Central banks

Political heat gives central bankers pause for thought on interest rate cuts

Federal Reserve and Bank of England weigh case for reducing borrowing costs as voters prepare to go to polls

Markets still expect the Federal Reserve to cut interest rates in mid-September, its final meeting before the US presidential election on November 5, despite a strong jobs report on Friday © Sarah Ailbiger/The Washington Post/Getty Images

Sam Fleming in London and **Claire Jones** in Washington JUNE 10 2024

Mounting political heat is complicating interest rate decisions in the US and the UK, where central banks are weighing whether to cut borrowing costs as voters prepare to go to the polls.

The Bank of England and the Federal Reserve want to avoid any perception that they were cutting interest rates to help incumbent governments, former officials and economists said, making it more likely they will swerve moves that are too close to polling day.

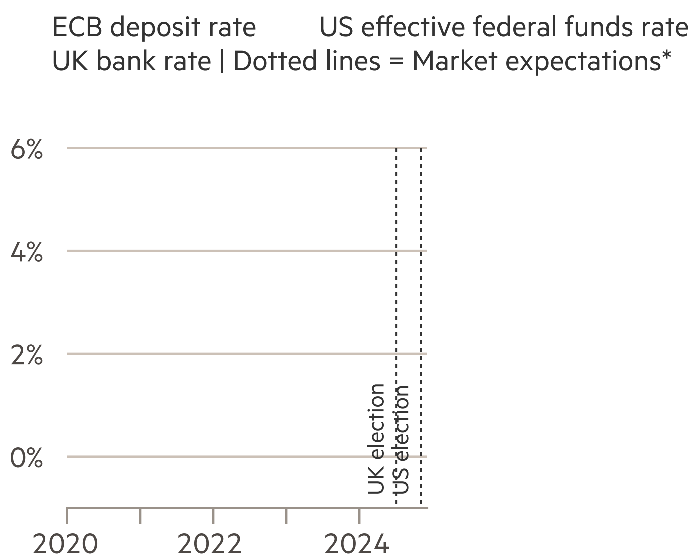
The situation is particularly tricky for the BoE, according to former monetary policymakers, given its next meeting is just two weeks before the July 4 general election. Governor Andrew Bailey has signalled that a rate cut is close.

"The central banks don't want to appear to be playing politics at all, so the easiest thing is to do nothing," said Charles Goodhart, a former member of the BoE's Monetary Policy Committee. "[But] if you don't [move rates] this month, you can do it next month."

Having raised rates to multiyear highs in response to the worst inflation surge in a generation, western central banks are now under intense pressure to reverse direction. The Bank of Canada and the European Central Bank are among those that have already taken their first step towards a looser monetary policy, making their first cuts last week.

But the Fed and BoE are lagging behind as they weigh the effects of sticky services inflation.

Elections weigh on timing of next Fed and BoE rate moves



FINANCIAL TIMES Source: LSEG • *Forecast interest rates implied by overnight swaps markets

In the US, the Fed is confronting a far more drawn-out election campaign than the accelerated process in the UK. Markets still expect the Fed will cut rates in mid-September, its final meeting before the November 5 presidential election, despite a strong jobs report on Friday.

But some think this could be difficult for US policymakers.

Adam Posen, director of the Peterson Institute for International Economics and a former member of the MPC, said the strong US economy meant the Fed was unlikely to put itself in the spotlight by cutting rates before the election.

“The Fed cannot put itself on hold indefinitely, and nor should it indicate that it’s going to be on hold,” he said. But he added that rate cuts were unlikely until September and “if the data allow them, they will try very hard not to do anything till November”.

Interactive: consumer price inflation

Annual % change in consumer price index

Choose countries...

UK US Eurozone Japan

Source: National statistics offices via LSEG

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While President Joe Biden has faced political pressure from some Democrats, he and his Treasury secretary, former Fed chair Janet Yellen, have been firm that they do not want to compromise the US central bank's independence.

The data could buy the Fed time. Personal consumption expenditures inflation, at 2.7 per cent, remains way above its 2 per cent goal. The labour market is cooling more slowly than anticipated.

Eswar Prasad, professor at Cornell University, said the May jobs figures almost certainly ruled a July cut out.

"Any action by the Fed, which looks unlikely in the summer, could now get pushed uncomfortably close to the November elections," said Prasad. "The combination of strong employment and wage growth, in tandem with persistent inflationary pressures, highlights the sustained growth momentum."

The Fed has already pushed back its November meeting so that it falls after the election. This gap also occurred in 2020.

Others argue, however, that the Fed is unlikely to let the timing of the general election play a role. Former Fed vice-chair Donald Kohn, said chair Jay Powell "has been very clear that their decisions are not driven by politics but by economics. I'm confident he'll stick with that".

He added: "So if we get to September and the labour market has weakened and inflation has remained low, I don't see why they wouldn't cut rates."

In the UK, Sushil Wadhwani, another ex-MPC member, said there was no reason in principle why the BoE cannot act before an election. He voted to cut rates just a day before the 2001 June general election, though the majority opted to keep them on hold.

But he added: "The current conjuncture is much more difficult for the bank, because they [politicians] have been saying more [about rates]."

Bailey said last month that MPC members "never discuss politics" in their meetings. "Our job is to take decisions consistent with our remit."

But Prime Minister Rishi Sunak last month suggested that a vote for his Conservatives rather than the opposition Labour party would be a vote for cheaper borrowing costs, in an intervention that appeared to ride roughshod over the BoE's independence.

"This most recent government has been much more willing to offer views on monetary policy than past governments; it doesn't really seem to understand the concept of operational independence," said Martin Weale, an MPC member from 2010-16.

"If I were a member of the MPC I would think I'd need a particularly good reason for making a change shortly ahead of a general election."

UK inflation figures for April were stronger than expected, while services CPI growth slipped only marginally to 5.9 per cent — well above the 5.5 per cent level forecast by the BoE.

But if May's inflation numbers, to be published on June 19, show a marked softening in consumer prices, the case for an immediate rate cut from 5.25 per cent at the BoE's following meeting might trump any political considerations.

"If the data on the 19th [is] sufficiently persuasive I don't think anyone can quarrel with them cutting," said Wadhwani.