Central Banks Weekly August 19th - Previewing Jackson Hole, PBoC, ECB Minutes, BoK; Reviewing RBNZ, Norges, CBRT

19th August 2022:

FOMC MINUTES REVIEW/JACKSON HOLE SYMPOSIUM (THU-SAT): The Fed's 46th annual Economic Policy Symposium at Jackson Hole is entitled "Reassessing Constraints on the Economy and Policy" and will take place on 25-27th August, with Chair Powell to deliver his remarks on the economic outlook on Friday at 15:00BST/10:00EDT. The event is usually seen as a platform that Fed officials use to signal upcoming policy changes. The FOMC's July meeting minutes stated that "participants judged that, as the stance of monetary policy tightened further, it likely would become appropriate at some point to slow the pace of policy rate increases while assessing the effects of cumulative policy adjustments on economic activity and inflation." Traders took this as a sign that with rates now at the estimated neutral level, the Fed might ease-off on lifting its Federal Funds Rate target, reverting to smaller increments of 50bps or 25bps; however, the language was offset by a line that said "many participants remarked that, in view of the constantly changing nature of the economic environment and the existence of long and variable lags in monetary policy's effect on the economy, there was also a risk that the Committee could tighten the stance of policy by more than necessary to restore price stability." That was marginally less hawkish as it implies 75bps shouldn't be the default assumption for September." BMO Capital Market's strategists suggest that this could mean that an overshoot on rates in the near-term could imply that the Committee is cognizant that they might have to cut rates soon after achieving terminal, which was seen between 3.75-4.00% when the Fed updated its forecasts in June (these projections will be revised at the September 21st FOMC). However, traders expecting any explicit policy signal may be left disappointed, judging by the commentary from Fed officials in wake of the minutes' release. Fed's 2022 voting member Bullard said he was leaning towards a 75bps rate rise in September, arguing that front-loading hikes would give the Fed more optionality next year, and reiterated his call for rates to rise to 3.75-4% by year-end as he is not ready to say the inflation surge has peaked; Fed's George, another 2022 voter, said that the easing of financial conditions may have been based on optimism that the Fed would slow down the pace of tightening, but that did not reflect how the Fed was thinking about policy, adding that the July inflation report was encouraging, but it was not time for a victory lap. Accordingly, Powell could re-emphasise that the Committee's decision-making will be driven by incoming data, and argue that there is still a great deal of work to be done in bringing inflation back to target.

PBOC LPR (MON): PBoC will decide on its benchmark rates on Monday with the central bank unanimously expected to reduce the 1-Year Loan Prime Rate by 10bps from the current 3.70% level, according to a Bloomberg survey, while there are mixed views regarding the 5-Year Loan Prime Rate (reference for mortgages) as most analyst expect this to be reduced by 10bps from the current 4.45% level, although around 38% are calling for a greater cut of 15bps to assist the flagging property sector. The expectations for the central bank to lower its benchmark lending rate for the first time since late January follows its recent surprise decision to cut rates on the 1-Year Medium Term Lending Facility and the 7-Day Reverse Repo by 10bps each as China contends with a slowing economy amid the impact of its strict zero-COVID policy and sporadic outbreaks of the virus. The slowdown has been evident in recent data releases with Chinese Manufacturing PMI at a surprise contraction last month, while Industrial Production and Retail Sales both missed forecasts and GDP for Q2 showed a wider than expected Q/Q contraction at -2.6% vs. Exp. -1.5% (Prev. 1.3%). Furthermore, Chinese authorities including the central bank have continuously pledged support measures, while a front-page report in the PBoC-backed Financial News noted that China needs additional policy stimulus to increase economic growth, which supports the calls for a cut to the LPRs.

ECB MINUTES (THU): Despite expectations for a 25bps hike across the ECB's three key rates, policymakers opted to "go big" and deliver 50bps worth of tightening, taking the deposit rate to 0% and therefore drawing a line under the Bank's NIRP. Alongside this, the Bank refrained from providing explicit guidance for the September meeting and is instead adopting a meeting-by-meeting approach. The Governing Council was also able to agree on an anti-fragmentation tool named the Transmission Protection Instrument (TPI) aimed at ensuring that the monetary policy stance is transmitted smoothly across all euro area countries. That said, PEPP will remain the first line of defence to counter risks to the transmission mechanism related to the pandemic. President Lagarde said that the Governing Council rallied around the consensus of a 50bps hike and that the ECB is accelerating the normalisation process, but not changing the ultimate point of arrival. In terms of the details of TPI, Lagarde noted that all nations are eligible, the ECB is capable of "going big" on the instrument, whilst the activation of TPI is at the discretion of the Governing Council. Lagarde later clarified that the four conditions for TPI are as follows: 1. Compliance of EU fiscal framework, 2. Absence of severe macro imbalances, 3. Fiscal sustainability, 4. Sound and sustainable macro policies. Any further colour around the discussion held on TPI and how it could be implemented would be of note for markets. Some commentators were quick to suggest that Italy might fail to satisfy such criteria and as such, the IT/GE 10yr spread was unable to narrow from the levels prompted by the resignation of Italian PM Draghi. Furthermore, the follow-up press release noted that purchases under TPI could be suspended if it is judged that persistent tensions are due to country fundamentals. Overall, given the fast-paced nature of inflationary developments within the Eurozone any policy signals towards the September meeting will likely be deemed as stale, particularly given the ongoing surge in Eurozone electricity prices since the meeting which have added further pressure to the price outlook within the region. As it stands, markets currently price in 42bps of tightening for the September meeting.

BOK ANNOUNCEMENT (THU): The Bank of Korea will decide on rates next week with the central bank likely to continue with its policy tightening and increase the 7-Day Repo Rate by 25bps to 2.50%. As a reminder, the BoK unanimously delivered a widely expected 50bps rate hike at last month's meeting which was its largest ever rate increase and it noted that inflation will remain high for some time which it sees surpassing the May forecast for the entire of 2022 and for core inflation to be higher than 4% for a considerable period. BoK Governor Rhee also noted that more policy tightening looks 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, while the central bank stated that inflation is to exceed 6% for the time being and that managing inflation is the utmost priority. Therefore, the central bank is likely to hike rates again next week given that inflation has continued to increase whereby CPI in July rose to 6.3% vs. Exp. 6.3% (Prev. 6.0%) which was the fastest increase since November 1998.

RBA MINUTES REVIEW: RBA Minutes from the August 2nd meeting reiterated that the Board expects to take further steps in the process of normalising monetary conditions in the months ahead, but is not on a pre-set path and noted that it seeks to do this in a way that keeps the economy on an even keel. Furthermore, members agreed it was appropriate to continue the process of normalising monetary conditions and that inflation was expected to peak later in 2022 before declining back to the top of the 2%-3% range by the end of 2024, while it stated that the resilience of the economy continued to be most evident in the labour market, although risks to the global economic outlook were skewed to the downside. The minutes provided very little in the way of new information, but did spur brief upside in AUD/USD as it stuck to the script of further policy tightening ahead.

NORGES BANK REVIEW: Overall, very much as expected. The Committee unanimously voted for a 50bp move due to the inflation situation and a desire to take action now to avoid such pressures becoming entrenched and the need to tighten more sharply action in the future - a justification that is very in-fitting with June's 50 bp MPR hike. On the flip side, but again as expected and in-fitting with June, the Committee highlighted the housing market and household consumption as areas to keep a close eye on in case rate hikes slow activity faster than expected. However, the Norges Bank clearly judges the inflation situation to be more pressing at this juncture. In wake of the announcement, NOK saw initial short-lived strength; though, this became more pronounced throughout the European morning. Further out, the September MPR will be closely watched for updated forecasts - particularly regarding CPI-ATE and the Policy Rate; currently, from the June MPR, seen peaking 2022 at 4.09% (already surpassed) and 1.99% respectively.

RBNZ REVIEW: New Zealand's central bank lifted the Overnight Cash Rate by 50bps to 3.00%, in line with expectations; its policy statement suggested that rates will be lifted even further in the meetings ahead, and lifted its projected peak terminal rate a little to 4.1%, and brought forward its expectation of when rates will arrive there. The statement repeated language that it "remains appropriate" to continue to tightening policy "at pace". Westpac said "the RBNZ is viewing the world firmly through an inflationary lens, with its statement giving short shrift to the idea of a softening in domestic demand." Westpac also notes that the RBNZ discussed how raising rates more quickly could help improve the credibility of its inflation target, but it did not elaborate on which arguments won the day, "but presumably the risk of driving the economy into recession was not seen as credibility-enhancing," Westpac says. The bank recently raised its view for the RBNZ hiking trajectory, and sees rates hitting 4% after 50bps hikes in both October and November; "However, where the RBNZ sees the cash rate remaining close to this level for some years to come, we see more of a cyclical aspect to this, with more room to cut interest rates once inflation pressures have been brought to heel," and while it does not expect a recession in NZ, it is expecting lean growth in the years ahead. "As such, we'll continue to watch the high-frequency data to gauge the extent of cooling in the domestic economy," Westpac said, "and we think that by the end of this year, that evidence won't have escaped the RBNZ's attention either."

CBRT REVIEW: Turkey's central bank resumed its brand of unorthodox policy, and dovishly surprised markets by cutting rates by 100bps to 13.00% in spite of inflation rising to an annual rate of 80% in July, with little evidence price pressures will begin cooling any time soon. Barclays says that there are three key points to note: 1) CBT justified the move by citing elevated downside risks to growth in Q3; "although we agree with this view, we are less sure the correct policy response is to cut rates given the inflation outlook," adding that most central banks have opted to maintain tightening cycles with those most concerned about growth choosing to only slow the pace of hiking; 2) CBT did not suggest this was the start of an easing cycle, but Barclays seems sceptical, arguing that "previous experience suggests that caution is often warranted around such commitments from central banks when faced with elevated uncertainties," and cites that the 200bps rate cut in October 2021 to 16.00%, where it apparently saw only limited room to cut further, but then went on to lower rates by 200bps over the following two meetings; 3) Barclays is puzzled by the CBT noting that widening spreads between lending rates and the policy rate which will see the central bank take macroprudential measures to narrow, arguing that where loan rates go down, it would support more lending activity, which would not bode well for Turkey's CA balance and inflation outlook.