Central Banks Weekly July 8th: Previewing RBNZ, BoK; Reviewing FOMC and ECB minutes

8th July 2022:

RBNZ ANNOUNCEMENT (WED): The RBNZ is forecast to increase rates for a 6th consecutive occasion at its meeting on Wednesday with the central bank likely to hike the Official Cash Rate by another 50bps to 2.50%. As a reminder, the central bank has conducted back-to-back 50bps increases in the past 2 meetings and was even more hawkish during the last one as it lifted its OCR forecasts which it sees peaking at nearly 4% in Q2 next year and increased its view on CPI, while the RBNZ suggested that rates are to surpass neutral as monetary conditions will need to act as a constraint on demand and that the risk of doing too little too late is worse than too much too soon. Governor Orr also noted the RBNZ is resolute in its commitment to price stability and very focused on restraining aggregate demand, while he stated the range of estimates for the neutral rate is around 2%-3% and that they need rates above 3%. This hawkish rhetoric from the central bank has reinforced the view that it is to maintain the current tightening path with ASB Bank and Bank of New Zealand both expecting the RBNZ to raise the OCR by 50bps in both July and August, while the NZIER shadow board also predicts a 50bps move at the upcoming meeting.

BOK ANNOUNCEMENT (THU): The Bank of Korea is expected to continue its hiking cycle with the central bank likely to increase the 7-Day Repo Rate from the current 1.75% level. As a reminder, the BoK conducted a 25bps increase at the prior meeting via a unanimous decision and it also raised its 2022 inflation forecast to 4.5% from 3.1%, while Governor Rhee noted that the policy focus will remain on stabilising prices for a few months and that the damage to the economy would be greater if the BoK missed out on rate hikes. Furthermore, Deputy Governor Lee said they need to tame inflation via pre-emptive policy and suggested rate hikes of 25bps are appropriate for now, but added that the door remains open for a big step and the need is growing for a policy response to stabilise inflation expectations. These hawkish comments by the central bank therefore support the view for the BoK to maintain its hiking pace, although firmer than expected CPI data for June, which rose by 6.0% vs. Exp. 5.9% and was the fastest pace of increase since November 1998, has spurred calls for a more aggressive move as a high ranking official at the central bank previously suggested the BoK is likely to weigh more on a 'big-step' rate increase if inflation in June reached 6% and Governor Rhee had also stated that all options, including a 50bps hike are on the table should high inflation persist. As such, analysts at SocGen are anticipating a 50bps hike to 2.25% and raised its terminal rate view to 3.00% from 2.50% whereby it expects next week's meeting to be followed by 25bps increases in August, October and November, with the hiking cycle to end thereafter as it believes inflation will peak in Q4 and concerns over the growth outlook to increase.

FOMC REVIEW: The FOMC's minutes from its June meeting revealed little by way of new information, and reiterated recent remarks from Fed Chair Powell that participants judged either a 50bps or 75bps rate hike would likely be appropriate at the July 27th confab. Participants agreed that the economic outlook warranted moving to a restrictive stance of policy and recognised the possibility that an even more restrictive stance could be appropriate if elevated inflation pressures were to persist, but officials stressed that they would take a data-dependent approach. Capital Economics said that the minutes showed that officials were in a "hawkish mood, rattled by the further sharp rise in underlying price pressures in April and May." Nevertheless, CapEco notes that a lot has changed over the past couple of weeks, as commodity prices fall back amid fears of a slowdown in global growth. The minutes noted that uncertainty was elevated over the next couple of years, and most assessed risks to the outlook for growth were skewed to the downside; however, the minutes did not make any mention of a "recession", and their recent economic projections also see growth holding up this year. CapEco points out that although officials thought that "consumption spending had remained robust", revisions to the data mean that Q1 was much weaker than believed at the time of the June FOMC, while Q2 could also be a challenging quarter. Additionally, at the meeting, most Fed officials agreed that risks to inflation were skewed to the upside; CapEco says it wonders whether Fed officials would say the same now, with a broad range of commodity prices in free fall. "June CPI will still show a big month-on-month rise in prices due to surging energy, but all of those gains are now likely to be fully reversed in July," it says, "in the immediate aftermath of the mid-June meeting, comments from officials suggested that another 75bps hike was the most likely outcome in late July, but recent developments leave the odds of 75bps versus 50bp much closer to 50/50."

ECB MINUTES REVIEW: The account of the ECB's June meeting saw policymakers conclude that on the basis of its updated assessment, it was deemed appropriate to take further steps in normalising monetary policy. Furthermore, monetary policy normalisation in the euro area was expected to proceed at a significantly faster pace than at the time of the Governing Council's 13-14 April meeting, with a rate lift-off expected in July. When it came to the magnitude of rate increases, the Governing Council expressed its intention to increase the key ECB interest rates by 25bps at its monetary policy meeting in July. However, a number of members expressed an initial preference for keeping the door open for a larger hike at the July meeting. Beyond July, it was judged that a larger (than 25bps) increment would be appropriate at the September meeting if the outlook for medium-term inflation had not improved by that time. Additionally, it was argued that if the monetary policy stance were normalised too slowly, monetary policy risked adding to demand pressures at a time when the economy was recovering from the pandemic and pressures on resources were already high. Moreover, it was cautioned that in communicating policy intentions for future meetings, the Governing Council should avoid unduly constraining its optionality and data-dependence. From a growth perspective, caution was expressed, whereby members broadly agreed with the downside risks to economic activity that the staff projections anticipated in the near term. That said, it was generally considered that stagflation was an unlikely outcome. With regards to fragmentation, a call was made for work on a possible new anti-fragmentation tool to be accelerated and completed rapidly since the risk of fragmentation could intensify as the ECB advanced with its monetary policy normalisation; a policy measure which was announced at a subsequent emergency meeting. Overall, the account offered little in the way of fresh insight to the market beyond the possibility of a potentially (not a base case assumption) larger-than-25bps hike at the July meeting; something which the hawks on the GC could look to push for a front-loading of normalisation before the growth outlook gets even bleaker towards the end of the year.

RBA REVIEW: The RBA decision to hike by 50bps was widely expected and the central bank refrained from any hawkish surprises as it reiterated that the Board expects to take further steps in the process of normalising monetary conditions, with the size and timing of future interest rate increases to be guided by the incoming data and the Board's assessment of the outlook for inflation and the labour market. Furthermore, the central bank noted that although Australian inflation was high, it was not as high as in other countries and it forecast inflation to peak this year before declining back towards the 2-3% range next year. Desks suggest the Governor’s statement also provides ample flexibility for the August confab. “From our perspective, the key objective of scrutinising the Statement was to detect whether there appeared to be any clear signal that the Board planned to scale back the sequence of 50 basis point moves which we have now seen for two consecutive months.” Westpac says, adding that “we are very comfortable that the Board will decide on a further 50 basis point lift at the August 2 meeting. However, we are expecting the Board to pause in September and October.”