Central Banks Weekly November 25th: Reviewing RBNZ, FOMC & ECB Minutes, Riksbank, CBRT, SARB

25th November 2022:

RBNZ REVIEW: The RBNZ delivered a 75bps rate hike to lift the OCR to 4.25% which was as expected and the largest hike in the central bank's history, while the announcement was perceived as even more hawkish as it was accompanied by upward revisions to the RBNZ's view for the OCR which it now expects to peak in December 2023 at 5.5% vs prev. view of 4.10%. That Bank stated that monetary conditions need to tighten further and the Committee considered a 75bps or 100bps rate increase compared with analysts' forecasts of either a 50bps or 75bps hike heading into the announcement. Furthermore, the RBNZ said that consumer price inflation is too high and the Committee agreed that the OCR needs to reach a higher level and sooner than previously indicated. During the press conference, Governor Orr said there will be a shallow recession, but noted that economic activity remains high and spending is strong, while the central bank also stated that they are mature in the tightening cycle and closer to the end than the beginning, but added that new shocks are arriving all the time.

FOMC MINUTES REVIEW: The Fed minutes were taken as dovish with markets now pricing in a ca. 80% chance of a 50bp hike in December and just a 20% chance of a 75bp move (down from about a 25% probability heading into the minutes). The minutes noted that a substantial majority of participants judged a slowing in the pace of interest rate hikes would likely soon be appropriate and would allow the Fed to assess progress towards its goals given the uncertain lags around policy. However, other participants noted that, before slowing the pace of policy rate increases, it could be advantageous to wait until the stance of policy was more clearly in restrictive territory and there were more concrete signs that inflation pressures were receding significantly. However, as has been widely flagged, the minutes emphasised with policy approaching a "sufficiently restrictive level", the final destination of the Fed Funds Rate had become more important than the pace. Meanwhile, many participants noted significant uncertainty about the ultimate level of the Fed Funds Rate and "various" participants suggested it was higher than previously expected. The minutes saw participants agree there were very few signs of inflation pressures abating (minutes were pre-October CPI) and they generally noted inflation risks remain tilted to the upside. There were also some concerns about the strength of the labour market, where a few participants said ongoing tightness could lead to an emergence of a wage-price spiral, even though one had not yet developed. Overall, the minutes suggested a slowdown is near as they approach restrictive territory, but it is uncertain what the terminal Fed Funds Rate will be, other than it would be data dependent and likely higher than what was previously expected - the September SEPs suggested 4.50-4.75%, but recent commentary has been inferring somewhere between 4.75-5.25%. The timing of how long rates are to stay in restrictive territory remains unclear, and will likely be directed by economic data.

CBRT REVIEW The CBRT cut its Weekly Repo rate by 150bps to 9% (prev. 10%), in line with expectations, while a notable line from the release confirmed prior guidance that "it has decided to end the rate cut cycle that commenced in August". In further commentary, the CBRT expects the disinflation process to commence on the back of measures taken and decisively implemented. The Bank added that it is critically important that financial conditions remain supportive, and the Committee evaluated that the current policy rate is adequate. Note, in response to the rate decision, there was little reaction seen in USD/TRY.

RIKSBANK REVIEW: Overall, in-line with the base case from the Riksbank given the hot inflation situation and the headwind of a domestic slowdown; thus, reaction was two-way and relatively limited. Delivering a 75bp hike to take the Rate to 2.50% with the Policy Rate Path lifted as such and implies a 25bp hike in February to 2.75% at which point the Riksbank will pause the tightening cycle. Note, the peak rate is now 2.84% and thus implies a small probability of further tightening beyond February's 25bp. The path now implies rates remaining at that peak for its entirety - i.e. to Q4-2024; though, this is likely a function of the uncertain inflation/domestic situation and the fact that Ingves wouldn't want to tie the hands of the new governor by suggesting when the first cut will occur. Reminder, the next meeting in February will be under new Governor Theeden who is expected to be neutral/hawkish when compared to departing Governor Ingves.

ECB MINUTES REVIEW: The accounts from the ECB's October meeting delivered the assessment that the outlook for euro area economic activity had deteriorated since the September monetary policy meeting. Furthermore, it was argued that a technical recession was becoming the baseline scenario and the most likely outcome. That said, it was decided that in view of the current inflation outlook, it was appropriate to continue normalising monetary policy by withdrawing accommodation. In terms of the magnitude of the hike, the rationale for opting for a 75bps move was based on the risk of a protracted period of excessively high inflation and the risk that this might add to medium-term price pressures.

Additionally, it was argued that falling short of market expectations would imply an unwelcome loosening impulse. "A few members" expressed a preference for a 50bps increase given that such a move would be accompanied by a signal on the need for further future rate hikes and adjustments to TLTRO conditions. Furthermore, the 50bps camp argued that an overly aggressive pace of tightening could have repercussions for financial stability, economic activity and evenetually inflation. Ultimately, the 75bps majority prevailed, however, the argument for a step down to 50bps appears to be increasing ahead of the December meeting. Beyond October, the account noted that in the event of a shallow recession, the Governing Council should continue normalising and tightening monetary policy, whereas it might want to pause if there was a prolonged and deep recession, which would be likely to curb inflation to a larger extent. Finally, the view was expressed that monetary tightening would probably need to continue after the monetary policy stance had been normalised and moved into broadly neutral territory.

SARB REVIEW: The SARB hiked its repo rate 75bps to 7%, as expected, albeit via a 3-2 split decision with the two dissenters preferring a 50bps hike. Alongside the release, the SARB issued its updated forecasts, where it cut 2022 GDP growth to 1.8% (prev. 1.9%), 2023 to 1.1% (prev. 1.4%), and 2024 to 1.4% (prev. 1.7%) citing high inflation, weak economic activity and the Russia/Ukraine war, amongst other factors. For this year, it maintained forecasts for growth at 0.4% in Q3, and only 0.1% in Q4, mainly due to record load-shedding. On the inflation front, core CPI is seen unchanged at 4.3% in 2022, but 2023 is higher than the previous at 5.5% (prev. 5.4%), while 2024 and 2025 are also unchanged at 4.8% and 4.5%, respectively. For headline figures, it is forecast at 6.7% for 2022, 5.4% for 2023, and 4.5% for 2024/2025, while it sees inflation reverting to mid-point of the target range by Q2 2024 as in Q2 it breached the upper end, and is likely to remain there until Q2 2023. In commentary, the SARB said risks to the inflation outlook are assessed to the upside despite the easing of global producer price and food inflation.