Key central bank meetings as higher interest rates start to bite

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The governing bodies of three of the world's major central banks are meeting this week to make crucial decisions on monetary policy that will give an indication of the agenda for 2024.

The US Federal Reserve will announce its interest rate decision today followed by meetings of the European Central Bank and the Bank of England tomorrow.

While present indications are that all three will leave interest rates on hold, statements from each of the meetings, starting with the Fed, will set the path for next year.

The recent falls in inflation have led to a divergence between the demands of financial markets that interest rates must now start to be reduced, or at least that a timetable for reductions be set out, and the statements from the central banks that it is still too early to give an indication as to when that might take place.

The latest inflation data in the US, released yesterday, showed core inflation, which strips out changes in food and energy, rising by 0.3 percent in November with the annual rate remaining flat at 4 percent. This was taken as another indication that the Fed could not have confidence that inflation was coming down and would not be able to shift to an easing stance.

The key question for the central banks' governing bodies, as it has been from the start of the so-called "fight" against inflation that began around 18 months ago, is wages. At first there was an attempt to cover over this objective, but it is now out in the open.

As the *Financial Times* noted, the three central banks are preparing to push back against investor predictions of falling interest rates because they "have signalled they want clearer evidence of weakening labour markets before cutting rates."

That evidence is not yet at hand. In the US, a stronger-than-expected labour market report last Friday showed that the unemployment rate had fallen to 3.7 percent. In the eurozone, the unemployment rate remains close to a record low of 6.5 percent amid data which show unit labour costs rising at the fastest since they started to be collected in 1995.

While wage increases are less than inflation, and do not make up for the past cuts, they are still too high as far as far as the ECB is concerned. Last week, ECB board member Isabel Schnabel, regarded as an inflation "hawk," said it was "going to watch upcoming wage agreements very closely" as they "will certainly also matter for our monetary policy decisions."

At the beginning of the month, Fed chair Jerome Powell said it would be premature to conclude with confidence that the central bank had reached a sufficiently restrictive interest rate or to "speculate on when policy might ease."

A few days earlier, the president of Germany's central bank, Joachim Nagel, had pitched the same theme declaring: "It would be premature to lower interest rates soon or to speculate about such steps."

However, the clamour in financial markets for monetary policy easing continues. They consider that the Fed and other central banks are going to be forced to act. As is always the case, there are two psychological motivations at work, greed and fear.

There is the hope that a cut in rates will open the way for a resumption of the vast accumulation of wealth that took place when interest rates were at historic lows and fear that if rates are not cut there will be major consequences.

Data on financial markets conditions point to this.

A report this week on Bloomberg, based on research by Oxford Economics, said the amount of maturing US corporate debt is set to double in the next two years,

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reaching around $1 trillion in 2025, and will triple in the eurozone to the equivalent of $400 billion.

According to Curtis Dubay, chief economist at the US Chamber of Commerce: "Any business that has a loan they took out pre-2022 is now going to be facing higher refinancing rates." He said there was a "lot of financial tightening occurring" because of the Fed's past actions—lifting interest rates to their highest levels in 22 years—and this was one reason why he saw the economy slowing in 2024.

Companies that have issued debt at below investment grade, during the period of ultra-low rates, are regarded as particularly vulnerable.

The recent collapse of the Austrian property group Signa, which owned Selfridges in London and the Chrysler building in New York, could well be a sign of things to come. The company had a property portfolio of $29 billion and racked up around €13 billion in debt when borrowing costs were next to nothing.

In the words of one European property executive regarding Signa chief René Banko: "He gorged himself on cheap financing, left, right and centre."

However, Banko was just an extreme example of what was a universal process. Now the chickens are now coming home to roost as a recent report in the *Financial Times* makes clear.

Alex Knapp, the chief investment officer at the $100 billion global real estate investor Hines, told the FT: "The scale of the cyclical reset in terms of real estate valuations is as big as the early 1990s or the global financial crisis. This is a big one, if that wasn't obvious."

As the FT reported: "Tom Leahy, executive director at MSCI research, estimated in September that about 50 percent of London's commercial real estate assets are now worth less than what they were acquired for. New York fared relatively better, with just a fifth under water."

The collapse is marked in Europe where, according to one analysis reported in the FT, more than €3.3 billion worth of UK and European office buildings failed to sell after being put on the market, including the Commerzbank Tower in Frankfurt. The firm conducting the survey said its list was probably just "the tip of the aborted sale iceberg."

One of the areas in the US most heavily impacted by the higher interest rate regime is high-tech start-up firms. As the *New York Times* pointed out in a recent article, WeWork, which raised more than $11 billion in public funding, Olive AI, a health care start-up which raised $852 million, Convoy freight start-up, $900 million and Veev a home construction start-up, $647 million, had all filed for bankruptcy or shut down in the past six weeks.

It reported that around 3,200 private venture-backed companies had gone out of business this year after raising $27.2 billion in funding amid what it called "an astonishing cash bonfire."

These issues will not feature in the comments and statements emanating from the central banks over the next few days—one of their tasks is to "talk up" the economy and the financial system and maintain they are "sound and resilient." But it is certain they will come up in the closed-door discussions.

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