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Central Bank Weekly June 17th :Previewing PBoC, Norges, CBRT; reviewing FOMC, BoE, BoJ, SNB, BCB

17th June 2022:

PBOC LOAN PRIME RATES (MON): There are mixed views on whether the PBoC will maintain or cut its Loan Prime Rates on Monday with the 1-Year LPR currently at 3.70% and the 5-Year LPR at 4.45%. As a reminder, the PBoC defied expectations of a 5bps cut to the 1-Year LPR last month and kept it unchanged, but delivered a surprise 15bps cut to the 5-Year LPR (exp. unchanged) which is the reference for mortgages, although this wasn't too much of a shock given that the central bank had maintained the 1-Year MLF Rate and effectively cut interest rates for first-time homebuyers by 20bps in the days before the decision. Since then, there has been an easing of COVID restrictions in China and the data releases have also improved with Industrial Production showing a surprise expansion of 0.7% vs. Exp. -0.7% (Prev. -2.9%) in May and Exports also firmer than expected at 16.9% vs. Exp. 8.0% (Prev. 3.9%), which suggests less urgency to cut the benchmark lending rate. Nonetheless, UOB still sees downside risks to the economic recovery in H2 due to China's zero-COVID policy and has lowered its forecast for GDP growth to 4.1% from 4.9% for this year, while it continues to see room for further monetary policy easing, including a 5bps cut to the 1-Year LPR next week and a future RRR cut as MLF maturities increase in H2.

RBA MINUTES (TUE): The RBA will release minutes from the June meeting where the central bank hiked rates by 50bps to 0.85% (exp. 25bps increase) and noted that inflation in Australia has increased significantly, while it reiterated its commitment to doing what is necessary to ensure that inflation returns to the target over time. The RBA also stated that inflation is likely to be higher than expected a month ago and that the Board expects to take further steps in normalising monetary conditions over the months ahead, with the size and timing of future interest rate increases to be guided by incoming data and the assessment of the outlook for inflation and the labour market. Furthermore, it noted that the Australian economy is resilient, although one source of uncertainty about the outlook is how household spending evolves, given the increasing pressure on finances from higher inflation.

NORGES BANK (THU): Within the May policy announcement, the Norges Bank pointed markets towards a hike taking place at the June gathering. At that point in time, the general assumption was that the June increase would be 25bp in magnitude taking the Policy Rate to 1.00%. However, we have seen pronounced and unexpected monetary policy tightening since then with the Fed lifting rates by 75bp and the SNB by 50bp, while the ECB held an emergency meeting on fragmentation. Given this, the bar for a 50bp move has, perhaps, been lowered. Typically, the Regional Network report is one of the key contributors for policy makers in terms of assessing the economy, but given the dated survey period and above developments since publication, the value of the findings are somewhat diminished. Reminder, the Norges Bank has previously intimated conditionality between the prospect of persistently higher inflation and quicker rate hikes occurring. May's headline ATE inflation print was 3.4% YY, significantly above the Norges Bank's 2.9% 2022 peak prediction and its May forecast of 2.6% for the metric. Given the hotter than expected inflation reading and recent global Central Bank policy action, a 50bp move is a possibility; although, SEB does not view this as necessary, believing inflation is not showing signs of "persistence" and a 50bp move could be detrimental to households.

CBRT (THU): The Central Bank of Turkey will likely keep rates unchanged once again next week, leaving its one-week repo rate at 14.00% despite super hot inflation. Analysts at Credit Suisse expect headline inflation to remain in the 60-70% area through November, and while the CBRT is monitoring the "cumulative impact of the recent policy decisions", it suggests to Credit Suisse that the Central Bank will keep policy on hold for the foreseeable future. "This means that the real policy rate will move deeper into negative territory in the coming period, leaving the lira vulnerable to further depreciation and keeping the risks to our inflation forecasts firmly to the upside". The desk also believes uncertainty from Lira depreciation in context of inflation is larger than prior experiences of TRY deterioration and expects authorities in Turkey will "continue to implement ad-hoc measures as long as they can in order to sustain what we view as this ultimately unsustainable policy stance".

BANXICO (THU): After Banxico's 50bps hike in May expectations have been building towards a 75bps hike after it added language that taking more forceful measures to attain its inflation target may be considered due to growing complexities in the environment for inflation and its expectations. The vote split in May was not unanimous either, where Espinosa voted to raise the Bank Rate by 75bps instead. Meanwhile, the minutes saw that all members noted inflation expectations for 2022 and 2023 have increased considerably. Since then, the FOMC has also hiked by 75bps, which will likely see Banxico follow suit. Analysts at Rabobank expect Banxico to hike by 75bps on Thursday, but looking ahead the desk expects another 75bp move in August, followed by two more 50bps and then a final 25bp hike in December to

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end the tightening cycle at 9.75%. Rabo notes this is a faster and higher terminal rate than they initially expected and is a result of the Fed's increased pace of normalisation, hawkish Banxico rhetoric and a continued rise in core inflation. The latest inflation data for May saw M/M core inflation rise 0.59%, cooling from 0.78%, but still above the 0.55% expectation while headline inflation rose 0.18%, only marginally above expectations. Y/Y core inflation rose 7.28%, up from 7.22% and above the 7.24% forecast, while the headline Y/Y print rose 7.65%, from 7.68% and above the 7.26% consensus. Although Rabo revised higher its rate forecast for the Banxico, they have maintained their USD/MXN view and expect it to trade within a 20-21 range over the coming months.

FOMC REVIEW: The Federal Reserve lifted the Federal Funds Rate target by 75bps to 1.50-1.75%, in line with the recent reports heading into the meeting, and continues to anticipate that ongoing increases in the target range will be appropriate, adding that it was strongly committed to returning inflation to its 2% objective. Esther George dissented, calling for just a 50bps hike, to which we await her reasoning (typically released on the Friday of the meeting week), but it is likely to be based off her prior comments that she requires something "very different" for a larger hike and her expressed hesitancy to invert the yields curve. A key statement change saw the following line removed, "With appropriate firming in the stance of monetary policy, the Committee expects inflation to return to its 2 percent objective and the labor market to remain strong", and replaced with "The Committee is strongly committed to returning inflation to its 2 percent objective", which SGH Macro's Tim Duy sees as the Fed's acknowledgement that both sides of the mandate are no longer possible in the near term. The statement gave no explicit signal regarding the size of the Fed's July move, although the updated projections see rates rising to 3.25-3.50% by the end of this year, implying the possibility of a 75bps hike in July, followed by a 50bps hike in September, and then 25bps at its November and December meetings; however, it could also be interpreted as three 50bps rate rises followed by a 25bps move – this suggests that incoming data on inflation is likely to guide officials in July. However, some analysts are already tilting towards the latter after Chair Powell said he did not expect moves of 75bps to be common, but either 50bps or 75bps in July would seem most likely. Either way, the messaging seems to be that the decision will be guided by incoming inflation data, as it was in June. The new forecasts see interest rates peaking at 3.75-4.00% in 2023, implying a front-loaded hiking cycle with the prospect of a further two 25bps rate rises next year. The Fed then envisages rates falling back in 2024. The Committee raised its estimate of the neutral rate marginally to 2.5% from 2.4%, which still implies that policy will move into restrictive territory by the end of this year. Accordingly, the FOMC revised down its projections of growth to 1.7% this year vs its 2.8% forecast made in March, and has pencilled in growth at the same rate next year, before rising in 2024 to the longer-run growth rate of 1.9%. The projections suggest a soft landing, something Powell said in the Q&A that he still thinks can be achieved, but did concede that outside events have made it harder, "we just don't know if we can", he warned. There is also an allusion to the impact of slower growth on employment; within its statement, the Fed removed language that it "expects the labour market to be strong," and now projects unemployment at 3.7% at the end of this year (from its previous 3.5% forecast), rising to 3.9% in 2023 (prev. 3.5%), and 4.1% in 2024 (prev. 3.6%), but still sees the longer-term unemployment rate at 4.0%. Meanwhile, its core inflation view was raised by 20bps this year to 4.3%, before easing to 2.7% next year, and then 2.3% in 2024. Analysts at Barclays, who were the first major bank to call for a 75bps rate rise in June, noted that the increment was a strong move from the central bank, calling it a "statement hike," but believes the FOMC will move to a 50bps rate rise at the July meeting given the challenging conditions the economy is seeing, particularly within the housing sector.

BCB REVIEW: Brazil's central bank voted unanimously to raise its Selic rate by 50bps to 13.25%. Although the rate decision was in line with expectations, analysts said the statement was more hawkish than expected, since the central bank suggested it could raise rates further in the months ahead; there was a building expectation that the COPOM could have signalled the end of the hiking cycle at this meeting. "The Copom foresees a new hike of the same or lower magnitude, which then leaves little to no room for stopping the hiking cycle at 13.25%," Rabobank said, "this is the more hawkish aspect of this statement, raising the odds of driving inflation expectations closer to the target." But Rabo notes that the central bank now also says that its strategy is consistent with inflation convergence to 'a level around' its target, instead of its target midpoint; Rabo says that this is a sign that the current monetary policy cycle is at a very advanced stage. The bank now sees COPOM firing its final rate hike in August, lifting rates by 50bps to 13.75%; it then sees a pause, before an easing cycle starts in Q1 2023, which Rabo thinks will eventually see the Selic rate reduced to 9.50% by the end of next-year.

BOE REVIEW: As expected, the MPC opted to raise rates by 25bps, taking the Bank rate to 1.25% via a unanimous decision. The decision to increase was unanimous, but there was disagreement over the necessary magnitude with three dissenters (Haskel, Mann and Saunders) opting for a 50bps increase on the basis that "faster policy tightening now would help to bring inflation back to the target sustainably in the medium term". Policymakers opted to continue with their rate hiking cycle on the basis that CPI inflation is expected to print over 9% during the next few months and to rise to slightly above 11% in October. Furthermore, the MPC judges that indicators remain consistent with a tight labour market. From a growth perspective, Bank staff analysis suggests that the Government's recent Cost of Living Support package could boost GDP by around 0.3%. That said, Q2 GDP is now expected to contract by 0.3%, which would be a worse outturn than expected at the time of the May MPR. Elsewhere in the statement, the MPC opted to remove prior guidance which noted that some degree of further tightening in monetary policy may still be appropriate in the coming months.

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This was replaced with language noting that "the Committee will be particularly alert to indications of more persistent inflationary pressures, and will if necessary act forcefully in response". Some have suggested that this could pave the way for a 50bps increase in August. However, we are yet to see from MPC members themselves if this is the correct interpretation of the adjustment. From a medium-term perspective, the MPC remains at pains to stress that the current implied market path for the Bank rate would push inflation "well below" target in three years' time and as such continues to object to current market pricing. That said, at the time of writing, markets are not willing to play ball on this front with the year-end Bank Rate seen at 3% which would imply some combination of 7 x 25bps (three 50bps rises and one 25bps) hikes at the remaining four meetings of the year.

SNB REVIEW: An unexpected 50bp rate hike from the SNB accompanied by the Bank not ruling out further increases. A move that exceeds even the most 'hawkish' calls for a June 25bp hike going into the meeting. The driver for the SNB is the inflation situation, with the Bank noting that since the March gathering there has been a further considerable and broad-based increase in inflation in many nations. A concern that is evidenced by the new inflation forecasts only showing CPI marginally below the 2.00% target at 1.90% in 2023, when conditioned on the 50bp hike. In the subsequent press conference, Chairman Jordan made this point clear by remarking that without the hike, forecasts would be more pronounced; adding, that it would be difficult to reduce inflation if it was persistently above the 2.00% target. Elsewhere, the CHF classification was omitted from the statement and not mentioned until the presser where Jordan described it as no longer highly valued, given high inflation and its depreciation. Finally, but unsurprisingly given the hike, the exemption threshold was reduced to 28x (prev. 30x). Overall, the decision was a significant hawkish surprise which sparked a rout for equities and pronounced global yield and CHF upside in its wake as the SNB took action to prevent inflation becoming entrenched above target; note, June's inflation print is due on July 4th, May's YY reading was 2.90%.

BOJ REVIEW: The BoJ kept policy settings unchanged as expected with rates at -0.10% and QQE with yield curve control maintained to target 10yr JGB yields at around 0%, and the decision on YCC made via an 8-1 vote as Kataoka dissented. The BoJ was widely expected to maintain its ultra-easy policy settings as officials have repeatedly reinforced their dovish rhetoric, although there was increasing speculation heading into the meeting that the central bank may have to rethink its policies including adjusting or even abandoning YCC owing to the recent rapid JPY depreciation. Nonetheless, the BoJ refused to conform to the tightening trend amongst its global counterparts and stuck with a dovish stance in which it reiterated guidance to conduct fixed-rate bond operations every working day unless bids are not expected and maintained guidance that it will take additional easing steps without hesitation as needed. Furthermore, it noted that the economy is picking up as a trend, though some weakness has been seen and that they must carefully watch the impact of FX moves on Japan's economy and prices, while the timing of the release was relatively swift (13 minutes into the Tokyo lunch break), indicating a lack of lengthy debate over the outcome.

PBOC REVIEW: China's central bank kept its 1yr MLF rate unchanged at 2.85%. UOB's analysts said "as the outlook is still fragile, we maintain our view that there is room for further monetary policy easing including a cut to the banks' reserve requirement ratio as the MLF maturities increase in the second half of the year," adding that "overall, we expect the 1yr LPR to move lower to 3.65% in June, and then to 3.55% by end of Q3 2022 following earlier easing measures by the PBoC." UOB notes that the May activity data was better than feared, with industrial production showing resilience; but retail sales still contracted for the third consecutive month, the urban unemployment rate is above the official target, while fixed asset investment slowed - the latter could benefit, however, from increased infrastructure spending later in the year. "Taking into consideration of the data released, we think China's economy will avoid a contraction in Q2 2022, which we are now expecting growth of around 1.0% Y/Y, and thereafter, a lower comparison base and government's stimulus will boost GDP growth to slightly above 5% Y/Y in H2 2022" as China's zero-COVID policy continues to pose downside risks to the recovery. Additionally, the bank notes increasing headwinds to global growth as higher inflation prompts central banks to aggressively tighten policy.

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