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Central Banks Weekly October 7th: Previewing FOMC minutes; reviewing RBA, RBNZ

7th October 2022:

FOMC MINUTES (WED): The FOMC hiked rates by 75bps to 3.00-3.25% in September, in line with the consensus expectation. The statement was largely unchanged from the July meeting, noting that "the Committee... anticipates that ongoing increases in the target range will be appropriate." That left the focus on the updated economic projections, which were judged as hawkish: officials now see rates at 4.25-4.50% by end-2022 (previously 3.25-3.50%); officials also raised their view of the terminal rate (now see 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 on the Fed over how far it needs to get into restrictive territory, and Powell danced around that, saying the Fed has now moved to the "very lowest" level of what it considers restrictive, saying there is still a ways to go on rates, without giving specifics on where he sees the terminal level, 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. NOTE: The Fed meeting minutes are an account of that particular meeting, they do not factor in commentary or developments that followed in wake of the meeting; as such, while many desks will be keeping a close eye on them for any remarks that suggest the Fed would be prepared to halt the course of its policy normalisation if it triggered an unnecessary US recession or financial stability risks, the minutes may not feature some of the more recent thinking of officials. For instance, traders have attributed some of the recent commentary from Fed chair Brainard, Atlanta Fed's Bostic, San Fran Fed's Daly, where they suggested that the Fed was cognizant of these concerns in its policymaking (adding that they have a domestic mandate, and fighting inflation remains the priority).

RBA REVIEW: RBA surprised markets with a smaller-than-expected rate hike in which it opted for a 25bps increase instead of the market consensus for a 50bps rise, and following the central bank's hints throughout the past month of a future slowdown in pace of tightening. Nonetheless, the RBA has suggested further upcoming hikes with the Board committed to returning inflation to the 2%-3% range over time and it expects to increase interest rates further over the period ahead. It also reiterated that the size and the timing of future interest rate increases will continue to be determined by incoming data and the Board's assessment of the outlook for inflation and the labour market, while the central bank also noted that the Cash Rate had been increased substantially in a short period of time and that it remains resolute in its determination to return inflation to target.

RBNZ REVIEW: RBNZ delivered its 5th consecutive 50bps increase to lift the OCR to 3.50% which was widely expected as money markets had priced in an 84% chance of such a move ahead of the announcement. The central bank's rhetoric didn't provide anything to suggest an immediate slowdown in the rate hike cycle as the Committee agreed it is appropriate to continue to tighten policy and that monetary conditions needed to continue to tighten until inflation is back in the target range, as well as noting that core consumer inflation is too high. Furthermore, the central bank considered either a 50bs or 75bps increase at the meeting and some members highlighted that a larger increase in the OCR now would reduce the likelihood of a higher peak being required, while the RBNZ's rhetoric and actions could even be perceived as more hawkish given the contrast to the rate hike slowdown by the RBA the day before.

ECB MINUTES REVIEW: The account of the ECB's September meeting provided little in the way of fresh insight into thinking at the Bank, but did provide some colour on the debate between policymakers at the time. In terms of the economic view of the Governing Council, members broadly agreed with the assessment of the current situation presented by Chief Economist Lane. More specifically, it was judged that inflation expectations were still anchored and wage growth remained moderate with little evidence of second-round effects. Additionally, it was argued that growth

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concerns should not prevent forceful rate hikes as inflationary pressures were seen as unlikely to abate on their own. In terms of the decision itself, a 75bp increase was judged to be a proportionate response to the further upward revisions to the inflation outlook. At the more dovish end of the spectrum, while a 25bp increase was seen as clearly insufficient to address the current inflation outlook, some argued that a 50bp hike would be large enough to signal determination in proceeding with the interest rate normalisation. In the end, the 75bps camp won the debate, arguing that even with such a move, policy would still remain expansionary. Looking further ahead, the size of the upward revision in the staff inflation projection for 2024 was not seen as sufficiently large as to require a more aggressive response, since it was uncertain how much inflation was likely to dampen domestic demand. Finally, on the EUR, it was noted that without a timely reduction in monetary policy accommodation, inflationary pressures resulting from a depreciation of the Euro might increase further, while lower exchange rates provided limited support to economic activity in an environment of continued global supply bottlenecks and shortages.

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