Central Banks Weekly September 9th; reviewing ECB, BoC, RBA

9th September 2022:

ECB REVIEW: In-fitting with market pricing and against a split consensus amongst analysts, the ECB opted to pull the trigger on a 75bps hike, taking the deposit rate to 0.75%. The statement noted that the GC expects to raise rates further over the next "several" meetings, whilst taking a data-dependent and meeting-by-meeting approach. In terms of other measures, the ECB opted to continue with its current reinvestment policy whilst suspending its two-tier system by setting the multiplier to zero. The accompanying staff forecasts saw 2022, 2023 and 2024 inflation projections revised higher with the 2024 forecast of 2.3% indicating that further policy tightening is required. On the growth front, 2022 GDP was revised a touch higher, however, 2023 was slashed to 0.9% from 2.1% with the downside scenario touting the possibility of negative growth. At the follow-up press conference, President Lagarde noted that the decision on rates was unanimous, albeit there were differing views across the council. With regards to the magnitude of hikes going forward, Lagarde noted that 75bps increments are not the norm, but moves will not necessarily get smaller as the ECB heads towards the terminal rate. Note, Lagarde stated that the terminal rate is not known, however, the judgement is that rates are not at a neutral setting yet. Despite guidance that the GC will be following a meeting-by-meeting approach, Lagarde stated that hikes will probably take place at more than two meetings, but fewer than five. Overall, the ECB cemented its commitment to deliver on its tightening pledges despite the grim growth outlook for the region, that said, it remains to be seen how much this commitment will hold up as winter approaches. As it stands, market pricing looks for 50bps hikes at the October and December meetings with a further 50bps of tightening envisaged in 2023. After the meeting and presser, ECB sources via Bloomberg hit which were hawkish in nature suggesting another possible 75bps move in October while adding that ECB's Lane was more hawkish in the meeting than his recent speech. Meanwhile, the sources added QT is expected to be discussed at the non-policy meeting in Cyprus on Oct. 5th and will likely also be debated at subsequent meetings.

BOC REVIEW: The Bank of Canada hiked rates by 75bps, as expected, a lower increment than the 100bps at its previous meeting; its latst rate moves takes the overnight rate to 3.25%, above the BoC's estimate of neutral (between 2-3%). The central bank's guidance was little changed, and reiterated that further hikes would be necessary to bring inflation to target, implying the BoC is not yet done with monetary tightening, and will move rates even further into restrictive territory. There was little reaction to the announcement, and markets still see the eventual terminal rate at around 3.8% (implying an overnight rate of either 3.75-4.00%). The BoC was vague with its guidance, noting that future rate moves will be assessed by how much more is needed to bring inflation to target – most likely implying a data-dependent approach, on a meeting-by-meeting basis. Analysts at Canadian bank RBC expect one more 25bps rate rise in October, but noted that the BoC's September decision suggests that there are upside risks to its call for rates to peak at 3.50%, and said that it sees a mild recession in 2023. On inflation, the BoC acknowledged the pick-up in July Core CPI measures, noting that surveys suggested short-term inflation expectations remained high, and the longer that these remain high, the larger the risk that elevated inflation becomes entrenched. The BoC also recognised that the fall in headline CPI was primarily due to gas prices, while data also indicated a further broadening of price pressures, particularly in the services segment. Growth in the Canadian economy was somewhat weaker than the BoC had expected, but it highlighted that indicators of domestic demand were very strong. Ahead, it continues to expect the economy to moderate in H2 22 as global demand weakens and tighter policy in Canada starts to bring demand more in line with supply. On housing, it also acknowledged the housing market is starting to pull back as expected.

RBA REVIEW The RBA hiked rates by 50bps to 2.35% which was the fourth consecutive half point increase and widely expected. The Board reiterated that it is committed to doing what is necessary to ensure inflation returns to target and it expects to increase rates further in the months ahead, but is not on a preset path. Furthermore, it stated that the size and timing of future interest rate increases will be guided by incoming data and the Board's assessment of the outlook for inflation and the labour market, while it noted that the Australian economy is continuing to grow solidly and national income is being boosted by a record level of its terms of trade. The actual policy announcement lacked any major fireworks and the absence of any hawkish surprises resulted in a brief dovish reaction, while comments from RBA Governor Lowe later in the week were also perceived to be less hawkish and hinted of a future slowdown in the tightening cycle as he noted that the case for a slower pace of rate hikes becomes stronger as the level of the Cash Rate increases.

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