Markets embrace the Higher-for-Longer theme

Published 25 September 2023

Aneeka Gupta
Director, Macroeconomic Research, WisdomTree Europe

It has been a big week of central bank policy announcements. While central banks in the US, UK, Switzerland, and Japan left key policy rates unchanged, the trajectory ahead remains vastly different. These central bank announcements were accompanied by a significant upward breakout in bond yields. Interestingly most of the increase in yields has been driven by higher real yields rather than breakeven inflation signifying a tightening of conditions. The bond markets appear to be acknowledging that until recession hits, yields are likely to keep rising.

Connecting the dots

The current stance of monetary policy continues to remain restrictive. The Fed's dot plot, which the US central bank uses to signal its outlook for the path of interest rates, shows the median year-end projection for the federal funds rate at 5.6%. The dot plot of rate projections shows policymakers (12 of the 19 policymakers) still foresee one more rate hike this year. Furthermore, the 2024 and 2025 rate projections notched up by 50Bps, a signal the Fed expects rates to stay higher for longer.

The key surprise was the upgrade in growth and unemployment projections beyond 2023, suggesting a more optimistic outlook on the economy. The Fed's caution is justified amidst the prevailing headwinds – higher oil prices, the resumption of student loan payments, the United Auto Workers strike, and a potential government shutdown.

Quantitative tightening continues on autopilot, with the Fed continuing to shrink its balance sheet by $95 billion per month. Risk assets such as equities, credit struggled this week as US yields continued to grind higher. The correction in risk assets remains supportive for the US dollar.

Figure 1: Fed's Dot Plot – Summary of Economic Projections

Source: The Federal Reserve, WisdomTree as of 21 September 2023. Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

A hawkish pause by the Bank of England

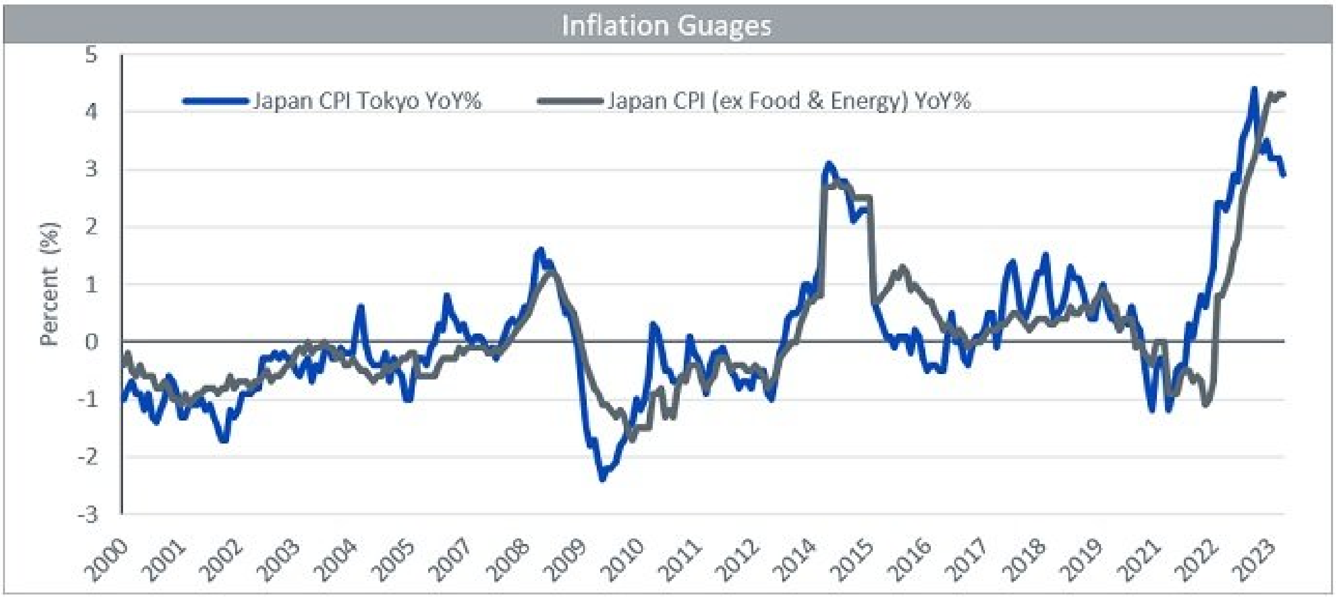
In sharp contrast to the US, economic data has weakened across the board in the UK, with the exception of wage growth. The weakness in labour markets is likely to feed through into lower wages as discussed here. After 14 straights rate hikes, the weaker economic backdrop in the UK coupled with falling inflation influenced the Bank of England's (BOE) decision to keep rates on hold at 5.25%. The Monetary Policy Committee (MPC) was keen to stress that interest rates are likely to stay at current levels for an extended period and only if there was evidence of persistent inflation pressures would further tightening in policy be required.

By the next meeting in November, we expect economic conditions to move in the MPC's favour and wage growth to have eased materially. As inflation declines, the rise in real interest rates is likely to drag the economy lower without the MPC having to raise interest rates further. That said, the MPC is unlikely to start cutting rates until this time next year and even then, we only expect to see a gradual decline in rates.

Bank of Japan maintains a dovish stance

Having just tweaked Yield Curve Control (YCC) at its prior Monetary Policy Meeting (MPM) on 28 July, the Bank of Japan decided to keep its ultra easy monetary settings unchanged. The BOJ expects inflation to decelerate and said core inflation has been around 3% owing to pass-through price increases. Governor Ueda confirmed that only if inflation accompanied by the wages goal was in sight would the BOJ consider an end to YCC and a rate shift.

With its loose monetary policy, the BOJ has been an outlier among major central banks like the Fed, ECB and BOE which have all been hiking interest rates. That policy divergence has been a key driver of the yen's weakness. While headline inflation in Japan has been declining, core inflation has remained persistently higher. The BOJ meeting confirmed that there is still some time before the BOJ exits from negative interest rate policy which is likely to keep the Yen under pressure. The developments in US Monetary Policy feeding into a stronger US dollar are also likely to exert further downside pressure on the Yen.



This year global investors have taken note that Japanese stocks are benefitting from the weaker Yen, relatively cheaper valuations and a long-waited return of inflation. Japanese companies are also becoming more receptive to corporate reform and shareholder engagement.

Adopting a hedged Japanese exposure

Taking a hedged exposure to dividend paying Japanese equities would be a prudent approach amidst the weaker yen. This goes to a point we often make - currency changes do not need to impact your foreign return, and you can target that local market return by hedging your currency risk. A hedged Japanese dividend paying equity exposure could enable an investor to hedge their exposure to the Yen.

Related blogs:

+ What's Hot: Higher for Longer

+ What's Hot: Bank of Japan sitting on the fence on easy policy exit

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an oer for sale nor a solicitation of an oer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can oen lead to a number of dierent interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public oering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.