Central Banks Weekly January 20th: Previewing BoC; Reviewing BoJ, ECB, Norges Bank, CBRT

January 20th

BOC POLICY ANNOUNCEMENT PREVIEW (WED): After lifting its Bank Rate by 50bps in December, to 4.50%, the BoC said it "will be considering whether the policy interest rate needs to rise further" as it "continues to assess how tighter monetary policy is working..." and "how inflation and inflation expectations are responding." Analysts have taken this as a sign that the central bank is on the cusp of downshifting the pace of its hikes, with many now expecting a 25bps move in January. That said, the central bank has kept its policy options open, meaning that an unchanged outcome, 25bps hike and even another 50bps hike are all possibilities. Canadian bank RBC is modelling a 70% chance that the BoC raises by 25bps, a 20% probability of a larger 50bps move, and assigns a 10% chance of an unchanged decision. Explaining its thinking behind 25bps, RBC notes that recent data has been close to neutral; "we have seen some slowing on the activity side, especially forward-looking activity in the Business Outlook Survey, but underlying inflation is uncomfortably high and inflation expectations remain lofty," RBC writes, "the labour market remains very tight," and it adds that "this is not an environment where data has softened enough to warrant a pause, nor has it been strong enough to continue at a 50bps clip." Indeed, Governor Macklem in December remarked that elevated inflation means the BoC had to be more concerned about under-tightening. Elsewhere, many are arguing that the BoC's January rate hike could be the last of the cycle. The question becomes how the BoC could communicate this. RBC suggests that consistent with the optionality that the central bank has retained in its communications, it looks for the January statement to use similar language to the December version; RBC says "this means making it clear that it could be the last hike, but not committing to it and leaving the data to determine the near-term rate path."

BOJ REVIEW: The BoJ defied heightened speculation for another policy tweak and kept all settings unchanged with negative rates at -0.10% and the parameters of its YCC maintained at current levels. The central bank also stuck with its forward guidance on rates and stated that it will continue large-scale JGB buying and make nimble responses for each maturity, while it reiterated it will not hesitate to take additional easing measures as necessary. Furthermore, the BoJ extended the fund operation to support financial lending by one year and enhanced its fund supply operation against pooled capital, while the Outlook Report was dovish leaning as Real GDP forecasts were cut across the projection horizon and although members mostly raised the Core CPI view, the estimates for Fiscal 2023 and 2024 both remained below the 2% target, which is a level that could have paved the way for policy normalisation. During the press conference, BoJ Governor Kuroda stuck to a dovish tone in which he noted that he does not expect 10yr JGB yields to continue trading above 0.5% and there is no need to further expand the bond target band. Kuroda also stated it is still early days since the adjustment to the new yield range and the BoJ needs more time to assess the impact on market functioning, while he also reiterated that they will continue monetary easing to achieve sustainable and stable inflation.

ECB MINUTES REVIEW: The account of the ECB's December policy announcement focused on the debate on the Governing Council over whether to opt for a 50bps or 75bps hike. The argument for the latter was based on the view that "raising interest rates by less than 75 basis points would send the wrong message and risked being perceived as inconsistent with the 2% inflation target". Source reporting at the time suggested that over a third of members wished to raise rates by this magnitude. The argument for 50bps was framed as "a sustainable pace at which monetary policy could be tightened in an expeditious manner". Additionally, "an increase of this magnitude would acknowledge the uncertainties surrounding the state of the economy and the inflation outlook". In the end, policymakers coalesced around the idea of a 50bps move whilst highlighting the Bank's intentions to raise rates significantly at a sustained pace; this was seen as broadly equivalent to raising rates by 75 basis points at the present meeting. On the balance sheet, the decision was taken to shrink the APP portfolio at an average pace of EUR 15bln per month as of March 2023 until the end of Q2, at which point, the pace will be reviewed. In terms of dissenting views, some members expressed a preference for reducing the APP portfolio at a faster pace or for terminating reinvestments altogether. It was cautioned, however, that too fast a pace of reduction could lead to the re-emergence of bond market fragmentation, which could make further interest rate increases more difficult to pursue. Overall, the account offers little in the way of fresh insight at the Bank with markets still trying to digest source reporting from earlier in the week which suggested that the ECB could step down to a 25bps increment of hikes by March; reporting which has subsequently received pushback from the likes of Knot and Villeroy.

NORGES BANK REVIEW: Overall, the Norges Bank policy announcement was in-line with the base case for an unchanged rates, given guidance from December’s gathering implying that the Q1 hike would most likely occur in conjunction with the March MPR. While the Board acknowledged that inflationary pressures remain pronounced and this could suggest hiking in January, the global easing of such pressures and the domestic impact of extensive tightening thus far successfully argued against a hike. The reaction was minimal, with some modest gyrations on either side of 10.75 in EUR/NOK around the decision, and perhaps just an unwinding of the minority hawkish positioning going into the announcement. Looking ahead, the Norges Bank has guided us towards a hike “most likely” taking place at March’s MPR, if December’s MPR holds true this could mark the end of the current tightening cycle; though, the December Repo Path does keep some optionality for further tightening if CPI-ATE remains stubbornly elevated.

CBRT REVIEW: The Turkish Central Bank opted to maintain its Weekly Repo Rate at 9.00% ¬– in line with expectations, and for the second month in a row. The statement largely reiterated known positions from the central bank. “The CBRT will continue to use all available instruments decisively until strong indicators point to a permanent fall in inflation and the medium-term 5% target is achieved in pursuit of the primary objective of price stability” and will “continue to take its decisions in a transparent, predictable and data-driven framework.” The statement also suggested that underlying inflation trends had improved. Following a 1.5ppts rate cut in November, analysts believe that rates are likely to remain at the current level until mid-2023, when elections are held in Turkey, given the questionable independence of the central bank.