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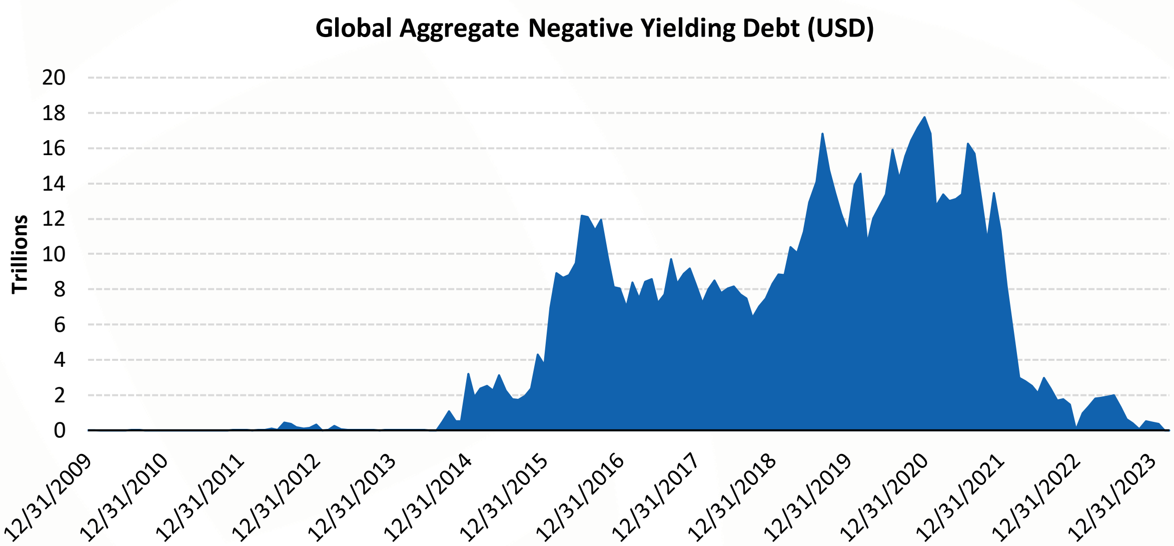
Bond Market Update: Spotlight on Central Banks

By Bill Smith, Fixed Income Trader and Portfolio Manager

While changes in monetary policy are always good for a headline, March has been particularly notable for central banks across the globe. The Bank of Japan raised rates for the first time since 2007. The Swiss National Bank surprised markets with a 25-basis-point cut. Even the U.S. Federal Reserve added to the excitement, maintaining a call for three rate cuts this year despite a recent run of hotter-than-expected U.S. inflation data. As we move further into 2024, and more central banks contemplate shifts in monetary policy, we expect headline-making events have just begun.

The End of an Era: Bank of Japan Hikes Rates to Zero – 0.1%

The negative interest rate experiment that began with Denmark's central bank in 2012, and eventually grew to include the European Central Bank, as well as central banks in Japan, Sweden and Switzerland, has officially ended. The Bank of Japan, the last remaining central bank with a policy rate below zero, moved into slightly positive territory last Tuesday. This marks Japan's first interest rate hike in seventeen years, and the first time rates have been positive since 2016. It should also close, at least for now, the chapter on negative yielding debt, which peaked around $18 trillion in 2020.



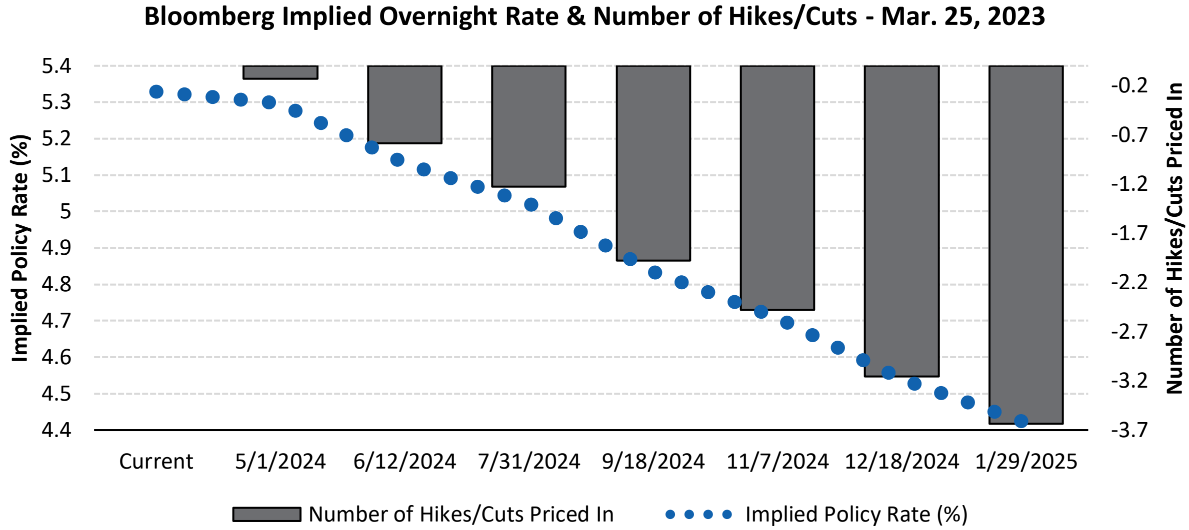
Source: Bloomberg. Past performance is no guarantee of future results.

First Mover: Swiss National Bank Cuts to 1.50%

On March 21, the Swiss National Bank (SNB) surprised markets with a 25-basis-point cut to the SNB policy rate, citing a belief that "the fight against inflation over the past two and a half years has been effective." This is the first rate cut from a major central bank this year and may very well mark an inflection point from tightening to easing as other central banks look to follow suit.

Fed Holds Rates Steady at 5.25 – 5.50

In a widely anticipated move, the U.S. Federal Reserve (Fed) held rates steady at last week's Federal Open Market Committee Meeting, where Fed Chair Jerome Powell reiterated, "Our policy rate is likely at its peak for this tightening cycle and that, if the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year." Interestingly, the Fed's median projection for rate cuts remained unchanged. The Fed's "Dot Plot" still calls for three 25-basis-point cuts this year despite a recent spate of elevated U.S. inflation data, and a slight increase in the Fed's 2024 median Core PCE forecast to 2.60% in the March Summary of Economic Projections. The Fed and markets now appear aligned on easing expectations with Bloomberg's interest rate probability model calling for three cuts as well.



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Near Term Rate Volatility to Remain High

Although a lower yield environment in 2024 appears likely, especially after moves from the SNB and with global inflation trending lower, we have certainly seen our fair share of false starts over the last year. We expect fixed income volatility will remain elevated until the markets gain more confidence that central bank easing is more broadly underway.

A prudent approach to fixed income investing calls for diversification across both credit and duration exposure. As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

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