Central Banks Weekly September 23rd: Reviewing FOMC, BoE, SNB, Riksbank, Norges Bank, BCB, SARB; previewing Banxico, RBI

23rd September 2022:

BANXICO ANNOUNCEMENT (THU): Hot domestic inflation and a hawkish US Federal Reserve mean that the Banxico will likely lift rates by 75bps, analysts say. The recent bi-weekly CPI report showed unadjusted CPI of +0.44% (exp. 0.42%) in H1 September, as analysts were expecting, while consumer prices were unchanged at 8.8% Y/Y (exp. 8.7%). Pantheon Macroeconomics notes that underlying inflation pressures still remain elevated in Mexico, though a relatively stable MXN and tighter financial conditions are cushioning. "Conditions likely will improve over the coming months, as we expect domestic demand to soften and tighter monetary policy to bite," Pantheon writes, "improving supply chains, lower commodity prices and less-harsh base effects will also help to push inflation down to about 8.5% in October, then 8.2% in December and around 7.2% in March." but that said, Pantheon says that risks are tilted to the upside, and Banxico will continue to hike in the near term to bring inflation expectations under control. "Following the FOMC's meeting, we now expect Banxico to hike by 75bps to 9.5%, followed by a terminal 50bps hike in November," PM writes, "but this outlook remains heavily conditional on the Fed."

RBI PREVIEW (FRI): India's central bank is expected to hike its key rate next week, with to 26 out of 51 economists calling for the central bank to raise the Repurchase Rate again by 50bps to 5.90%, while 20 forecast a 35bps rate increase, and the remaining analysts anticipate hikes between 20-30bps. At its last meeting, the RBI hiked its Repurchase Rate by 50bps amid mixed expectations of between 25bps-50bps, and said that a further calibrated withdrawal was warranted to keep inflation expectations anchored. It also noted that CPI inflation had eased from its surge in April, but remained uncomfortably high. The central bank also recently noted that it will have to front-load its monetary policy to fight stubborn inflation and shield medium-term growth in the economy as front-loading of monetary policy actions can keep inflation expectations firmly anchored and reduce the medium-term growth sacrifice. The latest key data releases from India suggests the central bank will continue with the current pace of hikes as inflation has remained stubbornly elevated and above the 2-6% tolerance range with CPI in August firmer than expected at 7.0% (vs exp. 6.9%), while the most recent Industrial Production disappointed at 2.4% (exp. 4.3%) and GDP for the April-June quarter was also short of estimates but firmly accelerated to 13.5% (exp. 15.2%, prev. 4.1%). Another factor that could compel the central bank to stick to the current pace of rate hikes is the continued policy normalisation by most of the major global central banks including the Fed and given that the INR recently extended to fresh record lows against the USD, as the RBI would likely want to avert further pressuring the currency by slowing down on its hiking cycle.

FOMC REVIEW: The FOMC hiked rates by 75bps to 3.00-3.25%, in line with the consensus expectation. The statement was largely unchanged from he July meeting, noting that "the Committee... anticipates that ongoing increases in the target range will be appropriate." That left much focus on the updated economic projections, which were judged as hawkish: officials now see rates at 4.25-4.50% by the end-2022 (previously 3.25-3.50%); officials also raised their view of the terminal rate (now sees The FFR range peaking out between 4.50-4.75% in 2023 vs previous forecast of 3.75-4.00%); after 2023, the Fed expects rates will decline to 3.25-4.00% by the end of 2024, and then fall to 2.75-3.00% in 2025; it left its estimate of the neutral rate unchanged at 2.5%. Inflation projections were unsurprisingly lifted, and the central bank does not expect headline PCE to be at target before 2025; growth projections were slashed, and at least one official sees a contraction in 2023. Chair Powell's press conference was underwhelming by comparison, and he revealed little by way of fresh insight, affirming many of the points he made at the recent Jackson Hole Economic Symposium. Powell once again caveated the Dot Plots, stating that it does not represent a plan or commitment from the Fed. The Fed chief was asked about the conditions that officials would need to see before endorsing arguments for lower rates, and repeated that there would have to be a confidence that inflation is moving back down to 2%. In wake of the meeting, one point analysts picked up on is the divergence of views at the Fed on how far the Fed needs to get into restrictive territory, and Powell danced around that, saying that the Fed has now moved to the "very lowest" level of what it considers to be restrictive, saying there is still a ways to go on rates, without giving specifics on where he sees the terminal, aside from his comment that the Fed would likely get to levels in the Dot Plot. Goldman Sachs said the updated Dot Plot suggests that the Fed would hike rates by 75bps again at its November meeting, followed by a 50bps rate rise in December, and then a 25bps hike in January. For 2023, GS says that the path of rates will depend on how quickly growth, hiring and inflation slow, and whether the FOMC will really be satisfied with a sufficiently high level of the funds rate and willing to slow or stop tightening while inflation is still uncomfortably high.

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BOE REVIEW: A unanimous decision to increase the Bank Rate, but three-way dissent on the eventual 50bp hike with Dinghra taking the dovish mantel from Tenreyro and voting for 25bp while known hawks Haskel, Mann and Ramsden supported a 75bp increase. Given the 50bp hike disappointed market pricing for 75bp, a snap dovish-reaction was seen sending Gilts to session highs and pressuring Sterling. However, with reference to the Gilt move, this swiftly reversed to below pre-release levels given numerous bearish factors. Specifically, the BoE confirmed that they are going to reduce their holdings of gov't bonds by GBP 80bln over the next 12 months. A reduction that, while caveated by a statement that the schedule can be amended, is of particular note at a time when the UK gov't is likely to substantially increase Gilt issuance to fund energy measures. Additionally, the BoE retained its guidance that they will continue to "respond forcefully" as necessary to inflation and while the peak forecast was reduced vs August's update, it remains elevated and well above target. Finally, the Bank has downgraded its view on the UK economy in the near-term, Q3 2022 is now expected to see GDP declining by 0.1% (vs August projection of +0.4%), for a second quarter of contraction; a forecast which, if confirmed by the ONS release, implies the economy is already in a technical recession. Next up, we look for any guidance from rate-setters on the UK govt's recently announced fiscal support measures, particularly those pertaining to energy, and what tightening action the associated demand-push implications of such assistance may warrant.

SNB REVIEW: As expected, the SNB lifted its Policy Rate out of NIRP to 0.50% via a 75bp hike; however, this magnitude disappointed market pricing for a 100bp move and thus a pronounced dovish reaction in the CHF, and to a lesser extent in markets broadly, occurred. A hike that was once again deemed to be merited by the inflation situation and as such was accompanied by reiterated guidance that further hikes cannot be ruled out. Additionally, repeating guidance that they are willing to intervene in FX markets as necessary with Chairman Jordan subsequently stressing they are ready to step in to prevent excessive weakening or strengthening of the Franc. Rates/FX aside, the SNB has altered the mechanics of its Exemption system, the Threshold for this was reduced to 28x (prev. 30x) at the June gathering, and now sight deposits above the threshold are to be remunerated at a 0.00% interest rate - essentially flipping the prior system to account for the lifting of rates into positive territory.

NORGES BANK REVIEW: The second consecutive 50bp hike lifted the Key Policy Rate to 2.25% and now takes the total magnitude of tightening to 225bp worth over the past year. In face of this pronounced hawkish action, the Norges Bank will now be taking a "more gradual approach" to policy tightening. Specifically, Governor Bache said the November meeting will likely feature a 25bp hike. A magnitude that is also implied by the updated Policy Path that is seen peaking around 3.0% towards end-2023. The Bank justifies this more gradual approach due to the clear signs that the economy is cooling in wake of the pronounced monetary tightening. Overall, the meeting was in-fitting with expectations and sparked relatively limited NOK reaction.

RIKSBANK REVIEW: A 100bp hike which surpasses consensus for a 75bp increase, but chimes with the around 60% probability via market pricing for a full point rise given the inflation narrative. While the announcement is clearly hawkish at face-value, and indeed implies further rate hikes, the Policy Path indicates a 'peak' around end-2023/start-2024, though this is perhaps not too surprising given the decision to frontload hikes. Note, despite the Riksbank's guidance taking a somewhat dovish skew the full-point hike sparked broader hawkish price action; albeit, much of this was in place following German PPI. Elsewhere, the Bank confirmed QE amounts as announced in June, but adds that purchases will end in 2022. For the meetings ahead, we look for whether CPIF will average 7.8% for 2022 as forecast, compared to the most recent 9.0% print in August and for any guidance/commentary from officials around the new Policy Path for any diverging opinions on how much additional tightening is required.

BCB REVIEW: The COPOM kept the Selic rate unchanged at 13.75% in its first split decision since March 2016 (the vote was 7-2, with Governor Neto among the seven voting for unchanged, while two members voted for a 25bps hike), though the outcome was in line with analyst expectations. Inflation is seen at 5.8% by the end of 2022 (above the target's upper bound of 5.00%), but then falling to 4.6% by end-2023 (unch), and then to 2.5% by the end of 2024. Rabobank said that "despite high inflation in 2022, we have to bear in mind that 2023 and 2024 make up 75% and 25%, respectively, of the BCB's relevant monetary policy horizon as of 22Q3," and "the COPOM kept its Q1 2024 projection at 3.5% Y/Y, being free from calendar effects and temporary tax cut effects." Rabo says that this was the most dovish aspect of the statement. Ahead, Rabo thinks that the COPOM "is most likely sitting on their hands until year-end, holding the Selic rate at 13.75%," adding that "they would then start the easing cycle only by end-23Q2, until reaching 11.00% by end-2023 and 8.00% by end-2024."

SARB REVIEW: South Africa's Reserve Bank voted unanimously to lift rates for the sixth straight meeting, by 75bps to 6.25% (in line with consensus), suggesting that inflation remains the key focus as it continues to run above target, rather than domestic weakness. The vote split revealed that three sought a 75bps hike, while two were looking for a more aggressive 100bps rise. "Increased concerns about the de-anchoring of inflation expectations likely factored into the decision," Capital Economics said, "inflation expectations rose compared to the July meeting on measures that the SARB tracks, with all indicators for 2022 exceeding the upper target band." and the consultancy argues that the SARB's decision was also likely influenced by the hawkish Federal Reserve, which also lifted rates by 75bps this week, with the

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weakness in the ZAR also featuring in officials' deliberations. Ahead, Capital Economics expects headline inflation to remain above target well into 2023, as food inflation remains high even as fuel inflation drops back and the weak economy keeps core price pressures contained. "With policymakers' laser focus on fighting inflation, we expect the tightening cycle to press ahead with a further 150bps of hikes over the coming quarters, and the benchmark rate is likely to reach 7.75% by mid-2023" CapEco writes, "but inflation will probably decline markedly thereafter, and more dramatically than the SARB expects - this is likely to pave the way for rate cuts towards the end of next year or in early 2024."

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