Central Bank Weekly May 13th: Previewing ECB, SARB, PBoC; reviewing Banxico

13th May 2022:

ECB MINUTES (THU): As expected, the ECB refrained from tweaking its monetary policy settings with rates left unchanged and the parameters of its bond-buying operations maintained. As such, the ECB stated it will lower purchases under APP to EUR 30bln from EUR 40bln in May and then to EUR 20bln in June before concluding in Q3. The initial market reaction to the statement was a dovish one with a lack of specificity on when in Q3 purchases will conclude, serving as a disappointment to some who had been hoping for greater clarity. At the accompanying press conference, introductory remarks from Lagarde stated that several factors point to low growth ahead, new pandemic measures in Asia are contributing to supply chain issues and inflation pressures have intensified across many sectors. On policy measures, Lagarde refrained from providing any firmer pointers on when in Q3 purchases under APP will conclude. However, since the meeting, consensus has coalesced around the view that asset purchases will be concluded on July 1st. Lagarde also reiterated her line from the previous press conference that the "some time" linkage between the end of APP and start of rate hikes could mean "weeks" or "several months". In the wake of the meeting, Reuters ECB sources suggested that policymakers saw a July hike as still possible, but they were unanimous in their support for April's decision. Meanwhile, Bloomberg sources suggested there was a growing consensus for a 25bp rate hike in Q3. Note, on May 11th, Lagarde placed particular emphasis on the "weeks" aspect of this guidance with other officials at the Bank endorsing a move on rates in July. Finally, during her remarks, Lagarde didn't add anything to the reports ahead of the meeting which suggested that the Bank was looking at crafting a crisis tool if bond yields were to jump.

SARB PREVIEW (THU): The South African Reserve Bank is likely to lift rates by a 50bps increment, taking its Repo Rate to 4.75%, as it looks to manage the impact of higher inflation and potential second round effects. Elize Kruger, an independent South African economist cited by Reuters, said "workers will demand higher wages to compensate for higher living costs, also adding to the production costs in the economy and in this process prices in most of the CPI basket will show increases," adding that "the SARB would be very uncomfortable if second round effects start to appear in a meaningful way." A 50bps increment move has not been made by the SARB in over six years, and some analysts still expect a smaller 25bps, but they are in the minority. According to a Reuters poll, since the last meeting, analysts have been hawkishly revising their expectations towards the larger move. The latest survey, however, sees the central bank moving back to 25bps hikes per quarter until rates are lifted to 6.00% in Q3 next year.

PBOC LPR (FRI): PBoC will decide on its Loan Prime Rates with the central bank likely to keep the 1-Year Loan Prime Rate at 3.70% and the 5-Year Loan Prime Rate at 4.60%. As a reminder, the PBoC defied expectations for a 5bps reduction last month as it opted to keep its benchmark lending rates unchanged, while the 25bps RRR cut it announced in April was viewed as conservative as this was smaller that what many anticipated and less than last couple of 50bps reductions. This suggests the central bank is staying true to its prudent approach to monetary policy and its recent support pledges have been more of a targeted nature including focusing on support for small firms and sectors hit by COVID, as well as agricultural production and energy, while it also announced to launch a CNY 100bln lending facility to support financing of transport and logistics sectors. The recent weakening of the yuan is another factor that would likely influence the PBoC to hold off on immediate rate cuts as the central bank would want to avoid exacerbating the pressure on the currency and it even reduced the RRR on FX deposits by 100bps effective May 15th which is seen as a move aimed at slowing the yuan's depreciation. Conversely, future rate cuts cannot be ruled out given the slowing of the economy amid lockdown and virus-related restrictions affecting Shanghai and Beijing as China sticks to a zero-Covid policy, which has already resulted in sharper than expected contractions to Chinese PMI data and a significant slowdown in Chinese Exports for April.

BANXICO REVIEW: Banxico voted by 4-1 to lift rates by 50bps to 7.00%, as market participants were expecting; one member (Espinosa) voted for a larger 75bps hike. The central bank also added language to its statement that suggested that it could consider more forceful measures to attain the inflation target due to growing complexities in the environment for inflation and expectations; it also noted that headline and core inflation expectations had risen 'significantly', firming its language from the prior meeting. Longer run inflation expectations were stable, but remained above target. The statement also noted that global economic conditions were worsening and uncertainty continues to prevail. The drivers of inflation are judged to be little changed: high core inflation, COVID-related inflation pressures, higher commodity prices, MXN depreciation. Pantheon Macroeconomics' analysts now expect the Banxico to raise rates by a further 50bps at its next three meetings, and then 25bps rate rises in the final two meetings of the year, though caveat that risks are tilted to the upside. "The main interest rate is at its highest level since early 2020 and policymakers have left the door wide open to further tightening," Pantheon writes, "we expect further hikes over the coming meetings, but the pace is uncertain, mainly depending on global food prices, the Fed, and the MXN."