Central Banks Weekly November 4th: Previewing Banxico; Reviewing FOMC, BoE, RBA, Norges

4th November 2022:

BANXICO PREVIEW (THU): At its last policy meeting, Banxico hiked interest rates by 75bps to 9.25%, in line with the consensus view, and minutes from that meeting suggested that further rate hikes were on the table. The central bank's recent monthly poll revealed analysts think rates will end 2022 at 10.50%, raising their expectations from 10.25% in the prior month's poll - and it appears that the current level of rates has begun prompting conversations on the Board about when it will end the hiking cycle. Board member Esquivel, whose term concludes at the end of this year, recently cautioned against lifting rates to an aggressively restrictive level given a weakening economy, and said policymakers should begin thinking about ending the rate-hiking cycle, arguing that a benchmark rate between 10.25-10.50% should be a sufficiently high and restrictive level of rates. He also said that expectations for rates next year are 'atypically' high, and "we cannot think they can stay there for very long". Indeed, this thinking is in line with the central bank's poll, where analysts think that rates will fall to 9.75% next year (in the previous poll, they were expecting 10.25% in 2023).

FOMC REVIEW: The Federal Funds Rate target was lifted by 75bps to 3.75-4.00%, as expected. The statement was dovishly received by the market, after it stated that the Fed will consider the "cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments" when determining the pace of future rate increases. Analysts rationalised that with rates in restrictive territory, the Fed can downshift to a slower pace of normalisation to assess the impact of the 375bps worth of rate tightening unleashed since March. However, Fed chair Powell's press conference injected a hawkish bias after he suggested that it was "very premature" to consider pausing the course of hiking. The Fed chair said that the time to slow rate hikes might come as soon as the December meeting, he impressed that inflation remains well above the Fed's longer-run goals, with price pressures evident across goods and services. And although longer-term inflation expectations still appear well-anchored, the Fed wants to see inflation coming down decisively, and is prepared to stay the course until the job is done, with the Fed strongly committed to its inflation target of 2%. He added that there was still "some ways to go" on rate hikes, while the 'ultimate rate level' might even be higher than previously expected (NOTE: the Committee forecast a 4.50-4.75% terminal rate in its forecasts). The Fed Chair said the debate on how far to lift rates was the important question, but there was still ground to cover before the Fed can 'meet that test', adding that there is a lot of uncertainty regarding the lagged impact of policy tightening. The press conference left the market with a tone of risk-off, and the market-based expectations for the terminal rate rose, now seeing rates peaking between 5.00-5.25% in May/June 2023 (last week, money markets were expecting rates to peak at 4.75-5.00% in May).

BOE REVIEW: In-fitting with the majority of expectations and market pricing, the BoE hiked the Bank Rate by 75bps, though its decision was subject to dovish dissent from Swati Dhingra (called for a 50bps rate hike) and Silvana Tenreyro (called for a 25bps rate rise), with both policymakers alluding to headwinds facing the domestic economy, as well as policy transmission lags. As such, and as the BoE explicitly pushed back on peak market pricing (again), an immediate dovish reaction was seen. Interestingly, the line that "…further increases in Bank Rate might be required for a sustainable return of inflation to target, albeit to a peak lower than priced into financial markets." was the judgment of a "majority" of the MPC – though, it is unclear whether the other members took issue with the further hikes or the pushback on peak market pricing. For the majority of the MPC, the justification for a 75bps move was to reduce the risks of more extended and costly tightening later. Alongside this, fresh forecasts were released, which gave a particularly grim outlook for the economy; the MPC sees Q/Q GDP coming in at -0.5% in Q3 2022 vs -0.1% expected in September. The inflation forecast now shows a peak around 11% in Q4, which is marginally hotter than the prior meeting's projection of "just under" that figure – note, the forecasts account for the 17th October statement from Chancellor Hunt in relation to the Energy Price Guarantee, which the BoE assumes will feature some fiscal support after the initial six-month period. Reminder, the full Autumn Statement will be released on November 17th. Overall, the meeting was in-line with market expectations on the magnitude of tightening, although the BoE has gone to great lengths to pushback on peak market pricing while retaining the optionality to "respond forcefully" if necessary. For December, pricing continues to imply a 50bps increase; though, it remains to be seen if more members will join the dovish chorus of Dhingra, Tenreyro and some global peers in applying a greater weighting to growth and policy transmission.

RBA REVIEW: The RBA lifted its Cash Rate Target by 25bps, taking it to 2.85%, as expected, and against some outside bets for a 50bps increase. The central bank said that the Board remains resolute in its determination to return inflation to target, and expects to increase rates further over the period ahead. It also reiterated that the size and timing of future rate adjustments will continue to be determined by the incoming data and the Board's assessment of the outlook for inflation and the labour market. It noted that the central forecast for GDP growth has been revised down a little, with growth of around 3% expected this year and 1.5% in 2023 and 2024, while inflation is now forecast to peak at around 8% later this year, while the central forecast is for CPI inflation to be around 4.75% over 2023 and a little above 3% over 2024. RBA Governor Lowe said the board has judged it appropriate to raise rates at a lower magnitude, but would return to larger increments if necessary. The governor also suggested they will hold the rate if the situation requires, and that rates were not on a pre-set path. Following the decision, analysts at ING said “it looks more probable now that the RBA will simply stick to a 25bps rate increase pace until it believes it has taken rates high enough.”

NORGES REVIEW: Overall, the announcement was in-fitting with the guidance provided by the Bank in September; though, going into the decision, expectations were evenly divided between a 25bps and 50bps move; market pricing was skewed towards the larger increment, and thus the 25bps hike ‘disappointed’ expectations. A smaller hike was delivered despite the deteriorating inflation situation, a development that the Norges Bank explicitly referenced and said could have merited a larger increment of tightening. However, the Committee continues to place emphasis on the growth situation: “there are signs that some areas of the economy are cooling down” and it acknowledged that the tightening effects that the higher policy rates were beginning to have. For the December gathering, the Committee points to a further hike being likely. As a reminder, the repo path from September implied 25bps increases would be delivered at both the November and December gatherings. Finally, the subsequent presser from Governor Bache didn’t provide much additional colour on the statement.