Central Banks Weekly August 26th - Reviewing Powell at Jackson Hole, PBoC, ECB Minutes, BoK

26th August 2022:

POWELL AT JACKSON HOLE: Fed Chair Powell's speech at Jackson Hole did not reveal anything by way of new information. The Fed chair emphasised that it would be moving rates into 'sufficiently restrictive' territory, where it will likely be held for some time, in order to return inflation to target. Powell reiterated that the decision on September 21st between whether the Fed will lift rates by 50bps or 75bps will be driven by the "totality" of data since the July meeting. That puts a great deal of emphasis on the US jobs report due on September 2nd, and the US CPI report due September 13th. On the tone of incoming data, Powell welcomed July's lower inflation readings, but added that this was still short of what needed to be done before the Fed is confident that inflation was coming down. Echoing what was said in the recent meeting minutes, Powell said that at some point, as the Fed's policy stance tightens further, it would be appropriate to slow the pace of rate hikes, but with rates at the current long-run estimate of neutral between 2.25-2.50%, now was not the place to stop or pause rate hikes. Powell's remarks did not contain any fresh insight on where the Fed thinks the terminal rate is (it as estimated to be between 3.75-4.00% in the June SEP, and those forecasts will be updated at the September meeting), nor was there any indication on how long the Fed would stay at terminal; instead, Powell emphasised that restoring price stability would take some time, requiring 'forceful' use of the central bank's tools. In an immediate reaction, the implied probability of a 50bps or 75bps fluctuated, but is ultimately still looking like it is a coinflip (that will most likely be determined by incoming data); additionally, money markets are still pricing rates to rise to between 3.50-3.75% by the end of the year, and still are pricing a Fed rate cut in Q3 of 2023.

PBOC LPR REVIEW: The PBoC cut the 1-Year LPR by 5bps to 3.65% and reduced the 5-Year LPR by 15bps to 4.30% vs expectations for a 10bps cut to both, while the reduction in the 5-Year LPR which is the reference for mortgages, also followed recent measures to support the construction and delivery of unfinished residential projects through special loan schemes from policy banks. There were wide expectations for a cut to both the 1-year LPR and 5-year LPR after the central bank conducted 10bps reductions in the 1-year MLF and 7-day Reverse Repo the week before although a minority had forecast the PBoC could deliver a greater reduction of 15bps to the 5-year LPR to support the flagging property sector. Since the announcement, there has been speculation of more policy easing as Security Times noted the PBoC could reduce RRR this year to compensate for MLF maturities and that further RRR cuts could lower lending prime rates, while former PBoC adviser Li Daokui suggested that the PBoC has room to cut its main interest rates by up to 50bps over the next year if COVID continues to drag on the economy.

ECB MINUTES REVIEW: The account of the July meeting revealed that a "very large" number of members agreed that it was appropriate to raise the ECB's key interest rates by 50bps given the deteriorating inflation outlook. Such a move was viewed as providing a clear signal of the Governing Council's determination to act whilst providing greater flexibility in reacting to incoming data and proceeding with normalisation at future meetings. Not all agreed with the consensus with some members favouring a 25bps hike given that this was the intended move communicated at the June meeting and would preserve consistency with communications. Furthermore, these members of the GC saw such a move as "more in line with a gradual monetary policy normalisation" given the looming risk of a recession and would be compatible with returning inflation to target over the medium term. Looking ahead to September, there was "broad support" for transitioning to a meeting-by-meeting approach to interest rate decisions given that the usefulness of forward guidance was judged to have diminished in the normalisation phase. Also of note, the decision to hike rates by 50bps was not viewed as shifting the ECB's assessment over the terminal rate. Elsewhere, the decision to support the Transmission Protection Instrument with "forceful and convincing communication" was unanimous whereby the scale of TPI purchases would depend on the severity of the risks facing policy transmission. Overall, as is often the case given the dated nature of the account, traders were provided little in the way of clues for the September meeting with market participants likely to be more mindful of upcoming data developments and GC rhetoric when considering whether or not policymakers will pull the trigger on another 50bps increase. As it stands, currently price in 56bps of tightening for the September meeting and 128bps by year-end.

BOK REVIEW: BoK hiked its base rate by 25bps to 2.50% through a unanimous decision and which was widely expected as BoK Governor Rhee had flagged a return to 25bps moves after the historical 50bps hike in July. The BoK said that inflation will remain high for the time being and export growth will slow, while Governor Rhee noted that strong inflation could last longer than previously seen and that policies will continue to be inflation-focused for a while, as well as made it clear that there will be no change in the 25bps rate increase stance for the foreseeable future.

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