Central Bank Weekly January 27th: Previewing FOMC, BoE, ECB and BCB; Reviewing BoC

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FOMC POLICY ANNOUNCEMENT (WED): The consensus expects the FOMC will lift its Federal Funds Rate target by 25bps to 4.50-4.75%, although some still expect the central bank to hike rates by a larger 50bps increment. Money markets are pricing the smaller move with almost certainty. Money market pricing and commentary from Fed officials has been diverging; policymakers have been reticent to get into discussions about when the central bank will cut rates, instead focussing on the still-high inflation levels. For historical context, the Fed has tended to hold rates at neutral for between 3-15 months, with the average being about 6.5 months. Money markets, however, are pricing rate cuts at the end of this year as the economy slows. While the Fed will likely to continue its course until its inflation goals are more clearly in sight, investors are debating the level that rates will peak, and how long they will be held at terminal; money markets imply the terminal rate between 4.75-5.00%, more dovish than the 5.00-5.25% pencilled in by officials in their December economic projections. Accordingly, Chair Powell is again expected to lean back on the market's dovishness, as well as the looser financial conditions that have been seen recently. On an operational note: Chair Powell tested positive for COVID, it was announced on January 18th; in the event that Powell is unable to attend the February FOMC, guidance suggests that the FOMC's Vice Chair Williams will assume Powell's duties.

BOE ANNOUNCEMENT (THU): 29/42 surveyed analysts by Reuters look for a 50bps hike in the Bank Rate to 4%, with the remaining 13 looking for a more modest 25bps adjustment. Market pricing agrees with consensus as a 50bps move is priced at around 76%. A consensus on the vote split is yet to be published, however, the decision will likely be subject to dissent given that Tenreyro and Mann voted unchanged at the December decision. HSBC looks for similar dissent this time around with none of the other members of the MPC expected to switch to the unchanged camp yet. Within those remaining seven, there is likely to be a split of views, the extent to which is hard to judge given the lack of comms from the MPC since December. HSBC has attempted to form a base case scenario with an out-of-consensus call for a 25bps hike in which Bailey, Cunliffe, Broadbent and Pill go for 25bps whilst Mann, Haskell and Ramsden back a 50bps move. However, such a step down in the cadence of rate hikes would likely need to be accompanied by guidance that rates will still have further to run given developments in the labour market. Looking beyond February, a 25bps hike in March is priced at around 80% with markets split on whether a further 25bps would follow in Q2 to take the terminal rate to 4.5%. In terms of the accompanying forecasts, HSBC expects that the impact of the stronger GBP and softer energy prices will likely outweigh the impact from stronger growth and lower rates, which should therefore lead to a downward revision to the MPC's Q4 2023 inflation forecast to 6.9% from 7.9%.

ECB ANNOUNCEMENT (THU): 55/59 surveyed analysts look for a 50bps hike in the deposit rate to 2.5% with market pricing assigning a circa 90% chance of such an outcome; this would take the deposit rate into slightly restrictive territory. The December meeting saw President Lagarde state "based on the information that we have available today, that predicates another 50-basis-point rate hike at our next meeting, and possibly at the one after that, and possibly thereafter". This statement saw consensus coalesce around the idea of a 50bps hike for the upcoming meeting and comms from ECB officials have done nothing to lead markets away from this view. That said, some confusion around the rate hiking cycle was observed after a Bloomberg report suggested that policymakers are reportedly beginning to consider just a 25bp hike in March. Nonetheless, commentary from policymakers has done little to suggest that the GC is considering such a step down at this stage and has leaned against such reporting. In terms of market pricing, a 50bps increase in March is priced at around 80% with another 25bps expected to come thereafter in May; what happens beyond May is subject to divided opinion. With regards to the balance sheet, the prior meeting saw the GC announce that from the beginning of March 2023 onwards, the APP portfolio will decline at an average pace of EUR 15bln per month until the end of Q2 with its subsequent pace to be determined over time. For the upcoming meeting, further details on the programme are set to be announced, on which, Morgan Stanley expects "more details on how the decline in reinvestments will be distributed between the different APP programmes, as well as jurisdictions (most likely to be done proportionally in line with the capital key)". MS adds that a detailed announcement of the entire expected QT path is less likely with guidance to be kept "general".

BCB POLICY ANNOUNCEMENT (WED): The COPOM in December held the Selic rate at 13.75%, as the market was expecting. Credit Suisse said its accompanying statement appeared neutral, with the central bank not giving any further information about the prospective scenario. The statement did allude to concerns about fiscal dynamics, noting that "the Committee will closely monitor future developments in fiscal policy and, in particular, its effects on asset prices and inflation expectations, with potential impacts on the dynamics of future inflation." Political pressure seems to be ramping up on the central bank. Additionally, a former Deputy Governor who played a crucial role in developing the BCB's inflation-targeting regime, said that officials had set excessively restrictive goals, and that the current targets failed to account for the country's unusually large fixed fiscal outlays, adding that officials were putting themselves in a corner, noting that Brazil, unlike other EM economies, spends more on pensions and public services. Credit Suisse said that "the uncertainty surrounding the waiver amounts and conditions to be approved in the Bill for Constitutional Amendment for the Transition and the absence of a credible fiscal anchor in the short term lead us to believe that interest rates will not be sufficiently restrictive, given neutral interest rates have risen and inflation expectations should remain high." The bank recently revised its expectations for the Selic rate, and now sees 11.50% by year-end (vs 13.75% previously), and for the end of the 2024 year, sees the Selic at 8.50% (cut from its prior view of 11.50%).

BOC REVIEW: The Bank of Canada hiked rates by 25bps, as expected, to 4.50%. However, it gave an explicit signal that it expects rates to be held at this level, providing the economy develops broadly in line with its forecasts, though caveated that it remained prepared to raise rates even further if it is necessary to bring inflation back to target. The pause signal was a dovish surprise, with analysts mostly expecting the central bank to maintain its prior guidance. The MPR saw the Bank lower its 2022 and 2023 inflation forecasts, but 2024 inflation is expected at 2.3% (prev. 2.2%), the same year it expects it to reach its target. Growth forecasts were raised for 2022 and 2023, but lowered for 2024. Meanwhile, the neutral rate estimate of 2-3% was left unchanged, and its output gap estimate was revised higher to 0.5-1.5% from 0.25-1.25%. At his post-meeting press conference, Governor Macklem stressed that the pause was conditional as the BoC takes time out to assess whether they have reached a sufficiently restrictive level, and hinged on how the economy progresses. Macklem also stressed that it is too early to be talking about rate cuts, and when he was asked about the potential for an economic recession, said that there could be a mild one, and added that the BoC expects growth to stall over the next few quarters, but that was what is needed. In a later interview with Reuters, Macklem said that if service price inflation was stickier than expected, the BoC would likely need to raise rates further, and the biggest near-term economic risk would be if a rapid reopening of the Chinese economy caused global commodity and oil prices to rise.