



# Central bank rate-cut pricing is eye-catching but deceiving

From the Field  
February 2024

**T**raveling to meet with clients around the globe in early 2024, many have asked me about my outlook for interest rate cuts from developed market central banks. The financial media has devoted much attention to the surprisingly large number of 2024 rate cuts reflected in interest rate derivative markets. Market sentiment shifted dramatically with the dovish pivot from developed market central banks that started with the Federal Reserve in late November 2023 and gained steam in the eurozone and the UK in December and January.

## Average pricing of rate cuts involves extremes

The level of easing implied by prices of futures contracts and other derivatives is simply an average of expectations priced in across a range of potential outcomes. In other words, this average captures the views of both those who think inflation will reignite, constraining rate cuts, and those who believe a severe economic downturn will result in aggressive rate decreases.

Part of the market projections for aggressive 2024 rate cuts reflects the fact that some institutional investors are using interest rate futures to hedge against the possibility of a deep global recession in 2024. These positions would benefit from the rapid loosening of monetary policy in a recession, ideally offsetting some of the losses sustained in the riskier parts of their overall asset allocation.

## The Federal Reserve

In early February, U.S. federal funds futures contracts showed expectations for five rate cuts of 25 basis points by the end of 2024,<sup>1</sup> with the first move coming at the May Fed policy meeting. This was actually lower than the mid-January pricing that indicated seven cuts beginning in March. The blowout January U.S. nonfarm payrolls report that showed more than 300,000 jobs added was probably a major factor behind the tentative repricing of Fed cuts amid the volatility.

Could the Fed ease by 125 basis points over the course of the calendar year? It's



**Arif Husain**  
*Head of Fixed Income and  
Chief Investment Officer,  
Fixed Income*

<sup>1</sup> Source for all interest rate probability data: Bloomberg Finance L.P.

certainly possible—if the U.S. economy weakens notably, unemployment increases, and inflation continues on its downward trajectory. But so far there's little sign that any of these conditions are in the immediate future for the U.S. Another factor that could tilt market estimates of Fed easing toward more cuts is a flight-to-quality premium for the highest-quality assets, which is a form of risk hedging.

## The European Central Bank

The eurozone economy looks anemic compared with the U.S. from a growth point of view, with pronounced weakness in the manufacturing sector. As of early February, the overnight index swaps<sup>2</sup> (OIS) market indicated that participants expected five 25-basis-point cuts in 2024 from the European Central Bank (ECB), with the first move in April. In January, OIS had showed expectations for six decreases. Given the weakness of the eurozone economy relative to the U.S., the projections for the same number of cuts from the Fed and the ECB make little sense, although inflation appears more entrenched in the eurozone.

## The Bank of England

Turning to the UK economy, which may be in the worst shape of any major developed market, OIS data in early February showed

“

I think the various developed market government yield curves will react to central bank easing in different ways.

that four Bank of England (BoE) rate cuts were probable by the end of the year. At first glance, it may seem incongruous that markets were projecting fewer rate reductions from the BoE than from the Fed. However, UK inflation, while down from its very elevated levels in 2022 and early 2023, is still much higher (and probably stickier) than in the U.S., giving the BoE a narrower needle to thread than the Fed.

## Diverging yield curves

I think the various developed market government yield curves will react to central bank easing in different ways. In the U.S., I expect the Treasury curve

to steepen as rate-cut expectations drive short-term yields lower while longer-maturity yields stay relatively steady—this “bull steepener” is a historically typical reaction to impending monetary policy loosening.

In the eurozone, where markets in early February still priced in the first ECB rate cut in April, I expect a different German sovereign yield curve dynamic. I anticipate the first ECB move in June, not April, so the German curve would likely “bear flatten” as short-term rates that had been priced for an April cut instead move higher. The UK sovereign yield curve will probably experience a similar bear flattening as the first BoE rate cut that markets currently project for June seems too early.

## Lumpier cuts more likely than smaller insurance cuts

Stepping back to take a broader look at developed market economies and monetary policy, I think that “lumpier” rate reductions in larger increments that start later in the year are more likely than the series of steady insurance cuts in smaller increments that many appear to expect. This fits into my view that inflation will ultimately prove to be stickier and growth less resilient than recent data have shown, forcing central banks to keep rates steady before rapidly loosening as economic growth slows.

<sup>2</sup> An overnight index swap is a transaction involving one party paying the overnight lending rate in exchange for receiving a fixed rate agreed upon by both parties.

## INVEST WITH CONFIDENCE™

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

---

### Important Information

**This material is being furnished for general informational and/or marketing purposes only.** The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

**DISCLOSURE CONTINUES ON THE FOLLOWING PAGE.**

---

**Important Information (cont.)**

**Australia**—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. For Wholesale Clients only.

**Brunei**—This material can only be delivered to certain specific institutional investors for informational purpose only. Any strategy and/or any products associated with the strategy discussed herein has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

**Canada**—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

**Colombia, Chile, Mexico, Perú, Uruguay**—This material is prepared by T. Rowe Price International Ltd - Warwick Court, 5 Paternoster Square, London, EC4M 7DX which is authorised and regulated by the UK Financial Conduct Authority - and issued and distributed by locally authorized distributors only. For professional investors only.

**DIFC**—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd which is regulated by the Dubai Financial Services Authority as a Representative Office. For Professional Clients only.

**EEA**—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

**Hong Kong**—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

**Indonesia**—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

**Korea**—This material is intended only to Qualified Professional Investors. Not for further distribution.

**Mainland China**—This material is provided to qualified investors only. No invitation to offer, or offer for, or sale of, the shares will be made in the mainland of the People's Republic of China ("Mainland China", not including the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the Mainland China. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the Mainland China, or nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China.

**Malaysia**—This material can only be delivered to specific institutional investor. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

**New Zealand**—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

**Philippines**—ANY STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING DISCUSSED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

**Singapore**—Issued by T. Rowe Price Singapore Private Ltd. (UEN: 201021137E), 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

**South Africa**—Issued in South Africa by T. Rowe Price International Ltd (TRPIL), Warwick Court, 5 Paternoster Square, London EC4M 7DX, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL's Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: [www.faisombud.co.za](http://www.faisombud.co.za), Email: [info@faisombud.co.za](mailto:info@faisombud.co.za)

**Switzerland**—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

**Taiwan**—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

**Thailand**—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

**UK**—This material is issued and approved by T. Rowe Price International Ltd, Warwick Court, 5 Paternoster Square, London EC4M 7DX which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

**USA**—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2024 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.