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Central Bank Weekly April 8th: Previewing ECB, BoC, RBNZ, BoK; Reviewing FOMC minutes, RBA, RBI, CBR

8th April 2022:

ECB POLICY ANNOUNCEMENT (THU): After pivoting its APP at the March meeting in a more hawkish direction, the upcoming announcement is expected to be more of a stock-take on how the Eurozone economy is responding to the fallout from the Ukraine/Russia crisis and subsequent impact on inflation. As it stands, the Eurozone is facing a deteriorating growth outlook given the economic reverberations from the Russia and Ukraine conflict whilst trying to tame rampant inflation which saw Y/Y HICP jump to 7.5% in March from 5.9% in February. Accordingly, ING suggests that the ECB's 2022 inflation projection of 5.1% presented in March is already looking outdated with a risk of double-digit prints to come. The possibility of stagflation in the Eurozone will naturally lead to a split in views between the doves and the hawks on the Governing Council with the former represented by the likes of Panetta who suggests that asking the ECB to bring down high inflation in the near-term would be extremely costly. At the more hawkish end of the spectrum, Belgium's Wunsch expects the deposit rate (currently -0.5%) to reach 0% by year-end. The ECB will ultimately not be forced into making a policy decision at the upcoming meeting with uncertainty surrounding Ukraine providing some cover. However, various desks expect that by June, the Bank will need to offer greater guidance on how it intends to navigate the current economic climate. ING suggests that one compromise that might be sought on the Governing Council would be a more explicit distinction between policy normalisation and monetary policy tightening whereby the former would include an end to net asset purchases and bringing the deposit rate back to zero whereas tightening would be the start of a longer rate hike cycle. In terms of the latest polling, Reuters reported that of the 41/53 respondents who forecast the deposit rate to rise from a record low of -0.50% this year, 31 expect it to do so in Q4, 10 say it will happen as soon as July-Sep.

RBNZ POLICY ANNOUNCEMENT: (WED) The Reserve Bank is expected to lift its Cash Rate by 25bps to 1.25%. Westpac's analysts say that, like the February confab, it is a close call between a 25bps increment and a larger 50bps hike, a situation not helped by minimum data releases between the two reviews. "The data that we have had suggests that near-term inflation is a growing headache for businesses and households," Westpac writes, "But it also shows that monetary policy moves to date are getting the intended traction via the housing market." Westpac adds that the central bank has not provided very much guidance on how it views recent developments, "but its decisions to date suggest to us that the hurdle for larger OCR hikes is quite high."

BOC POLICY ANNOUNCEMENT (WED): After a 25bps rate rise in March, the consensus expects the Bank of Canada will hike by 50bps at its April meeting, taking its main rate to 1.00%, according to a Reuters poll. Some desks forecast a smaller +25bps increment, but all five of the major Canadian banks are expecting the larger increase, and also see another +50bps move at the June confab too. The bigger move has been flagged by remarks made by the Deputy Governor Kozicki, who pledged a 'foreceful' response to manage inflation, while the US Fed has also signalled intent to lift rates aggressively, and is expected to continue doing so. Money markets are pricing rates rising to 2.75% by the end of this year. There is also a possibility that the Bank begins the process of QT; Governor Macklem said QT was the logical next step after rate rises begin. Traders will be assessing the pace of the process; Macklem has noted that around 40% of the BoC's bonds will mature within the next two years, when the Bank stops reinvestments, and has previously said that wage growth and longer-run inflation expectations will determine the pace at which QT happens. Meanwhile, updated macroeconomic forecasts will likely see inflation projections raised.

BOK POLICY ANNOUNCEMENT (THU): The BoK is likely to hold rates at 1.25% in a meeting that will take place without its Governor (lawmakers are due to hear the nomination of Chang-Yong Rhee on April 19th). The Bank's policymakers will be aware of energy prices stoking inflation above the 4% level amid tight labour market conditions; however, Fed hawkishness, as well as the War in Ukraine and COVID are risks to the growth outlook, while consumer caution on taking on new debt is also set to drive the wait-and-see approach, according to Societe General. "Our base scenario is still for one 25bps hike per quarter, resulting in a year-end (and terminal) rate of 2.0%," The French bank said, "we expect rate hikes to resume at the following meeting in May." The bank argues that although it sees risks of a higher terminal rate to manage rising inflation, it awaits more information on the Governor nominee's stance before reviewing its call.

FOMC MINUTES REVIEW: The Fed's March meeting minutes signalled that "many" participants were in favour of a 50bps rate hike, but ultimately opted for a 25bps move due to the uncertainties around Ukraine. Participants also believe that it would be appropriate to raise rates to neutral "expeditiously" (NOTE: the Fed currently sees neutral at 2.4% vs

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rates at 0.50% presently). Analysts said that this all but confirms we will see a 50bps move at the May meeting, with money markets now assigning an almost 90% probability of this outcome. Crucially, the Fed began to give some guidelines for its balance sheet normalisation strategy: Committee members "generally agreed" that the balance sheet drawdown should be passive, with monthly caps of USD 60bln for Treasuries, and USD 35bln for MBS, totalling USD 95bln per month. That total figure is almost double the previous episode of balance sheet tightening, and was a little below the consensus view, which had been centring around USD 100bln (though some desks thought the MBS cap was a little higher than expected). The minutes said these caps could be phased in over a period of three-months, or perhaps longer if needed; direct sales of MBS holdings would be considered after the runoff process was "well under way." The release suggests that this balance sheet runoff programme could be announced at the May meeting.

ECB MINUTES REVIEW: The account of the March meeting focused on the initial fallout from the Russian invasion of Ukraine and the need to recalibrate monetary policy in the midst of rampant inflation. On the former, there was broad agreement on the direction of the initial effects of the war on the euro area economy, namely upwards on inflation and downwards on economic growth, which was best characterised as yet another negative supply shock. It was noted that this could have inflationary or disinflationary impacts in the longer term. On inflation, the Governing Council judged that it could no longer afford to look through higher inflation, even if it was driven by an adverse supply shock. As such, a large number of members called for immediate further steps towards monetary policy normalisation. Therefore, the view was taken that APP purchases had by now fulfilled the stated objective of reinforcing the monetary policy accommodation provided by the ECB's negative interest rates. On rates themselves, the decision was taken to de-link the date of an initial rate rise from the duration of asset purchases on the basis that it would provide the Governing Council with optionality and flexibility. As such, any adjustments to the key ECB interest rates will take place "some time after" the end of net asset purchases under the APP. The reference to "some time" conveyed the notion that the time interval between the end of net asset purchases and lift-off was not predetermined. The account provided insight into the decision-making process at the time, however, the developments in the Ukraine/Russia conflict, the above-expected March inflation print and comments from policymakers at the Bank suggest that the landscape has continued to evolve ahead of next week's meeting. Commentary this week has shown a divide between the doves and the hawks on the Governing Council with Wunsch calling for the deposit rate to hit 0% by year-end, whilst Panetta suggested that asking the ECB to bring down high inflation in the near-term would be extremely costly. In the minutes, it also noted that among those calling for action at the meeting, "some members preferred to set a firm end date for APP net purchases during the summer and not to make that date conditional on unfolding events", which could clear the way for a possible rate rise in Q3. However, others expressed a preference for adopting a wait-and-see approach at the present meeting in view of the exceptionally high uncertainty created by the Russia-Ukraine war.

RBA REVIEW: A hawkish hold by the RBA saw the Cash Rate maintained at 0.1%, but the reference to a "patient" monetary policy approach scrapped. The statement made it clear that it had shifted more aggressively to focus on inflation. For reference, "inflation" was mentioned 10 times in the statement vs "labour" which had been mentioned seven times. "Higher prices for petrol and other commodities will result in a further lift in inflation over coming quarters, with an updated set of forecasts to be published in May." The statement, however, made no direct hints as to the timing of any rate hikes. But on Friday, the RBA's Financial Stability Review said it is important that borrowers are prepared for an increase in interest rates, and global asset markets are vulnerable to larger-than-expected rate increases. Following the decision, Westpac dramatically shifted its expectations and now sees a sequence of rate hikes covering most months in 2022, reaching a cash rate of 1.25% by year's end. The bank now forecasts rate hikes in June (15bps), July (25bp), August (25bps), October (25bps), and November (25bps). The bank's prior view saw hikes in just August, October and December. "Hikes will resume in 2023 as wages growth and very tight labour markets signal the need for higher rates. The cycle will peak by mid-2023 around 6 months after the peak in the federal funds rate." Westpac says.

RBI REVIEW: India's central bank left rates unchanged at 4.0%, as was expected, though retained its "accommodative" stance (also as expected). However, the RBI has begun alluding to policy tightening ahead, and said it would focus on withdrawing accommodation going forward, adding that it is to restore the LAF corridor to 50bps and floor to be constituted by the newly introduced standing deposit facility. The Governor noted that the growth outlook assumed oil prices at USD 100/bbl, and pledged that the RBI would take whatever action is required at the appropriate time on inflation. The Governor also made clear that the central bank would not do anything that goes against economic sanctions on Russia. A Grant Thornton analyst said the RBI's policy on keeping the repo rate unchanged reflects the need to balance growth vs inflation. "Having said this, the RBI does not downplay the inflation risks and understands that the monetary policy will be less accommodative," adding that "it would however, be worthwhile to note that this is a very courageous call by the RBI, especially when everyone around the world is increasing interest rates."

CBR REVIEW: In an unscheduled announcement, the Russian central bank cut its Key Rate by 3ppts to 17.00%, and said it was holding open the prospect of further rate reductions at upcoming meetings. The central bank explained that the decision reflected a change in the balance of risks of accelerated consumer price growth, decline in economic activity and financial stability risks. Ahead, the CBR will take into account risks posed by external and domestic conditions, and the reaction of financial markets. It will also consider actual and expected inflation dynamics relative to

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its target, and economic developments over the forecast horizon. The CBR notes that financial stability risks remain, but have ceased to increase for the time being owing to the adopted capital control measures. It also noted a steady inflow of funds to fixed-term deposits. Ahead, it sees annual inflation continuing to increase due to the base effects, yet the latest weekly data point to a noticeable slowdown in the current price growth rates, which can also be partly attributed to the Rouble's exchange rate dynamics, which has now strengthened back to pre-Ukraine invasion levels.

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