Central Bank Weekly April 29th: Previewing FOMC, BoE, RBA, Norges Bank; Reviewing BoJ, Riksbank, CBR

29th April 2022:

RBA ANNOUNCEMENT (TUE): The RBA will decide on rates next week in what is widely viewed as a live meeting with swaps traders fully pricing in a 15bps increase for the Cash Rate Target to 0.25% from the current record low of 0.10%, while swap markets also suggested a 25% chance of a greater 40bps move. The expectation for a sooner lift-off was spurred after the mostly firmer than expected inflation data for Q1 which showed headline annual inflation at 5.1% vs. Exp. 4.6% (Prev. 3.5%) which is the fastest pace of increase in more than two decades and the RBA's preferred trimmed mean inflation also surpassed the central bank's 2-3% target at 3.7% vs. Exp. 3.4% (Prev. 2.6%). This prompted an adjustment of rate hike expectations with JPMorgan anticipating the RBA to hike by 15bps in May and Westpac also brought forward its rate hike call in which it now expects a 15bps increase at next week's meeting followed by a 25bps move in June from a previous forecast of a 40bps increase in June. The RBA have opened the door for a sooner hike after having dropped its reference to the Board being "patient" from the statement at the last meeting and noted that developments have brought forward the likely timing of first rate hike, while it also stated in the recent semi-annual Financial Stability Review that it is important borrowers are prepared for an increase to interest rates. Conversely, others are not convinced of a move at the upcoming meeting with Goldman Sachs and Capital Economics in the June lift-off camp, while arguments for a pause include the RBA's previous desire to wait for data over the coming months and with Australians set to go to the polls for the election on May 21st.

FOMC ANNOUNCEMENT (WED): The FOMC is expected to lift rates by a 50bps increment, taking the Federal Funds Rate target to 0.75-1.00%. Its March statement laid the groundwork for such a move ("anticipates that ongoing increases in the target range will be appropriate" – a line which is expected to be stated again in May). Additionally, remarks from officials before they entered the pre-meeting quiet period framed the Fed's task as firmly in the inflation-fighting sphere, with Chair Powell stating that it was "absolutely essential" to restore price stability. Officials have also spoken about "expeditiously" getting rates back to neutral (judged to be around 2.4%, according to the Fed's recent forecasts), which has built expectations for a front-loaded rate cycle. Accordingly, money markets are now pricing 50bps rate hikes at the May, June and July FOMC meetings; markets have also priced in the Federal Funds Rate target rising to 2.50-2.75% by the end of this year (vs the Fed's March forecasts, which pencilled in rates rising to 1.75-2.00% by end-2022). Elsewhere, the central bank may also announce the beginning of its balance sheet runoff. The minutes from the March meeting flagged that the process of quantitative tightening will begin at an upcoming meeting, while there was also a discussion about the cap amounts that the Fed will allow to roll-off the balance sheet on a monthly basis – the minutes suggested USD 60bln for Treasuries and USD 35bln for MBS holdings. Some desks think that these caps will be hit early, but the rising rate environment and lower mortgages refinancing could mean that only around USD 20bln or so rolls off on an average month. And given that the Fed wants its balance sheet to eventually be comprised primarily of Treasuries, traders will be paying attention to see any timelines of when the Fed is prepared to begin outright selling of its mortgage holdings to lower the size of the overall balance sheet. Additionally, in light of advanced Q1 GDP data this week, which showed a contraction of 1.4%, the Chair will likely be asked the extent to which the Fed is comfortable tightening policy in the face of slowing growth, and if it would be prepared to engineer a recession to manage price pressures.

NORGES ANNOUNCEMENT (THU): While the consensus continues to expect the Norges Bank will leave rates unchanged at 0.75%, a surprising hawkish pivot by its local peer, the Riksbank, has resulted in some analysts revising their own expectations towards a more hawkish outturn. That said, the meeting is one of the so-called intermediate confabs, so we will not get any updated economic projections or rate path, and according to the Scandi bank SEB, we should still be expecting an unchanged rate decision. "While recent developments have been mixed, there are no substantial deviations from the Bank's projections that would support a policy shift," it writes, and SEB thinks the central bank will reiterate its guidance that "the policy rate will most likely be raised further in June", and SEB doesn't even expect any fresh policy signals. "The market's hiking expectations are a tad more aggressive than implied by the rate path, but the upcoming rate announcement should not result in any large market moves," it writes.

BOE ANNOUNCEMENT (THU): The BoE is expected to continue its hiking cycle at the upcoming meeting by delivering another 25bps hike, taking the Base Rate to 1.0%. 33/44 surveyed analysts expect a 25bps hike, 1 expects a 50bps hike and 10 look for no change. In terms of market pricing, 27bps of tightening is priced in for the upcoming meeting with an additional five hikes priced in by the end of the year. The previous decision was subject to dovish dissent from Cunliffe who voted for a pause in the hiking cycle on account of concerns over the current squeeze on real household incomes. This time around, the vote split is expected to remain 8-1 with no other MPC members set to join Cunliffe in the pause camp given that the consensus amongst policymakers is set to prompt just a 25bps hike compared to the 50bps that the Fed is likely to proceed with next week. The meeting comes amidst the backdrop of rampant inflation in the UK with the Y/Y CPI metric rising to 7.0% in March from 6.2% ahead of the inclusion of the OFGEM price cap hike in April. Furthermore, the CBI reports that manufacturers are raising prices at the fastest rate in over 40 years to cover rising raw material and energy input costs. The labour market remains hot with the unemployment rate at multi-decade lows whilst wage growth remains elevated. Of concern, GDP metrics for Feb saw a cooling in the pace of Q/Q growth to 0.1% vs. the 0.8% observed in January whilst March's retail sales report was particularly soft with ING noting that "it's getting increasingly difficult to see how UK consumer spending avoids a downturn over coming months". With this in mind, Governor Bailey has cautioned that the BoE is walking a tightrope between tackling inflation and avoiding a recession. With a rate hike a near given for the Bank, focus will turn towards signalling for the coming months. In the previous statement, the Bank tweaked guidance so that it reads "modest tightening in monetary policy may be appropriate in the coming months" as opposed to the February statement which noted it is "likely to be". Any further softening of forward guidance on rates will be of note given how aggressive market pricing remains. SGH Macro suggests that the Bank is on the precipice of what it describes as "a 'second phase' of tightening, characterized by less frequent moves over a longer time horizon, with data dictating meeting-to-meeting outcomes". Elsewhere, current guidance from the BoE suggests that it will actively start selling Gilts when the Bank Rate hits 1%. However, policymakers have stated that selling Gilts when the Bank Rate hits 1% will not be an automatic process. ING thinks now is not the best time to sell bonds and therefore will hold off and instead opt to lay out details of how the policy could work when implemented. In the accompanying MPR, inflation and growth forecasts are set to be revised higher and lower respectively.

BOJ REVIEW: BoJ kept policy settings unchanged as expected with rates at -0.10% and 10yr JGB yield target at 0%. The decision to keep policy settings unchanged was as expected, although there were some outside calls that the BoJ could widen the tolerance band which if it had materialised, would have allowed yields to move higher and could have alleviated some of the pressure on the yen. However, this was not the case as the central bank maintained its ultra-easy policy settings and even announced it will be conducting special operations on every working day aside from when it is not expected. BoJ also left forward guidance on interest rates unchanged in which it expects short- and long-term policy rates to remain at present or lower levels and reiterated it will ease policy without hesitation as needed with an eye on the pandemic impact. Following the rate decision, Governor Kuroda said it is desirable for currencies to move stably, reflecting economic fundamentals, and that 2% inflation will not be sustained as energy price hikes fade. As such, USD/JPY surged to new 20-year highs which was aided by the glaring divergence between the Fed's steep rate-hiking path and portfolio reduction plans and the aforementioned BoJ's accommodation. Looking ahead, desks noted the divergence is not seen concluding any time soon, while Goldman Sachs anticipates further pressure for the Japanese currency and for FX intervention not to have much of a significant impact in stemming the depreciation unless there is a change to the BoJ's YCC settings.

RIKSBANK REVIEW: The Riksbank opted for a surprise hike of 25bps in a unanimous decision, taking the Repo Rate to 0.25% - only three out of 17 analysts polled by Reuters expected this. The repo forecast was also updated to show that "the repo rate will be raised a further two to three times this year and will be somewhat below 2 per cent at the end of the three-year forecast period" (prev. indicates that it will be raised in the second half of 2024). The Riksbank also decided to "reduce the pace of these purchases during the second half of 2022, so that the holdings begin to decline; the Riksbank will buy bonds for SEK 37bln during the second half of the year." (prev. SEK 37bln for Q2; expected to be broadly unchanged for the year, before gradually decreasing). Inflation was the main driver of the decision, with the statement warning that "Inflation has risen to the highest level since the 1990s and will be high for some time." At the post-meeting presser, Governor Ingves suggested the Riksbank is not putting the brakes on monetary policy, but rather taking the foot off the gas. Nonetheless, the release was clearly more hawkish than markets had expected amid the surprise hike, the massive upward revision to the rate path, the halving of QE, and the higher inflation forecast than some participants had expected. The decision has led Swedish bank Nordea to revise their Riksbank forecasts: "we change our forecast and now see three additional rate hikes this year, meaning a total of four rate hikes this year and a repo rate at 1.0% by year-end 2022." Further out, Nordea sees an unchanged Repo Rate during 2023 as the bank expects "economic activity and inflation to slow enough" to warrant a levelling out in the rate path.

CBR REVIEW: The CBR cut its key rate by more than forecast, lowering it by 300bps to 14.00% (exp. 15.00%). It also said that it sees the key rate in a range of 12.50-14.00% this year; previously, it had guided rates between 9.00-11.00% in 2022. Within its statement, it said that recent weekly data indicated a slowdown in current price growth as the currency strengthened and consumer activity cooled. And although inflation risks have recently decreased slightly, pro-inflationary risks were still considerable, adding that the decline in the potential of Russia's economy driven by restrictions may turn out to be more pronounced than the baseline scenario assumed. These pro-inflationary impulses were being accentuated by high, unanchored inflation expectations. The CBR estimates that economic activity had begun to decline in March, and high-frequency indicators were pointing to a contraction in consumer and business activity. Its latest forecasts see GDP falling by between 8.00-10.00% this year, mainly due to supply-side factors. Next year, the economy is expected to grow gradually. At her post-meeting press conference, Governor Nabiullina emphasised that the central bank sees further scope for rate cuts, but future moves will be more moderate; she also said that the CBR had considered a rate cut increment of 200-300bps at the April meeting. The governor also noted that while inflation pressure had stabilised recently, and will likely peak by the year end, price stability was the central bank's key priority, though it was not looking to lower inflation to its 4% target by any means possible. On the currency, the CBR does not target a specific RUB rate, Nabiullina said. And with the current capital controls, she suggested that the RUB rate should remain floating; responding to recent reports on pegging the currency to gold, she said the idea was not being discussed by officials at all. Meanwhile, the governor revealed that the central bank had proposed the government scrap its requirement of mandatory FX sales for non-commodity exporters; it has also proposed lowering the mandatory conversion rate for commodity exporters to 50%.