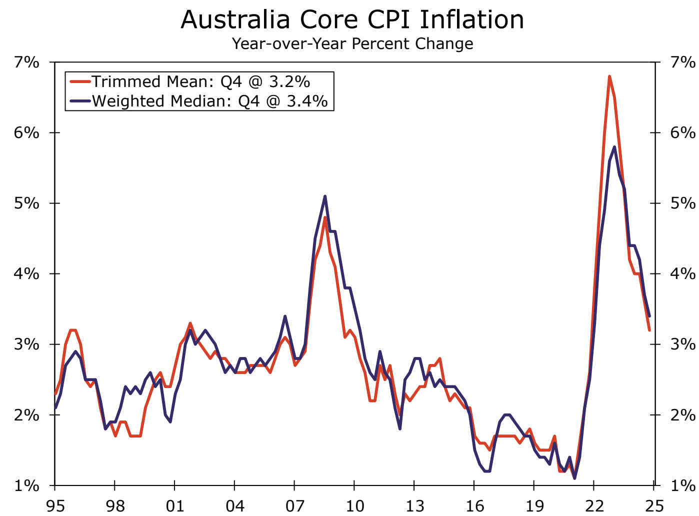
Benign Inflation To Quicken Reserve Bank of Australia Easing

While Australia was not among the central banks to announce a policy decision this week, there was nonetheless some significant and relevant news for the monetary policy outlook. Australia's Q4 and December CPI outcomes were benign, in our view, indicating that the Reserve Bank of Australia (RBA) is on course to return inflation to its medium-term 2%-3% target range. With respect to the more closely followed quarterly CPI readings, headline inflation slowed more than expected to 2.4%. Core inflation measures also slowed more than forecast, with trimmed mean inflation printing at 3.2% and weighted median inflation printing at 3.4%. While the annual increase in the core inflation measures are still above the top of the target range, the small quarterly increase in both measures suggests that on a shorter timeframe, underlying inflation may already be trending in line with target.

The December monthly CPI readings are also consistent with overall ongoing deceleration. While December headline inflation did tick higher to 2.5% year-over-year, trimmed mean inflation slowed further to 2.7%—inside the target range. This week's inflation data comes after December employment jumped by 56,300, although that report also revealed a drop in full-time jobs and a slight rise in the jobless rate. However, we think the benign CPI outcome will tip the RBA toward easing monetary policy earlier than we had previously forecast. **We now expect the RBA to lower its policy rate by 25 bps in February, with 25 bps rate cuts also seen in May, August and November, which would see the RBA's policy rate reach a low of 3.35% by the end of this year.**



Source: Bloomberg Finance L.P. and Wells Fargo Economics



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