Central Banks Weekly July 1st: Previewing RBA, FOMC minutes, ECB minutes, reviewing Riksbank

1st July 2022:

RBA ANNOUNCEMENT (TUE): The RBA is expected to increase rates for a third consecutive meeting next week with the central bank forecast to deliver another 50bps hike in the Cash Rate Target to 1.35%. As a reminder, the RBA raised rates by 50bps to 0.85% (exp. 25bps increase) at its meeting last month and noted inflation had increased significantly, while it is committed to doing what is necessary to ensure inflation returns to target over time. The Bank added that the Board expects to take further steps in the process of 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. Since that meeting, RBA Governor Lowe has sounded more hawkish on inflation which he suggested could hit 7% by Christmas and does not believe it will drop until Q1 next year, while he stated it is unclear how high rates will need to go, but suggested 2.50% was a reasonable level. Furthermore, Lowe noted they discussed a 25bps or 50bps hike at the June meeting and expect to discuss the same options this month as well. This subsequently saw markets price out the chance of a more aggressive move and supports the view that the central bank will maintain the current pace of 50bps which Westpac expects for both July and August, while Goldman Sachs forecasts the RBA to move by 50bps at each meeting through September.

FOMC MINUTES (WED): At its June meeting, the Fed lifted rates by 75bps to 1.50-1.75%, and said it continued to anticipate that ongoing hikes would be appropriate, adding that it was strongly committed to returning inflation to its 2% objective. A key statement change saw the line “with appropriate firming in the stance of monetary policy, the Committee expects inflation to return to its 2% objective and the labour market to remain strong” removed and replaced with “the Committee is strongly committed to returning inflation to its 2% objective.” The statement gave no explicit signal regarding the size of the Fed’s July move, although officials have been suggesting that it is likely to be a debate between a 50bps and a 75bps rate hike. Money markets appear to be tilting towards the latter, even after the May PCE report showed inflationary pressures continue to cool. The updated economic projections pencil in rates rising to 3.25-3.50% by the end of this year; that implies 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. The forecasts see 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. Fed’s Bullard, who votes in 2022, recently said that the Committee’s playbook may look similar to the 1994 cycle, where aggressive rate hikes were then followed by rate cuts the next year; the minutes will be looked at to see if this is a widely held view on the Committee. Elsewhere, 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.

ECB MINUTES (THU): As expected, the ECB opted to stand pat on rates with the deposit rate, main refi and marginal lending rates held at -0.5%, 0% and 0.25% respectively. On rates, the ECB announced its intention to tighten by 25bps at the July meeting. Beyond July, policymakers stated they will consider a larger increment in interest rate hikes if the medium-term inflation outlook persists or deteriorates. On the balance sheet, as expected, the Governing Council announced its decision to end net asset purchases under the APP as of July 1st. Note, the policy statement offered no fresh guidance on how it could deal with the issue of market fragmentation as it commences its rate hiking cycle. The 2022 inflation outlook was upgraded to 6.8% from 5.1% with 2024 inflation seen above target at 2.1% vs. prev. view of 1.9%. At the accompanying press conference, President Lagarde was pressed further on how the Bank intends to deal with fragmentation, to which she noted that the Bank can utilise existing tools, such as reinvestments from PEPP and, if necessary, deploy new instruments. Later in the press conference, Lagarde noted that there is no specific level of yield spreads that would be a trigger for an anti-fragmentation policy. When it comes to the decision-making process, Lagarde stated that policymakers were unanimous in their views. From a more medium-term perspective, the President was questioned on where the Governing Council judges the neutral rate to be, however, she remarked that this issue was deliberately not discussed. As ever, given the time lag between the announcement and the publication of the accounts, traders will take greater guidance from recent data points and commentary from officials. Furthermore, when it comes to the issue of fragmentation, the ECB carried out an ad-hoc meeting to address the matter and therefore the account will offer little in the way of insight on that front.

RIKSBANK REVIEW: Riksbank opted for a 50bps hike to its Policy Rate to 0.75% - in line with market pricing, and said the rate would be raised further and it will be close to 2% at the start of 2023. Inflation was the main theme of the release, which warned that “Inflation has risen rapidly and is expected to remain above 7 per cent for the remainder of the year” and “the risk of the high inflation becoming entrenched in price setting and wage formation has thus increased.” On QE, the bank said its asset holdings would shrink faster than was decided in April in H2. The Riksbank will purchase bonds for SEK 18.5bln instead of the earlier decided SEK 37bln. The decision was framed as a hawkish hike with the new path suggesting a potential 125bps further tightening by year-end with the Riksbank vowing to raise rates faster if deemed necessary. Looking ahead, the central bank has only two meetings left this year. Governor Ingves suggested inflation over the forecast is probably not enough for Riksbank to hold an extra policy meeting in the summer, but if the situation requires a 75bps hike, then Riksbank will carry out a 75bps hike. Analysts at ING “expect the Riksbank to stick to its hawkish rate path in September” but suggested the November meeting is uncertain given fears of a global recession.