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Central Bank Weekly February 3rd: Previewing BoC minutes, Riksbank, Banxico, CBT; reviewing FOMC, ECB, BoE, BCB

February 3rd

BOC MINUTES (WED): As a recap, The BoC hiked rates by 25bps 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.

RIKSBANK ANNOUNCEMENT (THU): Expected to hike as guided in November, though desks are split as to whether the move will be 25bp as the repo path from the last policy meeting implied, or if a larger 50bp increase will be delivered given that CPIF continues to increase and surpass the Riksbank's November forecasts. A 25bp hike can be justified by the view that much of the upside in headline inflation is due to volatile electricity prices and the core (ex-energy) measure was only marginally above target in December. As such, the Riksbank could argue that the hot headline prints are not representative of the underlying inflation backdrop, and thus stick with its guidance from November. Additionally, the broader economy continues to deteriorate and Sweden is in a recession. On the flip side, the main CPIF metric, while affected by electricity pricing, was above target in November and significantly so in December at 12.3% (Riksbank exp. 9.14%). This measure will undoubtedly be used as justification by some on the Board for hawkish action; a stance perhaps prefaced by Breman's recent remarks that inflation is far too high and does not appear to have peaked yet. Additionally, the ECB's 50bp hike alongside hawkish market pricing for the Riksbank adds credence to the argument for a larger tightening increment. Looking further ahead, prior guidance was for the interest rate to peak at 2.84% and then remain at this level, but the terminal rate looks all but certain to be lifted irrespective of the hike magnitude implemented at this gathering, with the Riksbank's assessment of CPIF/CPIF-XE likely to have the final say.

BANXICO ANNOUNCEMENT (THU): The Mexican central bank's January poll of private sector analysts shows expectations for benchmark interest rates to end this year at 10.50% (vs 10.25% in the December survey). Analysts also revised up their view of Mexican inflation, seeing headline CPI at 5.8% in 2023 (vs 5.10% previously), and the core rate of inflation at 5.20% this year (prev. 5.07%). Oxford Economics expects the Banxico to defy consensus expectations with a swifter normalisation cycle. "Our Taylor rule calculation supports our forecast of 175bps in rate cuts during the second half of 2023, taking the policy rate to 9.00%," the consultancy writes, and sees the central bank ending its tightening cycle in February with a 25bps hike to 10.75%, in line with forward guidance provided at the last meeting. "However, the unexpected strength of the peso and the market's recent repricing of a lower terminal rate and earlier rate cuts in the US should provide room for Banxico to start cutting rates from September onwards." OxEco says the Banxico' s decoupling from the Federal Reserve will likely cap the rise of the MXN, although it says that the likely "downturn in the US and a less attractive carry-trade return should prevent the currency from repeating its stellar performance last year"; it sees USD/MXN at 20.5 by the end of this year.

CBR ANNOUNCEMENT (FRI): All 13 analysts surveyed by Reuters expect Russia's central bank will maintain its key rate at 7.50%, as it continues its efforts to bring inflation back to the 4% target level. The survey suggests that the inflation goal will not be met this year, with analysts predicting it will end 2023 at 5.8%. The analysts surveyed also see the Russian economy contracting by around 2% this year, in contrast to the IMG's recent projections, which estimates above zero growth in 2023. Looking ahead, analysts see scope for the CBR to lower rates, with the key rate seen at 7.13% by the end of the year (range 6.50-8.00%).

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FOMC REVIEW: The Fed hiked its FFR by 25bps to 4.5-4.75%, as expected. The statement said the central bank continues to see "ongoing increases" in the Fed rate as being appropriate, coming against some expectations that the line could be dropped in order to give optionality for a lower terminal rate than the 5-5.25% median dot in the December SEPs. While that didn't happen, we did see a switch in language on guidance from the "pace of future increases" to the "extent of future increases," suggesting that debate is moving from the size of hike increments to how many hikes remain in the cycle, a dovish offset to the continued use of "ongoing increases". Elsewhere in the statement, the Fed acknowledged that inflation had eased somewhat, but remained elevated, while it also dropped references to public health as a factor in the Bank's policy assessment. Chair Powell's post-meeting press conference was judged as mixed; despite markets cherry-picking the dovishness, where he seemingly looked to sit on the fence on many topics rather than cut off his options. The Fed Chair confirmed that the disinflation process was underway, albeit he was eager to highlight that core services inflation, ex-housing, had not shown progress. Powell said the Fed's focus was not on short-term moves in financial conditions, but that it's important for them to continue to reflect the policy restraints put in place. He believes that policy is still not 'sufficiently restrictive', but left optionality by stressing data dependence, later saying that it is possible that the Fed updates its policy path if the data came in differently to what it expects. Powell said the Fed has not yet made a decision on the terminal rate, and that it will look at the data between now and the March SEPs, adding that it was possible that it could be both lower or higher than the 5.1% seen in the December SEPs. Powell sees a path to getting inflation to 2% without significant economic decline, though it could take more slowing in the economy than it expects. Overall, there was something for both hawks and doves in his remarks, and at risk of fitting narrative to price action, perhaps that is the takeaway. Where Powell has previously tended to lean on the hawkish side, refuting the notion of any imminent Fed pivot, he now appears to be shifting to a more ambiguous stance, giving him the optionality to shift when needed.

BOE REVIEW: As expected, the BoE opted to defy some outside bets for a 25bps hike and raised the Bank Rate by 50bps to 4.0%. The vote split was a replica of what we saw at the December meeting with dissent from Tenreyro and Dhingra, whilst the remainder of the MPC opted for a 50bps hike. The decision was based on the need to "address the risk that domestic wage and price pressures remained elevated even as external cost pressures waned". Elsewhere, focus for the release was on the MPC's adjustment to its guidance on rates which saw policymakers ditch the use of "forcefully" in its guidance and now state that "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required". Some desks suggested that the conditionality on further rate hikes could be suggestive that a pause in hikes is forthcoming. Accordingly, market pricing moved in a more dovish manner with odds of a 25bps March falling to around 60% from 80% pre-announcement with the chance of a May 25bps move around 12% vs. around 50% pre-announcement. The accompanying MPR saw a downgrade to the 2023 inflation forecast to 4.0% from 5.25% with inflation of just 1.5% next year. Interestingly, the MPC's constant rate forecast (i.e. if rates are held at 4%), suggests that CPI would be projected in two years at 0.8% and 0.2% in three years, therefore suggesting that current policy would be far too tight over the medium-term for the MPC to reach its inflation mandate. On the growth front, the dire 2023 forecast made in the MPR was upgraded, but still seen at -0.5% with a further contraction of 0.25% expected next year. Overall, the terminal level of the Bank Rate is clearly on the horizon and market pricing has acted accordingly. Analysts at Pantheon Macro suggest that as "signs of slowing price rises and accumulating labour market slack continue to emerge", the MPC will look set to hold the Bank rate at 4% in March and for the remainder of the year.

ECB REVIEW: As expected, the ECB delivered another 50bps hike to the deposit rate and reaffirmed its tightening intentions by stating that it intends to unveil another 50bps adjustment in March. Lagarde stated that another 50bps in March is warranted on account of underlying inflationary pressures, fiscal measures and wage growth. At the March meeting, the ECB stated it will evaluate the subsequent path of its monetary policy. On the balance sheet, the ECB announced that reinvestments will be allocated proportionally to the share of redemptions across each constituent programme of the APP. At the follow-up press conference, which at times offered more confusion than clarity, Lagarde stated that the Bank's economic assessment sees risks to the economic outlook and inflation as "more balanced". In terms of the decision itself, Lagarde says there was a "large consensus", adding there was a discussion on communication, but not full agreement. For the policy path going forward, Lagarde noted that the ECB will not be at peak rates in March and there will most likely be ground to cover; this suggests that hopes for a pause in May could be disappointed. Furthermore, Lagarde attempted to stress the longevity of reaching terminal by stating that when the level is reached, rates will need to stay there. Overall, and despite all this, there was a clear scaling back of hawkish market pricing for 2023 with around 25bps of tightening taken out, potentially as a by-product of market participants questioning the Bank's resolve to keep hiking rates alongside potential pauses from the Fed and ECB.

BCB REVIEW: The COPOM maintained its Selic rate at 13.75% for the fourth consecutive meeting, as expected. The central bank said that the global environment continues to be adverse and volatile, marked by prospects of below-potential global growth for next year, high volatility of financial assets and an inflationary environment under pressure, despite more positive signs at the margin. It also said that monetary tightening in advanced economies and the stronger market sensitivity to fiscal fundamentals required more caution by developing economies, despite recent global activity data showing some resilience. Domestically, the BCB said that recent indicators continue to be in line with its view for a

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deceleration; underlying inflation was still above its policy target range. The Committee judged that the uncertainty in its assumptions and projections was higher than usual. Pantheon Macroeconomics said that statement implies that “all in all, policymakers will keep interest rates on hold for the foreseeable future and won’t open the door to rate cuts until fiscal risk finally eases.” Pantheon still believes that rate cuts likely will come in Q3 2023, assuming that the fiscal backdrop is benign, and inflation remains under control; “but the risks of interest rates remaining on hold for longer than markets expect have increased dramatically in recent months.”

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