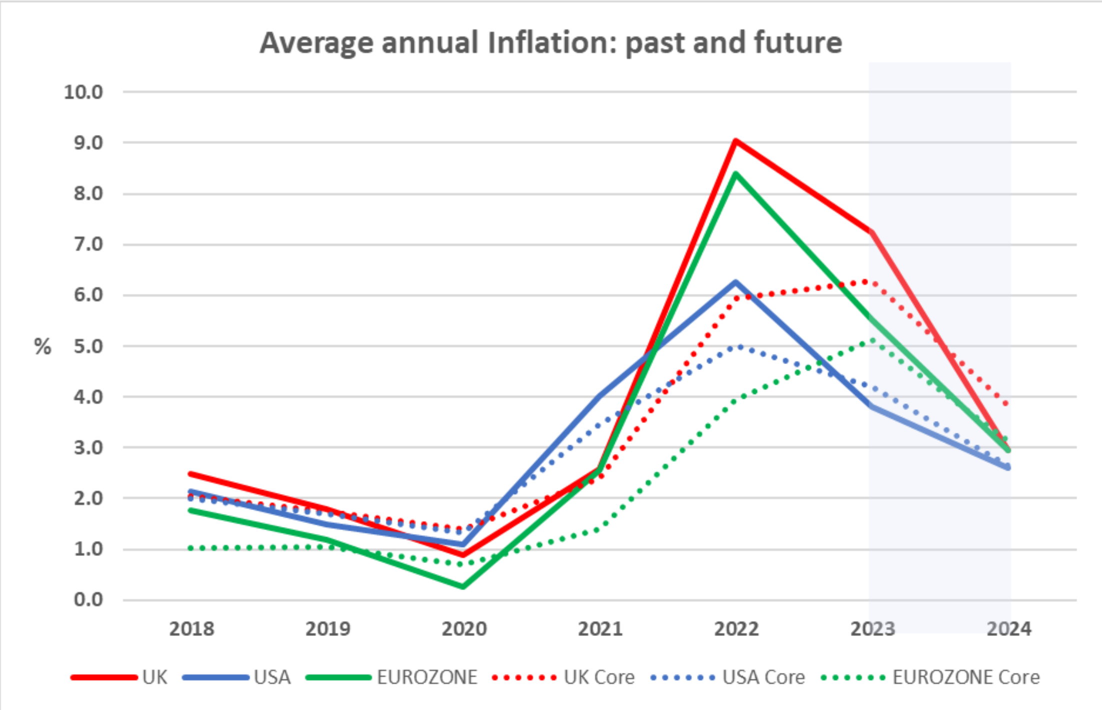
Where next for interest rates?

Synopsis: The OECD has recently published its September Economic Outlook. Its views on inflation and interest rates in 2024 are worth noting.

Date published: 25.09.2023

Ahead of a raft of central bank announcements on interest rates, the OECD published its latest quarterly report on the global economy with the cheery title, 'Confronting inflation and low growth'. On the two subjects du jour of inflation and interest rates, the OECD's observations are worth noting...

Inflation

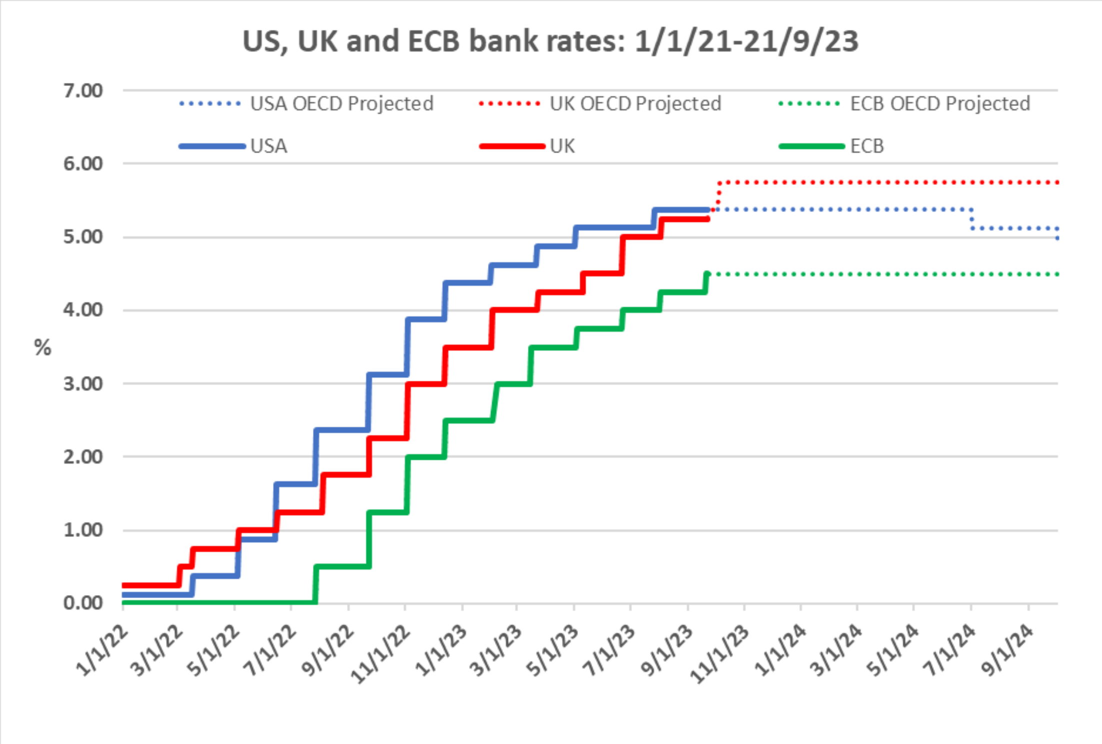


The OECD notes that headline inflation (the solid lines) is declining, reflecting a steep drop in energy prices from late 2022 through to mid-2023 (which is now in reverse with Brent above $90 a barrel). Core inflation (excluding energy and food – the dotted lines) has also begun to decline, but at a more moderate pace. The slower fall is attributed to tight labour markets and the time needed for the rise in energy prices during 2021-22 to fully pass through into the prices of other goods and services.

Looking ahead (the shaded area), the OECD says *'The full effects of the policy tightening in advanced economies are now seen as coming through with a longer lag than previously thought.'* As a result, it projects a fall in annual global GDP growth from 3% this year to 2.7% in 2024, with the consequent cooling in demand helping to ease both headline and core inflation rates.

The OECD sees UK headline inflation *averaging* 7.24% across 2023, but only 2.94% in 2024, while core inflation subsides from 6.28% to 3.82%. For comparison, the latest Treasury consensus forecast has Q4 2023 CPI at 4.6% and Q4 2024 CPI at 2.6%.

Interest rates



The story on interest rates is inextricably linked with the inflation projections. The Bank of England's decision not to pause (or stop?) rate increases, 'higher for longer' is the current interest rate mantra. The OECD added the 0.25% rise that never happened into its projections, although this might still be a correct level by the end of 2023. In any event, the OECD sees UK (and Eurozone) rates remaining unchanged throughout 2024.

For the UK, that echoes the views of the Bank of England's chief economist, Huw Pill. In a monetary conference held in South Africa in August, Pill spoke of his preference for the path of UK interest rates to resemble the Table Mountain route, rather than the Matterhorn. For comparison, the latest Treasury consensus forecast has Q4 2023 Bank (Base) Rate at 5.6% and Q4 2024 at 5.0%.

Comment

The combination of declining inflation and stable interest rates is not a common one: Matterhorns outnumber Table Mountains in the historic charts. What usually happens is that central banks are forced to cut rates more than they wish because 'something breaks' in the economy.

020 7183 3931
www.riskassured.co.uk