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Central Banks Weekly July 15th - Previewing PBoC, BoJ, ECB, SARB, CBRT, CBR; Reviewing BoC, RBNZ, BoK

15th July 2022:

PBOC LPR ANNOUNCEMENT (WED): The PBoC is likely to keep its benchmark lending rates unchanged next week with the 1-Year Loan Prime Rate currently at 3.70% and 5-Year Loan Prime Rate at 4.45%. The expectation for the central bank to maintain the LPRs follows its recent decision to keep the 1-Year Medium-Term Lending Facility rate unchanged, which is seen as a fairly reliable leading signal for the central bank's intentions and given that the PBoC has been reserved in its open market operations whereby it has conducted daily 7-day Reverse Repos liquidity injections at a meagre CNY 3bln to match maturing contracts. Furthermore, PBoC Governor Yi recently noted that policy will continue to be accommodative and considering inflation, real interest rates are "pretty low", which suggests tightening is off the table, while further loosening also seems unlikely as the central bank would prefer to avoid stoking currency depreciation or further reduce the attractiveness of Chinese government bonds with China's 10yr yield already at a gap to its US counterpart amid PBoC-Fed policy divergence. Nonetheless, prospects of a future rate cut cannot be dismissed given support pledges by Chinese authorities including PBoC's Monetary Policy Department Head Zou Lan who noted that China will further guide banks to lower real lending rates and with the central bank also stating it will use monetary policy tools flexibly at the appropriate time, while there are also expectations for China to miss its growth target with PBoC adviser Wang Yiming anticipating economic growth at 4.7% this year vs the official target of 5.5%.

BOJ POLICY ANNOUNCEMENT (THU): The BoJ is expected to maintain its policy settings at next week's meeting with the central bank likely to keep rates at -0.10% and QQE with Yield Curve Control to flexibly target 10yr JGB yields at around 0%. The BoJ has made it clear that it will sustain its ultra-loose policy, despite the rapid JPY weakening and trend of global central banks tightening policies, with Governor Kuroda noting that the central bank stands ready to ease policy further without hesitation as needed and expects short- and long-term policy rate targets to remain at current or lower levels. Furthermore, Kuroda noted shortly after the last meeting that he does not see a need for further policy easing now nor was he thinking about raising the cap on the BoJ's long-term yield target above 0.25% as this could result in higher yields and weaken the effect of monetary easing. Recent data releases have been disappointing and therefore support the view for the central bank to maintain its easy policy settings in which the Tankan Large Manufacturing and Non-Manufacturing Indices and Outlooks all missed expectations, although mostly improved from the prior quarter and Large All Industry Capex growth more than doubled against forecast. The latest Household Spending data showed a surprise contraction and Industrial Production also unexpectedly contracted, which prompted the government to lower its assessment of output, while National CPI Ex. Fresh Food remained slightly above the BoJ's 2% price target as expected at 2.1%, though this is unlikely to have ramifications for policy as the central bank has acknowledged that price increases were due to rising raw material costs and a weak Yen instead of being driven by a positive economic cycle, and therefore it would still be appropriate to keep its easing policy. The BoJ will also release its latest Outlook Report containing board members' median forecasts for Real GDP and Core CPI with recent source reports noting that the BoJ is expected to increase its FY22 inflation forecast marginally to slightly above 2% from 1.9% and lower its economic growth forecast from the current 2.9% view.

ECB POLICY ANNOUNCEMENT (THU): The ECB will deliver on its heavily flagged 25bp rate hike, a lift-off that will impact all three key rates and lift the main depo rate from -0.50% to -0.25%. Sources and commentary indicate that some of the more hawkish officials (e.g. Holzmann) on the GC want at least the optionality for a 50bp hike at this meeting, as such there could well be dissent on the vote. Note, in wake of the latest hot-US CPI data, market pricing turned significantly more hawkish for numerous central banks; with expectations for the ECB rising to circa. 25% chance of a 50 bp July move. Post-hike focus for the gathering will be, primarily, on three factors: the inflation assessment, guidance for September and the fragmentation tool. Firstly, the ECB's assessment of the inflation situation in June was that their projections indicated it will remain undesirably elevated for some time. Since then, June's EZ Flash inflation metrics have been released and posted another above-exp. increase to 8.6% from 8.1% (exp. 8.4%) for the headline; however, the super-core did incrementally and surprisingly dip to 3.7% from 3.8% - an occurrence that will be closely scrutinized to see if it's a one-off or the beginning of an easing in some price pressures. Nonetheless, the inflation situation remains hot and significantly above the 2.0% goal. As such, and secondly, the ECB's June guidance that if the inflation outlook persists/deteriorates a larger increment (re. hikes) would be appropriate in September; a condition that has, based on hard-data, likely been met. However, the 5yr5yr gauge of long-term EZ inflation expectations recently moved incrementally below the 2.0% target, for the first time since March. An occurrence that, if sustained, could offer

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some relief, but is unlikely to be sufficient to change the medium-term view and accompanying guidance for a 50bp hike in September; a magnitude that numerous officials have stated they anticipate. Finally, the fragmentation tool has, according to Bloomberg, been named the Transmission Protection Mechanism. Interestingly, the sources piece noted that there is not yet a sense of its certain arrival in July, and this rattled periphery debt in particular. Participants will be focused firstly on whether the tool arrives, and secondly its exact details following an emergency meeting to discuss it which added very little new information. However, subsequent sources indicate that the tool will involve the sale of other securities, in an attempt to prevent a further fanning of inflation. Additionally, PEPP reinvestment activity will reportedly have the periphery nations listed as “recipients” and the likes of Germany and the Netherlands “donors”, in a bid to prevent fragmentation. Reminder, the July meeting does not include new forecasts which are scheduled to be updated in September, but will, as always, feature a press conference from President Lagarde; additionally, the timings for the announcement and press conference are now 13:15BST/08:15ET & 13:45BST/08:45ET respectively.

SARB POLICY ANNOUNCEMENT (THU): The South African Reserve Bank is likely to lift its Repo Rate by a 50bps increment in July, taking the rate to 5.25%. The SARB lifted rates by 50bps in May, in line with the market view, with members seemingly supportive of a front-loaded rate hike programme. This is something many other major global central banks have been doing, and accordingly, EMFX like the South African Rand has come under pressure, compelling the SARB to adopt a similar strategy. ING notes that the Repo Rate at the current 4.75% level seems low relative to CPI, which is running at 6.5% Y/Y (NOTE: South Africa’s CPI data for June will be released the day before the SARB announcement). ING says the market expects rates will have risen to 6.00% by the end of this year, but the bank itself believes that ZAR weakness could prompt larger hikes.

CBRT POLICY ANNOUNCEMENT (THU): The central bank’s most recent monthly survey of business leaders and economists saw CPI expectations revised up, although those surveyed still see the repo rate at the current 14.00% in three-months’ time; in 12-months’ time, however, the expectation is that rates will have risen to 15.00% (vs 14.00% in the previous month’s poll). Credit Suisse has said that “Turkey’s recent monetary policy decisions have not been based on conventional economic principles,” noting that the central bank cut rates by a cumulative 500bps in late 2021 even as annual inflation was surging. Authorities have tried to protect the value of the currency with the TRY deposit scheme, launched late last year, but this ultimately has clouded visibility and predictability, the bank says. “The inflation outlook remains challenging,” it writes, “headline inflation will likely move toward 80% in the coming months and stay elevated through November - 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 bank sees rates at 14.00% in 12-months, but argues that this is not to suggest it thinks the current policy stance is sustainable; instead, it is a reflection that the timing of the policy adjustment required is impossible to predict. CS says, “that the timing of a conventional policy adjustment will also crucially hinge, in our view, on political considerations, in particular the presidential/parliamentary elections that will be held no later than in mid-2023.”

CBR POLICY ANNOUNCEMENT (FRI): Official commentary has primed us to expect another rate cut from Russia’s central bank in July, although the magnitude might not be as great as the 150bps reduction in June, which was motivated by declines in inflation, inflation expectations of household and corporates normalising, along with the RUB currency continuing to strengthen. And these themes may continue to support lower rates. Governor Nabiullina recently reiterated that the central bank will lower rates further as inflation slows, and she sees more scope for rate cuts, dismissing risks of a deflationary spiral. However, analysts note that household inflation expectations picked-up in June, and that could limit the CBR’s ability to lower its key rate from the current 9.5%. Potentially offsetting that, the central bank’s monthly business climate survey saw improvements, with companies noting that demand had stopped falling in May for the first time since February; although that data was for May it nevertheless highlights some of the themes that Russian officials have been impressing recently, like the improved expectations of businesses, and a less negative view of the current situation. Meanwhile, the RUB currency has largely moved sideways since the June meeting, though many note is at stronger levels against the USD now than it was in Q1 before Russia engaged in a conflict against Ukraine - another factor that could support a smaller increment cut in July.

BOC REVIEW: The Bank of Canada surprised with a 100bps hike, taking rates to 2.50%; analysts had expected the central bank to lift rates by 75bps. The statement stressed the need to bring inflation back to target and pledged to hike rates further, with the pace of future hikes to be guided by the BoC’s assessment of the economy. It also removed language to act “forcefully” to combat high inflation (signalling the 100bps move was deemed forceful in itself, and will unlikely happen again based on current inflation estimates, analysts say). In his press conference, Governor Macklem noted the reasoning behind the larger, “very unusual” hike was decided as the BoC wanted to front-load rate hikes. It believes that would better provide an opportunity for a softer economic landing, and means it can avoid having even higher rates down the road, while quick rate hikes prevent inflation from becoming entrenched. Macklem also stressed an economic slowdown was needed and there was room to reduce job vacancies without materially reducing unemployment. The BoC rate is now in the middle of its estimate of where the neutral rate is (2-3%), and the governor again signalled it is ready to move “quickly to the top-end or slightly above” neutral. Analysts at RBC suggest that a soft landing will be difficult to achieve, and expect a “mild recession” in Canada next year; the Canadian bank expects policy

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rates to rise to 3.25% by October (money markets currently pricing in between 50bps and 75bps rate hike in September, before rising to 3.5% in October). Meanwhile, the MPR saw growth revised significantly lower for 2022 and 2023, but slightly higher for 2024; inflation estimates were raised across 2022 through 2024.

RBNZ REVIEW: The RBNZ hiked the OCR by 50bps to 2.50%, as expected, which was the 3rd consecutive 50bps rate increase and 6th hike in as many meetings in the current tightening cycle by the central bank, while the RBNZ said it remains appropriate to continue to tighten policy and will tighten conditions at a pace to maintain price stability and support maximum sustainable employment. The RBNZ added that the Committee is resolute in its commitment to ensuring price inflation returns to the 1%-3% target range and it agreed to lift the OCR to a level where it is confident consumer price inflation will settle within the target range, but also said once aggregate supply and demand are more balanced, the OCR can return to a lower and more neutral level. Furthermore, the Committee agreed to maintain the approach of briskly lifting the OCR and remained comfortable with the projected path outlined in May, as well as noting near-term upside risks to consumer prices, but also medium-term downside risks to economic activity.

BOK REVIEW: The BoK raised its Base Rate by 50bps to 2.25%, as expected, with the decision made unanimously, while it stated that South Korea’s 2022 growth will moderate further from an earlier projection and was hawkish on inflation which it noted will remain high for some time. The central bank also stated that inflation will surpass the May forecast for the entirety of 2022 and that core inflation is to be higher than 4% for a considerable period. Furthermore, BoK Governor Rhee commented after the decision, which was the largest ever rate increase conducted by the central bank, that more policy tightening of 25bps increments look appropriate going forward should current inflation continue for the time being and that it is reasonable to expect rates at 2.75%-3.00% by year-end. This suggests the central bank will likely slow its tightening pace for the last 3 remaining meetings this year.

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