

Interest rates in focus as US eyes first increase since 2023

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Key points

- CommBank expects the US Federal Reserve to raise rates by 0.25 percentage points this week.
- The Bank of England is expected to hold, while the Bank of Japan is forecast to raise rates.
- The RBA's next interest rate decision is due on 29 September.

Interest rates will be firmly in focus around the world this week, with major central banks in the US, UK and Japan all due to make policy decisions.

The biggest focus will be on the US Federal Reserve, where stronger-than-expected underlying inflation has added to expectations of another rate rise.

US core inflation rose 0.3% in August, prompting markets to price about an 85% chance of a 0.25 percentage point increase this week, according to Commonwealth Bank economists.

CommBank expects the Fed to raise its policy rate by 0.25 percentage points to a range of 3.75% to 4.00% on Thursday Australian time.

"The unemployment rate is trending down and inflation has been too high for too long," CommBank Head of Australian Economics Belinda Allen said in a research note.

The last time the Federal Reserve raised its policy rate was in July 2023.

Fed faces persistent inflation

The latest US inflation figures strengthened the case for tighter policy after core inflation came in above expectations.

Bond markets responded by pushing shorter-term yields higher, while the US 10-year Treasury yield bond ended the week at 4.97%, its highest close since October 2023.

A bond yield is essentially the return investors demand for lending money to a government or company.

US shares nevertheless finished higher, with the Dow Jones Industrial Average up 1%, the S&P 500 gaining 0.9% and the Nasdaq rising 1%.

Oil prices also eased from a five-month high after reports of efforts to reach a temporary agreement over shipping through the Strait of Hormuz. Brent crude futures fell 2.8% to US\$104.61 a barrel.

UK and Japan take different paths

The Bank of England is also due to meet this week, although CommBank expects it to leave its policy rate unchanged at 3.75%.

UK headline inflation is expected to rise to 3.1% in August as higher energy prices feed through, while underlying inflation is forecast to remain around 2.6%. CommBank says subdued economic conditions should help limit the flow-through from higher energy costs into broader inflation.

Japan, however, is expected to move in the opposite direction.

CommBank expects the Bank of Japan to raise its policy rate by 0.25 percentage points to 1.25%.

Inflation remains above the central bank's target, while CommBank says the Bank of Japan will also be weighing persistent weakness in the yen and higher oil prices.

Australia's next rate decision

Attention will also turn back to the Reserve Bank of Australia later this week when the Governor makes her first public appearance since the August monetary policy meeting.

CommBank economists will be watching for any comments on recent inflation data and how the RBA is assessing the risk of another rate rise. Market pricing cited in the note puts the probability of a September increase at around 80%.

The RBA Monetary Policy Board meets on 28 and 29 September, with its next interest rate decision due at 2.30pm AEST on Tuesday, 29 September.

That leaves the coming fortnight as an important period for the Australian rates outlook, with incoming economic data, the Middle East conflict and comments from the RBA likely to shape expectations ahead of the meeting.

A global rates week

The different decisions expected this week underline the varying inflation and growth challenges facing central banks.

The US and Japan are expected to raise rates, while the Bank of England is forecast to stay on hold. Australia's next decision follows less than two weeks later.

For markets, the focus will be on whether central banks believe inflation pressures require further restraint, and how much more tightening may still be needed before the global interest rate cycle begins to turn.

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