Central Bank Weekly 28th January; Previewing the RBA, BoE, ECB; Reviewing FOMC, BoC, SARB

28th January 2022

RBA PREVIEW (TUE): The RBA is expected to keep its Cash Rate Target at 0.10% at next week's meeting where focus will be on what the central bank does regarding its bond purchases as the current programme of AUD 4bln a week is to expire in mid-February; most analysts surveyed by Reuters expect the programme to be scrapped. RBA Governor Lowe has previously stated that it could end buying in February if economic progress was better than expected, but may also review bond buying again in May if data disappoints, while the minutes from the prior meeting noted that among the options the Board discussed aside from ceasing purchases altogether, were to reduce the pace of QE from mid-February with an expectation of a likely end point in May or slow the pace of purchases and review it again in May. However, there have been increasingly hawkish views after the recent strong data out of Australia, including the Unemployment Rate which fell 0.3ppts to 4.2% in December and with annual CPI firmer than expected in Q4. Goldman Sachs anticipates that the central bank will end QE at the upcoming meeting and hike rates in May. Others including CBA, Westpac and RBC all expect the first rate hike in August -- most of these banks have brought forward rate hike expectations, although a recent Reuters poll showed that the median expectation was for the first rate rise to occur in November. Furthermore, participants will be eyeing if there is any change in language from the Governor who previously expected conditions for a rate hike will not be met this year and stated that they are "still a fair way" from a hike with the Board prepared to be patient.

BOE PREVIEW (THU): After opting to lift the Bank Rate by 15bps to 0.25% in December, the MPC is set to follow suit with a further 25bps hike to 0.5%. 29/45 surveyed analysts look for a 25bps hike, whilst markets (as has been the case in recent months) are more hawkish in their view by pricing in a 92% chance of a move on rates. Previously, the decision to raise the Bank Rate was subject to dissent from external member Tenreyro, it remains to be seen whether the policymaker will object this time around (no survey has been published on the vote split at the time of writing). In terms of the backdrop to the upcoming meeting, commentary from policymakers has been light in comparison to the run up to prior meetings with Governor Bailey cautioning that there are some concerns about the second-round effect from inflation on wages. Elsewhere, external member Mann suggested that monetary policy needs to temper 2022 expectations for wage and price increases to prevent them from being embedded in the decision-making of firms and consumers. Aside from these interjections, it appears that the Bank is taking a more hands off approach and is instead letting recent data releases cement expectations for the upcoming meeting. On which, Y/Y CPI rose to 5.4% from 5.1% and therefore printed 0.9pp above the projection laid out in the MPC's November MPR. In the labour market, the unemployment rate in the 3-months to November fell to 4.1% from 4.2% and the UK appears to have avoided a wave of mass redundancies following the winding down of the furlough scheme, with prelim December payroll numbers rising 184k M/M. November's slightly stale GDP release showed a 0.9% expansion ahead of the emergence of the Omicron variant. For the December reading, Pantheon Macroeconomics anticipates a 0.6% M/M contraction with a further 0.3% decline expected in January. That said, the impact of Omicron has been less damaging than some would have feared at the time of the prior meeting and as such, rates are set to rise to 0.5% next week; the point at which the Bank will halt reinvestments under the APF. Looking further ahead, markets expect the Bank Rate to reach 1.25% by year-end; but the likes of ING, UBS and Pantheon Macroeconomics suggest that this path is likely to prove too aggressive.

ECB PREVIEW (THU): After a blockbuster release in December which saw the central bank announce a conclusion to PEPP at the end of March and subsequently beef up its APP, the upcoming meeting (not accompanied by economic projections) is set to see policymakers take stock of the Eurozone economic outlook whilst maintaining the current parameters of its policy tools. With the statement of the release set to be relatively unchanged, focus instead will fall on the accompanying press conference and how President Lagarde judges the inflationary outlook. Since the prior meeting, Y/Y CPI rose to 5.0% in December with the core metric ticking higher to 2.7%. With the Bank moving further away from its transitory inflation stance seen last year, ING judges that the ECB will need to convey its ability to tame inflationary pressures whilst avoiding a rush from "inflation patience" to "inflation panic", as move towards the latter could lead to an aggressive hawkish repricing in the market which is already at odds with ECB comms. As it stands, markets fully price in a 10bps hike to the deposit rate by the October meeting, whilst ECB officials have been at pains to state that a hike is unlikely to take place until 2023. It is no coincidence that a lot of the commentary in recent weeks has suggested that although the transitory narrative has moved on since last year, policymakers still expect inflation to decline throughout the coming year. Some elements of the Q&A will likely centre on how the potential Ukraine-Russia conflict could impact the ECB's near-term price outlook, however, Lagarde will likely try and play down these potential impulses. From a more medium-term perspective, market participants will be congizant of upside risks to the inflation outlook in lieu of recent comments from Germany's Schnabel who cautioned that the green transition poses upside risks to medium-term inflation. SocGen raises two questions that it is looking out for in its outlook, 1) will core inflation be more closely anchored to the target than in the past? 2) how far away is a neutral policy stance? In terms of how to address the overall balancing act, ING suggests that policymakers will be best served by confirming the decisions unveiled in December whilst keeping the door open for faster asset purchase reductions and stressing the sequencing of policy rate hikes only after the end of asset purchases.

FOMC REVIEW: The FOMC signalled that it is of a mind to raise rates at its March meeting, as markets had expected. Chair Powell was less committal on the pace of hikes, which gives the central bank optionality to raise rates by more than the 100bps of tightening currently being fully priced by the market (with some probability of further hikes too), or indeed fewer hikes in the event of downside risks. Powell did not rule out the possibility of a 50bps rate hike if needed, nor did he rule out the notion that the Fed could hike at every meeting; however, some note that Powell's answer in response to a question on whether the Fed needed to raise rates above its 2.5% estimate of the neutral rate could be indicative of a more lengthy tightening cycle after Powell said that there is 'quite a bit of room' to raise interest rates without threatening the labour market. On the size of its USD 8.9trln balance sheet, the Fed will still conclude its asset purchases in March, opting against ending the programme early, perhaps in light of the recent market turmoil and its desire to avoid springing any surprises in this environment. The Fed's guidance suggest that the balance sheet will begin to be reduced after the hiking cycle has begun; the Powell again avoided committing to anything specific at this point, and said that the strategy of how the Fed would reduce the balance sheet would be discussed in coming meetings. Many analysts expect the run-off to begin in June or July, and as Powell alluded to, the pace of the reduction is likely to be quicker than USD 30bln/month cap the Fed used in its 2017 run-off. Finally, the Fed chair suggested that eventually, the composition of the balance sheet would be primarily comprised of Treasuries. With the balance sheet currently around 36% of GDP, some Fed officials have previously argued that the size could be reduced to 20% in the long-term, which some think implies the balance sheet could be reduced to around USD 2.8trln over a 5yr window.

BOC REVIEW: The Bank of Canada left rates unchanged at 0.25%, in line with expectations, though contrary to market pricing which assigned an almost 80% chance of a rate rise ahead of the meeting. The central bank removed its extraordinary forward guidance, noting that economic slack was now absorbed, and it estimates that the output gap is now between -0.75% and +0.25%; the bank had previously seen this happening in the middle quarters of the year. The BoC acknowledged that it expects interest rates will need to increase, with the timing to be shaped by the progress on inflation. Governor Macklem cited Omicron as the reason for the unchanged rate decision, and said it would also dampen spending in Q1. Although looking ahead, Macklem said rate hikes will not be automatic and decisions being made at each meeting, he wouldn't say how fast or how far rates will be going up, but it might take a few steps and then pause the rate hiking path and assess progress. The Monetary Policy report saw growth forecasts downgraded; CPI was left unchanged for 2021, although 2022 was revised up, while 2023 was left unchanged. The central bank acknowledged inflation remained above target amid supply constraints and high food and energy prices, which will see prices rise around +5% in H1 2022, before easing to +3% by year-end as supply issues wane. It noted that near-term inflation expectations had risen but longer-term expectations remained well anchored. On the balance sheet, the bank said that when rate rises begin, it will then consider exiting the reinvestment phase and reducing the size of its balance sheet by allowing a roll-off of maturing bonds. Analysts said that a March lift-off now seemed likely, and markets are pricing around 90% chance of a 25bps hike. RBC reckons that the BoC will hike three times this year, although it suggests that there are upside risks to that view; the apparent patience from the BoC reinforces its view the central bank will not be too aggressive in tightening. The Canadian Bank adds that the exiting of the reinvestment phase and balance sheet runoff could come in H1 22 but emphasises "that most tightening in financial conditions will come from the BoC raising its policy rate, not shrinking its balance sheet."

SARB REVIEW: South Africa's central bank continued with rate tightening, hiking its repo rate by 25bps to 4.00% (vote 4-1 vs the prev. 3-2), in line with market expectations, as concerns about upside inflation risks and global monetary policy divergence increased -- the latter being a shift when compared to previous meetings. "A hawkish pivot by global central banks and elevated domestic inflation readings probably tilted the balance on the MPC more towards tightening compared to the previous meeting," Capital Economics said, "signs that the economic hit from the latest Omicron-driven virus wave has been limited are likely to have made policymakers feel comfortable in tightening policy again." However, the consultancy notes that the SARB's statement supports its view that the tightening cycle will not be as aggressive as investors currently expect. The statement said that "the Committee believes a gradual rise in the repo rate will be sufficient to keep inflation expectations well anchored and moderate the future path of interest rates," and the Governor said that policymakers had not discussed a 50bps move, which some were looking for. And MPC member Loewald explained that the central bank was not "slamming" the brakes, but was instead just "taking its foot off the accelerator." Capital Economics argues that the dovish undertones on the MPC are unlikely to disappear, and it sees the repo rate rising to 5.25% by the end of this year, whereas there seems to be an analyst consensus expecting the rate to rise to 6.00% by the end of 2022.

Disclaimer

The information contained within this document has been prepared and issued by Newsquawk Voice Limited (**"Newsquawk"**) on the basis of publicly available information and other sources believed to be reliable. Whilst all reasonable care is taken to ensure that the facts stated are accurate, neither Newsquawk nor any of its directors, officers or employees shall be in any way held responsible for its content or your use of it. Neither the provision of any content herein nor anything on our website or any other media we use is intended to, and should not be construed as, providing advice and/or enticing an offer or solicitation to invest in, buy or sell securities or other financial instruments.

Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.

newsquawk.com · +44 20 3582 2778 · info@newsquawk.com