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Central Banks Weekly July 29th - Previewing BoE, RBA, BCB; Reviewing FOMC

29th July 2022:

RBA POLICY ANNOUNCEMENT (TUE): The Q2 CPI release seen this week has somewhat tempered and unified expectations for the RBA to hike by 50bps at its upcoming meeting – with money markets pricing in a 95.3% chance of such a hike, and a 4.7% probability of a 25bps move. To recap, headline CPI Q/Q and Y/Y both missed forecasts by 0.1 ppts, whilst the Trimmed Y/Y printed 0.2ppts above expectations and the Weighted Mean 0.1ppts under forecasts - the rest of the data was in-line with expectations. “A further 50bp in September will take rates to a level close to, but still slightly lower than, neutral (2.35%), and thereafter the RBA might consider that further moves can be done at a more leisurely pace depending on the run of data”, say the analysts at ING. Desks also point out that since the RBA meets each month, they have greater flexibility to react to data. All-in-all, given the recent set of numbers and as things stand, there are no expectations for the RBA to surprise, with Deutsche Bank and Goldman Sachs also revising their outside bets to a 50bps hike in August from their prior views of 75bps.

BCB POLICY ANNOUNCEMENT (WED): In June, the COPOM lifted the Selic rate by 50bps, taking it to 13.25%. The statement was more hawkish than expected, with the central bank suggesting that 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 the June 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, which is a sign that the current monetary policy cycle is at a very advanced stage. Rabo has argued that despite fears that the global economy is slowing, the it still sees the BCB hiking by 50bps in August, and then keeping rates at that level through the end of the year. “Even though we expect a longer Selic hiking cycle than at the beginning of 2022, we believe the Fed’s recent display of hawkishness and the intensification of the traditional electoral cycle will end up weighing on the BRL and other local assets going forward.”

BOE POLICY ANNOUNCEMENT (THU): The overall consensus looks for a 25bps hike to the Bank Rate to 1.5%, however, surveyed analysts are split in their views. 29/54 polled by Reuters expect a 25bps increase with the remaining 25 looking for a larger increment of 50bps. As such, there is a high level of uncertainty heading into the event and it remains unclear how many, if any, members will join Mann, Saunders and Haskell in voting for a 50bps hike. Market pricing has a higher level of conviction for the meeting with a 50bps increase priced in via a circa 90% probability; this is most likely a by-product of larger increases by other major global central banks such as the ECB and Fed. Looking further ahead, markets anticipate around 150bps of tightening by year-end. The ambiguity in the analyst community in part stems from the lack of clear guidance from MPC officials with Governor Bailey noting that a 50bps increase will be amongst the choices for the meeting (which is not a surprise given recent hawkish dissent), but cautioning against betting on such an outcome. Even hawkish dissenter Saunders refrained from suggesting how he would vote next week. From a data perspective, the June Y/Y CPI print rose to 9.4% from 9.1% and therefore exceeded the MPC’s forecast of 9.1%. However, survey metrics in July declined from prior levels with S&P Global noting that "UK economic growth slowed to a crawl in July”. Furthermore, the latest jobs data suggests that the labour market is no longer tightening. Of those looking for a 25bps increase, Oxford Economics suggests that although the outcome of the meeting is “finely balanced”, the consultancy favours a 25bps move given that “the likely increase in the BoE's inflation forecast will be due to factors outside the MPC's control”. Furthermore, Oxford Economics sees “scant evidence of second-round effects via higher wage growth, and surveys have shown a retreat in cost pressures”. As well as the decision itself, markets will be looking for any adjustments to the Bank’s current guidance that states “the Committee will be particularly alert to indications of more persistent inflationary pressures, and will if necessary act forcefully in response”. Elsewhere, traders will be eyeing any details around the Bank’s plans for selling its Gilts held in the APF. In a recent speech, Bailey noted that details of the MPC’s plans will be published alongside the MPR with a potential confirmatory vote by the MPC to follow as early as September. In terms of a potential size, Bailey noted that “we are currently looking at a total reduction in the stock of gilts held by the APF, which covers both sales and gilt redemptions, of something in the region of £50# 100bn in the first year”.

FOMC REVIEW: The Fed’s rate decision and statement was in line with expectations, acknowledging some of the downside seen recently; the post-meeting press conference was dovish, with Chair Powell essentially impressing that the Fed was going to be taking a data-dependent, meeting-by-meeting approach, rather than flagging the increment of

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rate hikes that the Committee would debate. The FOMC lifted rates by 75bps to 2.25-2.50%, as was expected, taking rates back to neutral for the first time since 2019. The only major tweak to the statement was its reassessment of the economy; the Fed now acknowledges that “recent indicators of spending and production have softened” (recall, it previously said that “overall economic activity appears to have picked up after edging down in the first quarter”). This change was to be expected given the softening in many key macro indicators. Going into the rate decision, a very small minority of analysts were suggesting that the Fed could slow the pace of its balance sheet normalisation, but the central bank opted against doing so. The statement offered no clues about what the Fed would do at its September meeting, but at his post meeting press conference, Chair Powell was more explicit, stating that over the coming months, the Fed was looking for compelling evidence that inflation was falling, and the pace of future rate hikes would depend on incoming data and the outlook for the economy. This suggests that the Committee will be data-dependent, and act on a meeting-by-meeting basis, rather than flagging policy in advance. Powell did, however, state that another large rate hike could be appropriate at the next meeting, and argued that the Committee wanted to get rates into moderately restrictive territory, which he said was between 3.0-3.5%. According to the June SEP, rates will be at that level by the end of this year (these forecasts will be updated in eight weeks’ time, but Powell referred journalists to the June SEP when asked about his economic views); money market pricing, which had expected rates at 3.4% by end-2022 before Powell spoke, eased to around 3.25% as the Fed Chair was speaking. Money markets are however pricing a degree of rate cuts next year; Powell was asked if his view of the terminal rate has changed (the June SEP implies this sits at 3.75-4.00%), and he responded that it had evolved for all participants on the Committee, and that the Fed would have more data by September. Naturally, Chair Powell was quizzed on whether the US economy was in a recession; Powell seemed reticent to use the phrase, but reiterated that it was necessary to slow growth in order to create some slack in the economy, to allow the supply-side to catch-up; Powell also said that the slowdown in Q2 was notable, but the economy was still on track to grow this year, and demand was strong.

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