Central Banks Weekly August 5th: Previewing Banxico; Reviewing BoE, RBA, BCB, RBI

5th August 2022:

BANXICO ANNOUNCEMENT (THU): Mexico's central bank is expected to lift rates by 75bps to 8.50%. It would be the second hike of that increment this year, and would match the US Federal Reserve recent move. At over 8%, inflation is soaring above the central bank's 3% target. However, growth conditions have held up, with the Mexican economy posting a third consecutive quarter of growth. Banxico has thus far raised rates by a cumulative 375bps over the last nine meetings, and according to a poll by Reuters, the key interest rate is likely to reach 9.5% by the end of this year.

RBA REVIEW: The decision to hike interest rates by 50bps to 1.85% was in line with market participants' expectations. The central bank reiterated that the Board expects to take further steps in the process of normalising monetary conditions and was is committed to doing what is necessary to ensure that inflation returns to target over time, but noted that it was not on a pre-set path. Furthermore, it the central bank reiterated its view that inflation is expected to peak later this year and then decline back towards the 2-3% range. The lack of any major hawkish surprises and the reference to not being on a pre-set path resulted in a dovish reaction. The RBA's Statement on Monetary Policy reiterated these themes, and also noted that inflation pressures are broad based, and that rate increases have been required to create a more sustainable balance of demand and supply. "The most important aspect of the Statement was whether there was any indication that the Board might ease back to a 25 basis point pace in September. But there does not appear to be any evidence to suggest such a policy and we confirm our view that there will be another lift of 50 basis points in September," Westpac said, "we expect that objective will require a series of four 25 basis point moves following the 50 basis points in September."

BOE REVIEW: As forecast by consensus and priced by markets, the BoE delivered a 50bps hike, taking the Base Rate to 1.75%. The decision to raise rates for a 6th consecutive time was unanimous, however, there was dovish dissent from external member Tenreyro who is of the view that the Bank Rate might already have reached the level consistent with returning inflation to the 2% target in the medium term. For the other eight MPC members, the decision to raise rates by the largest magnitude in 27 years was justified by the view that "there had been indications that inflationary pressures were becoming more persistent and broadening to more domestically driven sectors". On inflation, Q4 inflation is expected to rise to just over 13% (vs. the June forecast of slightly above 11%) on account of higher expected household energy prices. In 2023, inflation is now expected to pull back to 5.5% (vs. the May forecast of 3.5%) whilst the three-year projection is seen at just 0.76%. Given that the projections are based on the market-implied rate curve, this suggests that the MPC views the current rate path as too aggressive for it to be able to attain its 2% inflation mandate. From a growth perspective, the accompanying projections were sobering reading against the current inflationary backdrop with the UK now expected to enter a recession in Q4 and last for five quarters with consumption growth expected to turn negative. Despite the growth outlook, the MPC's statement reaffirmed the committee to act "forecefully" in the face of more persistent inflationary pressures. Accordingly, Governor Bailey noted that returning inflation to 2% remains the Bank's priority and the costs of the Ukraine war will not deflect the BoE from pursuing its mandate. Furthermore, Bailey stated that tighter policy now reduces the risk of more extended and costly tightening later. For the September meeting, Bailey noted that all options are on the table for September and beyond but the 50bps increase this week does not mean the BoE is moving to a pre-determined path of hiking rates by 50bps at each meeting. As it stands, post-meeting pricing pencils in 35bps of tightening for September and a total of roughly 100bps by year-end. Analysts at ING are of the view that there is a strong possibility of a 50bps move in September but such a move could be the last from the BoE as the window to hike rates closes. Asides from the decision itself, the MPC announced that subject to a vote, the "Committee is provisionally minded to commence gilt sales shortly after its September meeting". In terms of the size, a total reduction of GBP 80bln in the first year of the scheme was "likely to be appropriate" of which GBP 40bln would be active sales.

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BCB REVIEW: The BCB voted unanimously to lift its Selic rate by 50bps to 13.75%, in line with the consensus view, as it continues to advance the process of monetary tightening significantly into even more restrictive territory. But it did not specify whether the tightening cycle is ending or extending. The central bank's updated economic projections now see inflation at 6.8% this year (prev. 8.8%), or around 180bps above the upper bound of its inflation target, before falling to 4.6% next year. "They are now incorporating the effects of a recently Congress approved cut to energy taxes that resulted in lower inflation expectations in 2022 but higher ones in 2023," Rabobank says, adding that "the Copom unusually decided to shed light on their Q1 2024 inflation projection at 3.5% Y/Y, being free from calendar effects and temporary tax cut effects." Rabo says that this is the most dovish aspect of the statement. Looking ahead, the Committee will be looking at the need for a "residual adjustment, of a lower magnitude," which Rabobank says leaves room for either an additional 25bps rate hike at that meeting, or even stopping the tightening cycle. "We still believe the Copom is most likely sitting on their hands until year-end, bringing this long hiking cycle to a halt at 13.75%, they would then start the easing cycle only by the end of Q2 2023, until reaching 11.00% by end-2023 and 7.50% by end-2024." Rabo will be keeping an eye on the meeting minutes next week (Tuesday) for more details on the Committee's views on inflation and the state of the economy.

RBI REVIEW: India's Reserve Bank lifted its Repo Rate by 50bps to 5.4%, topping analysts expectations for a rise to 5.25%. The Reverse Repo and Cash Reserve Ratio were left unchanged, as expected. "With inflation currently at 7.0% Y/Y, the MPC judged that a further calibrated removal of accommodation was warranted and all but one of the committee felt that this was likely to be the case at coming meetings as well," ING said, "but we don't believe that this necessarily needs to be done at quite the same pace," citing recent signs that Indian inflation is moderating, with gasoline prices falling, and the declines in crude prices suggesting a lower inflationary impulse ahead. "If the destination for the RBI is to get real rates (policy rates minus inflation) to approximately zero, then continuing at even a 25bp pace over the remainder of the year (in line with our forecasts) should see the repo rate rise to 5.9% by the year-end," ING says.