Central Bank Weekly May 6th: Previewing Banxico, RBNZ Inflation Survey; reviewing FOMC, BoE, RBA, Norges Bank, BCB, RBI

6th May 2022:

NEW ZEALAND INFLATION SURVEY (THU): The RBNZ's quarterly survey of inflation expectations is expected to show a sharp rise in forecasts over short-term horizons – namely the one and two-year timeframes. Westpac suggested the jump higher in revisions in the Q1 release underpinned the case for a 50bps hike in April. "A result in that vein would support our forecast for another 50bp OCR hike in May," Westpac says.

BANXICO PREVIEW (THU): At its March meeting, the Banxico voted unanimously to hike rates by 50bps to 6.5%, as the market had expected; analysts also noted that the central bank did not describe the 50bps increment of the hike as "on this occasion", which might be taken as a sign that it is comfortable with lifting rates by that magnitude at future meetings. Banxico continues to take a data-dependent approach. Since the March meeting, the latest bi-weekly CPI data showed inflation rising to 7.7% Y/Y in the first part of April, amid broad-based price gains. Additionally, Q1 GDP data rose 0.9% Q/Q, a little short of the 1.1% analyst forecast, and although it was an encouraging start the year, analysts note the risks that lie ahead. "Looking ahead, the economic outlook remains challenging," Pantheon Macroeconomics said, "for a start, inflation will remain too high for comfort, disposable income is under renewed strain, remittances from the US likely will slow as the US housing market continues to roll over, and Banxico likely will continue to tighten to at least 8.25% over the coming meetings." Pantheon also notes that there is increased political uncertainty after President Lopez Obrador's populist policies, which will act as a headwind to capex and business sentiment. Internationally, the war in Ukraine is keeping inflation pressures alive, China's lockdown is having an impact on not only the domestic economy, but the global economy too, while the Federal Reserve in the US is pursuing a hawkish trajectory. Other analysts have said that this will keep the prospect of a 75bps rate hike at the Banxico's May meeting on the cards.

FOMC REVIEW: The Federal Reserve's May policy announcement was in keeping with market expectations. It lifted the Federal Funds Rate target by a 50bps increment to 0.75-1.00%, while the statement continuing to suggest the committee anticipates that "ongoing" rate rises will be appropriate. At the post-meeting press conference, Chair Powell leaned back against calls that the Fed could lift rates in 75bps increments, stating that the Committee was not actively considering rate rises of that magnitude, and arguing that 50bps moves at the next "couple" of meetings was likely to be appropriate. The Committee also announced a phased-in start to balance sheet normalisation beginning in June (some were expecting the process to begin in May); the maximum monthly caps will start at USD 30bln and USD 17.5bln for Treasuries and MBS respectively, ramping up to USD 60bln and USD 35bln over three-months. Powell said the effects of balance sheet reduction were uncertain, but there are estimates that it could deliver the equivalent of a 25bps hike over the course of a year, perhaps biasing the neutral rate to the low-end of forecasts. The Fed alluded to the negative GDP print in Q1, saying that although overall economic activity edged down, household spending and business fixed investment remained strong. Chair Powell is also confident that the Fed can engineer a soft economic landing as it lifts rates in the face of a growth slowdown, though he constantly caveated the challenges the central bank would face in that endeavour. Powell was dismissive about the prospects of an outright recession, and he said that there was nothing in the economy that suggests the US economy is close to recession, though that was not to mean that there will not be some slowing growth. On the notion that the Fed could lift policy above estimates of the neutral rate – something economists say will begin to restrict economic activity from the current accommodative stance – Chair Powell repeated that the Committee would not hesitate to hike above that level (which the Committee sees between 2-3%), but said that this was not a decision to be made now, implying he was in the camp that favoured raising rates to neutral and then assessing the magnitude to which further rate rises were needed.

BOE REVIEW: As expected, the BoE opted to hike the Bank rate by 25bps to 1.0%, taking it to its highest level since 2009. The decision was unanimous with Deputy Governor Cunliffe moving back into the hike camp after an unchanged vote in March. The decision over the magnitude of the hike was subject to hawkish dissent from Mann, Haskel and Saunders who voted for a 50bps increase on the basis that doing so would "help to bring inflation back to the target sustainably in the medium term, and reduce risks of a more extended and costly tightening cycle later". The decision to raise rates was in reaction to the current inflationary outlook, which now looks for CPI to "rise further over the remainder of the year, to just over 9% in 2022 Q2 and averaging slightly over 10% at its peak in 2022 Q4". This sentiment was reflected in the accompanying MPR which saw the 2022 CPI forecast lifted to 10.25% from 5.75%. With this in mind, the

MPC judged that "some degree of further tightening in monetary policy may still be appropriate in the coming months"; a view which was not supported by all members on the basis that risks around activity and inflation over the policy horizon were more evenly balanced. With regards to market pricing, the MPC once again attempted to highlight that the implied rate path is too aggressive by stating that such a path would see the inflation rate pushed to 1.3% in three years, well below the target. Heading into the release markets had priced in a further five hikes (excluding today's) by end-2022, this has now fallen to four being fully priced in with around a 50% chance of a fifth. During the press conference, Bailey stated he does not agree with those who think that the MPC should be raising interest rates by a lot more. The realignment in market pricing could also be as a result of the gloomier growth outlook which saw the MPC revise lower its 2023 growth outlook to -0.25% from 1.25% with 2024 GDP seen at just 0.25%. Now that the Bank Rate has hit 1%, the MPC offered an update on the future of its balance sheet given that current guidance noted that Gilt sales will commence when its key rate hits this level. Accordingly, the MPC has asked Bank staff to work on a strategy for UK government bond sales, and would provide an update at its August meeting. This would allow the Committee to make a decision at a subsequent meeting on whether to commence sales. Overall, the Bank remains in a tight bind by trying to balance rampant inflation with a dour growth outlook. For now, the Bank is attempting to make sure that second-round effects from the former do not materialise. However, the latter suggests that the MPC will likely fall short of the current levels of market pricing for rate hikes. Accordingly, ING expects further hikes in June and August, but suggests the Bank is getting closer to a pause in its tightening cycle.

RBA REVIEW: The RBA delivered a larger than expected hike in which it raised the Cash Rate Target by 25bps to 0.35% (exp. +15bps, although there were some outside calls for a 40bps move) and said it is committed to doing what is necessary to ensure that inflation in Australia returns to target over time. The Board judged now was the right time to begin withdrawing some of the extraordinary monetary support, while it will require a further lift in interest rates during the period ahead. The RBA also stated that the Board will continue to closely observe incoming information and the evolving balance of risks as it determines the timing and extent of future itightening. Furthermore, it is not currently planning to sell government bonds purchased during the pandemic and does not plan to reinvest the proceeds of maturing debt. The surprise move by the RBA spurred some hawkish adjustments to calls with Goldman Sachs forecasting rate increase of 50bps a piece at the next two meetings and for the Cash Rate to reach 2.6% by year-end, although the latest Statement on Monetary Policy showed the central bank's projections assumed a Cash Rate of 1.75% by December this year and 2.5% at the end of 2023.

NORGES REVIEW: As expected, the Norges Bank kept its Key Rate at 0.75% and reiterated guidance towards a June hike, alongside the MPR. Note, the release included two notable points: 1) The NOK has depreciated, and is weaker than projected – a factor that could, if it were to continue in the months ahead, potentially add weight to a hawkish revision in the future. 2) The committee acknowledged the below-expected inflation reading for March (released after the March MPR), and it continues to expect underlying inflation to increase due to rising wage growth and imported goods inflation. As such, the two inflation releases due prior to the June's MPR will be scrutinised to determine firstly if expectations are too elevated, and if wages/external pressures drive prices higher, as predicted.

BCB REVIEW: The Brazil central bank lifted its Selic rate by 100bps, in line with the consensus expectations, to 12.75%, as it continues "the process of monetary tightening significantly into even more restrictive territory." The central bank also said it was "likely" that the cycle would be extended at the next meeting, but with a rate rise of a smaller magnitude, though removing references that the rate cycle was already sufficient for a convergence of inflation. Analysts at Rabobank noted that the BCB assumes a steeper Selic-rate path from its Focus survey (sees 13.25% by end-2022, but falling to 9.25% by the end of next year); worse inflation expectations vs the Focus survey (7.9% by end-2022, falling to 4.1% by end-2023); and sees a stronger BRL (4.95 vs 5.05 at its previous meeting). "The overall message is more hawkish than the one after the previous meeting, as they are not shutting the door for further hikes after the June meeting, raising the odds of re-anchoring inflation expectations," Rabobank says, "going forward, unless CPI inflation does not bring upwards surprises, we still see the Copom raising the Selic rate in June by 50bps, bringing this long hiking cycle to a halt," and adds that "they would then start the easing cycle in 23Q1, until reaching 9.00% by end-2023." Rabo will be looking to the meeting minutes, released next Tuesday, for more details on the inflation outlook and the state of the economy.

RBI REVIEW: In an unscheduled announcement, the RBI lifted its benchmark repo rate by 40bps to 4.4%, and hiked the cash reserve ratio by 50bps to 4.50%. Governor Das explained that the decision was motivated by inflation, whose shock had been more severe than officials had foreseen. "We were already expecting more rate hikes than the consensus this year but the repo rate now looks set to rise beyond the 5.00% we had pencilled in for end-2022," Capital Economics said, "we now think it will rise to 5.65% this year." The emergency moves follow other action it had taken in April, where it introduced a Standing Deposit Facility which acts to raise the floor of the rate corridor, and has already resulted in some tightening of monetary conditions. Even so, analysts noted that the size and timing of the May announcement was a hawkish surprise (many were expecting a 25bps rate rise at the June meeting). "Looking ahead, further rate hikes look nailed on," CapEco says, "after all, the rise in headline inflation has further to run, and Governor Das noted that there is a growing risk that if inflation remains elevated at these levels for too long, it can de-anchor inflation expectations which, in turn, can become self-fulfilling and detrimental to growth and financial stability." CapEco explains that the unscheduled and larger than expected rate move in May mean that rates will likely end the year above 5.00%, with the consultancy seeing a rise to 5.65%, and then lifted further to 6.15% next year.