Central Bank Weekly June 3rd - Previewing ECB, RBA, CBR, RBI; reviewing BoC

3rd June 2022:

RBA RATE DECISION (TUE): The RBA is expected to continue hiking rates, and analysts expect a 25bps increase to the Cash Rate Target, taking it to 0.60% from the current level of 0.35%; OIS fully priced in a 25bps hike, and imply that there is probability for a more aggressive move. As a reminder, the central bank surprised markets at its last meeting by delivering a larger-than-expected increase of 25bps (exp. 15bps), and stated that further rises in interest rates would be required in the period ahead, adding that it was committed to doing what is necessary to ensure that Australian inflation returns to target over time. Minutes from that policy meeting noted that the Board considered three options: a 15bps, a 25bps and a 40bps rate rise, ultimately coming to the conclusion that a 15bps increase would have been inconsistent with the historical practice of changing the Cash Rate in 25bps increments, while an argument for a 40bps increase could be made given the upside risks to inflation and current very low level of interest rates. Governor Lowe has also kept the door open regarding the pace of rate increases, recently stating that he does not preclude bigger or smaller rate moves in the future, and that the Board was not on a pre-set path. As such, there are varied expectations for the upcoming meeting. Goldman Sachs anticipates the RBA will lift rates by 50bps at its next two meetings; Westpac has upgraded its call for June to a 40bps hike from a prior view of 25bps; AMP Capital expects the RBA to stick with a 25bps move; ANZ Bank suggested that a 40bps RBA hike in June will likely be discussed, but caveated that a Wage Price Index of +1.0% would be needed to trigger a 40bps move, and this failed to materialise with the Wage Price Index softer than expected at 0.7% vs. Exp. 0.8%.

RBI RATE DECISION (WED): Although India’s central bank is expected to lift rates, there are a wide range of views regarding how far the MPC will increase its Repurchase Rate (currently at 4.40%, Reverse Repo Rate at 3.35%, Cash Reserve Ratio at 4.50%). The RBI surprised markets with a rate hike during an off-cycle meeting last month, raising the Repurchase Rate by 40bps via a unanimous decision, and also increased its Cash Reserve Ratio by 50bps. MPC members unanimously decided to remain accommodative, while focusing on the withdrawal of accommodation, to ensure that inflation remains within the target going forward, while supporting growth. Since that decision, policymakers have made clear that rates will continue moving higher. Governor Das noted that it broadly wants to increase rates in the next few meetings, and that “the expectation of a hike is a no-brainer”. The Governor also said that a reason for the off-schedule meeting last month was to avoid a much stronger move at the upcoming meeting, while MPC member Varma said more than a 100bps rate increase is needed very soon. These intentions to tighten policy by the central bank are not too surprising given the surging inflationary environment; the latest CPI data rose to 7.79% vs. Exp. 7.5% (Prev. 6.95%), for instance, a level above the central bank’s 2-6% tolerance range, and has divided analysts’ forecasts between hikes of 25bps-75bps for next week.

ECB RATE DECISION (THU): Since its previous meeting, Eurozone inflation has continued to pick up, with the headline rising from 5.9% Y/Y to 7.4% Y/Y in April, and then extending to 8.1% in May. This has struck a sense of alarm at the central bank, which has resulted in an increasingly hawkish tone from members of the Governing Council. A blog post in May penned by President Lagarde deviated from her usually non-committal stance; she now expects “net purchases under the APP to end very early in the third quarter. This would allow us a rate lift-off at our meeting in July”. Furthermore, she added that “we are likely to be in a position to exit negative interest rates by the end of the third quarter”, going on to state that “even when supply shocks fade, the disinflationary dynamics of the past decade are unlikely to return”. This was viewed as giving the green light for purchases under APP to cease as of July 1st, paving the way for rate hikes at the July and September meetings, analysts said. Note, despite the pressing need to move on rates, the current sequencing between asset purchases and rate hikes means that a hike to the deposit rate will not take place at the June confab. For some of the more hawkish voices on the GC, such as Austria’s Holzmann, the recent inflation metrics emphasise the need for a 50bps hike. However, this is an issue that is unlikely to be resolved at the upcoming meeting given that the discussion around the magnitude of a hike will likely be a feature of the July gathering. In terms of market pricing, at the time of writing, the market looks for around 120bps of tightening this year, which would imply 25bps hikes at the four meetings after June, with an increasing likelihood of a 50bps hike at one of those meetings. Given the need for flexibility and lack of certainty surrounding the Eurozone outlook, it is hard to see how much vindication market participants will get for the aforementioned rate path. We will also be presented with the latest batch of macro projections from the Bank which will inevitably see an upgrade to the current 5.1% forecast for 2022 inflation. Of potentially greater interest will be the more medium-term forecasts and how they align with the Bank’s 2% target.

Finally, reporters will likely use the Q&A segment to question Lagarde on reports over a “new tool” designed to combat fragmentation in the Eurozone as the ECB begins to normalise policy. That said, it is unlikely that Lagarde will give much away on this front and instead stress the flexibility of existing tools.

CBR RATE DECISION (FRI): Some believe that less hawkish policy from Russia’s central bank has helped to stabilise the growth outlook. A Reuters poll saw economic forecasts improve in May despite the sanctions being slapped on the country in wake of its aggression against Ukraine. On the prices front, the Reuters poll suggested that inflation is seen rising from 8.4% in 2021 to 16.4% by the end of this year, with analysts cutting their view from forecasts made in April, when the consensus expected inflation would rise to above 20% this year. The poll said that this should continue to give the CBR space to lower rates further; it cut its key rate by 300bps to 11.00 in an unscheduled May meeting, and analysts think that rates could fall to 8.00% by the end of this year (in April, there was an expectation that rates would eventually fall to 10.5% this year).

BOC REVIEW: The Bank of Canada hiked rates by 50bps to 1.75% and announced it was continuing with its QT process, as expected. Some analysts were flagging potential risks of a 75bps rate rise, although this was not the base case, and while that was not forthcoming, there was a hawkish tilt in the statement. The BoC said that it was "prepared to act more forcefully if needed" to meet its inflation target, adding the word 'forceful', which some analysts said could possibly open the door to a potential 75bps move in the future. Canadian bank RBC is still calling for a 50bps move in July, however, which would take the Overnight Target Rate to the lower bound of neutral (which is estimated at somewhere between 2-3%), before turning to 25bp increments in September and October, and reaching a terminal rate of 2.5%. The BoC's tone on inflation was also hawkish, noting that risks of elevated inflation becoming entrenched had risen, inflation continues to broaden and it was persisting well above target, and is expected to further rise in the near term. However, the central bank has been encouraged by activity in the Canadian economy, noting that it was strong, and clearly operating in excess demand conditions, suggesting it is not too concerned about a slowdown as a result of its policy tightening. On the risks to the outlook, the BoC said that the invasion of Ukraine, China lockdowns and supply chain disruptions were all weighing on activity and boosting inflation, which may perhaps keep the Bank from shifting to more aggressive 75bps moves. On housing, it noted that activity was coming off exceptionally high levels, and that was a welcome sign as the impact of the BoC's normalisation process takes effect. RBC highlighted that the BoC passed on several opportunities in Wednesday's statement and instead put focus on the many arguments for further tightening.