Central Bank Weekly 4th February. Previewing RBI, Riksbank, Banxico, CBR; Reviewing ECB, BoE, RBA

4th February 2022

RBI ANNOUNCEMENT (TUE): RBI will conclude its final 3-day policy meeting of the current fiscal year on Wednesday with the central bank expected to maintain the Repurchase Rate at 4.00% although there are mixed views on whether the central bank will keep or hike the Reverse Repo Rate which is currently at 3.35%, while the central bank is likely to stick to an accommodative stance. As a reminder, RBI Governor Das stated at the last meeting that continued policy support is still warranted given the slack in the economy and ongoing catch up in activity. Das also noted the MPC views continued policy support is required for a durable recovery and there were more recent comments from Deputy Governor Patra that the RBI has not fallen behind the curve by maintaining its easy monetary policy stance despite other central banks tightening and that the accommodative policy stance has served India well. These comments suggest that the central bank is unlikely to hike rates immediately and a recent survey showed economists were not forecasting an increase to the Repurchase Rate before April, although some analysts anticipate the central bank could begin normalising the Reverse Repo Rate ahead of that to drain excess liquidity from the market as it seeks to keep inflation in check, while it was also suggested that India’s expansionary budget including record borrowing for the next fiscal year could further spur the RBI to act in order to contain inflationary risks.

RIKSBANK ANNOUNCEMENT (THU): The Riksbank is expected to keep current policy parameters unchanged, holding its Key Rate at zero. Since that November meeting, inflation readings have seen headline CPIF for November rise to 4.1% Y/Y, substantially above the Riksbank’s 2.9% expectation. Elevated price metrics have fuelled expectations that the Riksbank will bring forward its tightening guidance, but analysts still think it is unlikely to be raised by magnitude sufficient to bring a hike into the ‘near term’ horizon. However, many speculate that, like the ECB, the Riksbank would likely first reduce QE purchases before lifting rates. A survey by Nordic bank SEB ascribes a 24% chance to such an announcement, with around 5% predicting a rate hike at this meeting. It is worth caveating that sourced reports have suggested that a March announcement from the ECB on ending APP is an option, therefore, it would not be surprising to see the Riksbank wait until the ECB revises its programme before altering its own. Returning to inflation, and in the base-case of an unchanged announcement, Governor Ingves is likely to use the fact that core measures are in-fitting with their expectations and explain the headline upside as being energy driven, as justification for such a decision.

BANXICO RATE DECISION (THU): There is not yet a consensus on what the Mexican central bank will do at its February confab. Last week, GDP data for Q4 confirmed that Mexico fell into recession in H2 2021. But despite the economic softness, analysts still see the Banxico lifting rates by either 25bps or 50bps from the current 5.5%, as it focuses on tackling high inflation. First half of January inflation data revealed core prices eased but remained elevated; reopening from the pandemic, supply chain issues, higher energy costs and raw materials are likely to keep price pressures firm, analysts have argued. Meanwhile, there remains some questions on how the new governor will set policy. Oxford Economics think that the appointment of Victoria Rodriguez Ceja, an inexperienced public sector economist, "could bring a decisive dovish turn to the traditionally hawkish board, however, "the more hawkish pivot of the US Fed erased the space for Banxico to take a long pause," and it sees the central bank continuing with rate hikes through Q1 2022 until rates hit the 6.00% terminal rate level.

CBR RATE DECISION (FRI): After a 100bps rate rise in December, the consensus expects Russia's central bank will raise its key rate by another 100bps to 9.50%, as it tries to get inflation back to its 4.0% target by the end of 2022, and amid geopolitical tensions with Ukraine which saw the RUB currency fall significantly against the USD in January. However, analysts polled by Reuters expect that the CBR will begin lowering rates later this year, with its key rate seen ending 2022 at 8.50%. The central bank's tone will be monitored for any guidance on future rate moves; after the December meeting, some had framed the central bank's tone as softer, and there were then expectations of a 50bps rate rise in February; but the aforementioned geopolitical events and the subsequent fall in the currency is likely to see the CBR make a bigger move in February.

ECB REVIEW: As expected, the ECB opted to keep key rates unchanged whilst maintaining the parameters of its bond-buying operations which will see PEPP wound down in March and APP beefed up in Q2 before being trimmed down in Q3 and Q4. The statement carried little in the way of material changes other than policymakers removing the “either direction” reference when it comes to adjusting its policy instruments. Note, the Bank refrained from removing the word “shortly” from its forward guidance that states APP is expected "to end shortly before it starts raising the key ECB interest rates". Removing the word “shortly” in the future would have allowed the ECB to engineer a faster wind down of

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APP whilst not prompting expectations of an immediate rate hike. At the follow-up press conference, President Lagarde cautioned that inflation is likely to remain high in the near-term with risks tilted to the upside and there was unanimous concern about inflation on the Governing Council. From a medium-term perspective, Lagarde highlighted that inflation expectations have remained stable. The key takeaway from the press conference was Lagarde's unwillingness to push back on the prospect of a 2022 rate hike (Lagarde pushed back on the prospect of a 2022 hike at the December meeting). When pressed further on the matter, Lagarde stated that the ECB will not hike rates until it has completed net asset purchases and will carry out a thorough assessment in March, at which point it will be armed with staff economic forecasts and can make a decision on asset purchases for the remainder of 2022. Bloomberg source reports after the press conference suggested that a policy recalibration in March is a possibility and APP purchases could be concluded at the end of Q3. Reuters sources thereafter noted that "a sizable minority" wished to change policy at the meeting, whilst policymakers more broadly expect a policy change at the March meeting if inflation does not ease with an adjustment to APP seen as the first port of call. Overall, the reassessment of the ECB's policy path in 2022 prompted a marked shift in rate hike bets with markets now pricing in nearly 40bps of tightening by year-end with the first hike to come in July vs. pre-meeting expectations of around 20bps of hikes priced in by year-end with the first hike expected in September.

BOE REVIEW: As expected, the MPC opted to follow up the December 15bps hike with a further 25bps of tightening, bringing the Bank Rate to 0.5%. The decision to lift rates was unanimous, however, the magnitude of the rise was subject to a 5-4 vote split with Mann, Saunders, Ramsden and Haskel opting for a 50bps move to 0.75%. Nonetheless, with the rate at 0.5%, the Bank will now halt reinvestments under its Asset Purchase Facility. The decision to lift the Bank Rate again was justified by "the current tightness of the labour market and continuing signs of greater persistence in domestic cost and price pressures". As a guide, inflation is expected to increase further in coming months, to close to 6% in February and March, before peaking at around 7.25% in April (vs. prev view of. 6% forecast in December). From a growth perspective, GDP is expected to "slow to subdued rates" amid the adverse impact of higher global energy and tradable goods prices on UK real aggregate income and spending. Within the accompanying MPR, the 2022 GDP projection was subsequently cut to 3.75% from 5.0% with growth of just 1.25% pencilled in for 2023. In terms of the rate path, which implied a Bank Rate of 1.5% by mid-2023 ahead of the release, the MPC cautioned that such a level of interest rates would push inflation well below target in 2024 in an attempt to cool some of the aggressive market pricing. That said, given the 50bps dissents from four members of the MPC, markets now price in a rate of 1% in May, which would assume 25bps hikes at both the March and May meetings. At the follow-up press conference, Governor Bailey warned that policymakers face a trade-off between weakening growth and inflation, and as such markets should not extrapolate and assume rates are on a long march upwards. Nonetheless, markets see the Bank Rate reaching 1.5% by year-end. Strategists at ING do not share this hawkish view and pencil in rate hikes at just the March and May meetings.

RBA REVIEW: The RBA kept its Cash Rate Target at 0.10% and announced an end to bond purchases, as expected, but reiterated that the board is prepared to be patient. The central bank said it is still too early to conclude that inflation is sustainably within the target band, and it will be sometime before aggregate wage growth is at a rate consistent with inflation being sustainably at the target, while it will not increase Cash Rate until inflation is sustainably within the 2-3% target, and that easing bond purchases did not imply a near-term increase in interest rates was forthcoming. The RBA's decision to keep Cash Rate unchanged and scrap its bond purchases was widely expected although the central bank's dovish tone caught markets off guard given the recent hawkish calls by several banks, which had brought forward rate hike expectations following firm CPI and lower unemployment data. After the meeting, RBA governor Lowe rehashed the tone from the statement, and the comments within the Statement on Monetary Policy (SoMP) reiterates that the board is prepared to be patient as it monitors how the various factors affecting inflation in Australia evolve.

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