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Central Bank Weekly May 27th: Previewing BoC; Reviewing FOMC minutes, CBR, RBNZ, BoK, CBRT

27th May 2022:

BOC RATE DECISION (WED): Following a half-percentage rate rise in April, the Bank of Canada is expected to lift rates by a 50bps increment again in June as it tries to place a lid on price pressures, which would take its key interest rate to 1.50%. Economists have been revising their expectations more hawkishly following April's inflation metrics, which showed an average of the BoC's three core CPI measures rising to 4.23% from 3.77%, while the headline rose to 6.8% Y/Y, meaning that inflation has been above the BoC's 1-3% target range for over a year. Analysts said that this should keep the BoC in aggressive inflation fighting mode. Canadian bank RBC wrote that "the BoC is laser-focussed on taming inflation, but once the overnight rate reaches a more neutral level, it will be conscious of the potential trade-off between returning inflation expediently to target and prolonging the economic cycle"; RBC does not expect the BoC to take policy into restrictive territory (the neutral rate is estimated to be between 2-3%) unless inflation dynamics were compelling it to do so, and RBC warns that if it did, it would "amplify recession risk." A Reuters poll of fourteen economists revealed a split on views whether the current tightening would lead to an economic recession.

FOMC MINUTES REVIEW: The Fed's May meeting minutes didn't contain any new hawkish surprises. Most participants back 50bps rate rises at the June and July meetings, in line with the guidance from Chair Powell as well as recent commentary. It was also unsurprising that officials want to get rates back to "more neutral levels", and warned that hiking rates above neutral into restrictive territory "may well become appropriate" -- all in line with recent commentary. Interestingly, the minutes revealed that many participants judged that expediting the removal of policy accommodation would leave the Committee well positioned to assess the effects of policy firming later this year, a view that has been expressed by some officials, and hints that when rates get to neutral, there may be scope for the Fed to pause from tightening, or move to smaller 25bps increments of lifting rates, depending on how the inflation situation has developed. Goldman Sachs recently argued that for stocks, the choppy downside action seen in the last several weeks will only bottom-out when then Fed signals such a shift, arguing that the market needs to become more confident that the tightening of financial conditions had been sufficient, and that the Fed has delivered and signalled enough tightening; the bank also observed that monetary policy has historically stopped tightening around three months before equities bottom, and shifted to easing about two months afterwards. More recently, GS posited that there were two ways for the market to move beyond current dynamics: 1) if the market pivots towards fear of an outright recession (where we could expect stocks to stay pressured, but yields would likely move lower); 2) if the inflation picture improves, and the Fed's tightening is seen to be having an impact (GS says this would be a relief to both bonds and equities in the short term).

CBR REVIEW: The CBR this week announced it would hold an unscheduled meeting, where it cut rates by 300bps for the second time within a month (200bps cut was expected) to 11.0%, continuing to lower key rates amid strength in the currency and as it continues to receive energy revenues. Analysts have noted that the rise in the Rouble currency has helped stabilise inflation – the last two weekly reports have showed flat readings, while inflation expectations are cooling. The CBR also assesses that financial stability risks have eased, and Capital Economics argues that this may be a sign that policymakers will return their focus to the struggling economy. Going forward, CapEco does not see the central bank discontinuing this pace of easing, and notes that "whereas the statement from the scheduled Board meeting in late April said that the CBR 'sees room' for rate cuts, the language in the latest statement was less definitive – the CBR now 'holds open the prospect' for rate cuts." CapEco thinks that against a backdrop of high energy revenues and a strengthening currency, the CBR could further ease capital controls ahead, in addition to rate cuts. "We've brought forward some of the cuts in our interest rate profile and now expect the one-week repo rate to end the year at 8.00% (previously 10.00%)," CapEco said.

RBNZ RATE DECISION REVIEW: The RBNZ rate decision was viewed as a hawkish rate hike in which it opted to maintain the more aggressive pace of a 50bps increase for a second consecutive meeting to lift the OCR to 2.00%, as expected. The central bank raised its OCR forecasts which it sees peaking at nearly 4% in Q2 next year and would therefore be above the central bank's range of estimates for the neutral rate of around 2%-3%, while the committee agreed to continue to lift the OCR to a level that will confidently bring consumer price inflation to within the target range. RBNZ also stated that monetary conditions need to constrain demand until there is a better match with productive capacity but noted that once aggregate supply and demand are more in balance, the OCR can return to a lower and more neutral level. Furthermore, they agreed stabilising inflation is its priority and that a higher level of OCR is necessary to ensure annual inflation returns to the target range in the next two years, as well as noted that the risk of doing too little too late is worse than doing too much too soon. At the press conference, Governor Orr stated that they are very focused

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on restraining aggregate demand and need to anchor inflation expectations, while they believe without a doubt that there is a lot more work ahead on rates. This has supported expectations that the central bank will stick to the 50bps increments with Westpac, ASB Bank and Bank of New Zealand among those anticipating the RBNZ to maintain the current pace of rate hikes at the July and August meetings.

BOK RATE DECISION REVIEW: BoK hiked its 7-Day Repo Rate by 25bps to 1.75%, as expected with the decision unanimous, while it raised its 2022 inflation forecast to 4.5% from 3.1% and the 2023 forecast to 2.9% from 2.0%. BoK also noted that consumer price inflation is to remain high in the 5% range for some time and sees it as warranted to conduct monetary policy with more focus on inflation, which supports the view the central bank will continue with its tightening cycle. The decision by the BoK to increase rates in the first meeting under the stewardship of newly appointed Governor Rhee, was widely anticipated as Rhee previously stated that the BoK should continue rate hikes unless it poses a problem for growth and that household debt needs to slow on continued policy tightening, while he also previously kept the door open to the possibility of a future 50bp move but suggested to wait for the data from July-August to determine if it is required.

CBRT ANNOUNCEMENT REVIEW: As widely expected, the Turkish Central Bank (CBRT) maintained its One-Week Repo Rate at 14.00%. The CBRT reiterated that it “will continue to use all available instruments decisively within the framework of its liraization strategy until strong indicators point to a permanent fall in inflation and the medium-term 5 percent target is achieved in pursuit of the primary objective of price stability.” The central bank also said collateral and liquidity policy actions, of which the review process is finalized, will be implemented. The bank pointed the blame for inflation on the rising energy costs arising from “geopolitical developments and temporary effects of pricing formations that are not supported by economic fundamentals,”. The release did not offer anything by way of fireworks. Analysts at Credit Suisse believe “The MPC is currently monitoring the ‘cumulative impact of the recent policy decisions’, which suggests to us that it will likely remain on hold in the foreseeable future”, and added that “The authorities will probably continue to implement ad hoc measures as long as they can in order to sustain what we view as this ultimately unsustainable policy stance.” The Swiss bank believes that the timing of a switch back to conventional policy hinges on politics as presidential/parliamentary elections will be held no later than mid-2023.

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