Central Bank Weekly May 26th: Previewing ECB and CBRT minutes; reviewing FOMC, RBNZ, PBoC, BoK, SARB

PREVIEWS

ECB MINUTES (THU): As expected, the ECB stepped down to a 25bps cadence of rate hikes from the 50bps unveiled in March. The decision to implement further tightening was based on the GC's judgement that the "inflation outlook continues to be too high for too long". The smaller increment of tightening was likely amid concerns that "past rate increases are being transmitted forcefully to euro area financing and monetary conditions, while the lags and strength of transmission to the real economy remain uncertain". Moving forward, future "decisions will ensure that the policy rates will be brought to levels sufficiently restrictive...". The main surprise from the announcement came via the balance sheet whereby the GC now expects to discontinue the reinvestments under the APP as of July 2023. Some observed that the decision on the balance sheet could have been part of a compromise between the doves and the hawks on the GC with the latter favouring a 50bps hike today or a potentially more aggressive rate path going forward; something which Lagarde later denied. However, sources later suggested there was a deal involved, but the hawks apparently gave up on a 50bps hike without much of a fight. At the follow-up press conference, Lagarde stated that the decision "was not a pause" and the ECB still has "more ground to cover"; a comment which gave the announcement a more hawkish skew than the initial policy statement. In terms of the balance of views on the GC, Lagarde noted that the decision was not unanimous with some members preferring a 50bps adjustment, however, no members wished for an unchanged rate. Looking beyond May's meeting, Lagarde said she does not have an exact number for what "restrictive" will mean for the ECB with regards to the terminal rate, however, she judges the Bank will know when it gets there. The sources later revealed that some policymakers see two-to-three hikes ahead. As always, the account of the meeting will be deemed as stale in some quarters. Furthermore, with a June hike fully priced in and the Bank in data dependent-mode, it's hard to see what, if anything, the account can reveal to help shape expectations for policy after next month's meeting.

CBRT MINUTES (THU): The Turkish Central Bank opted to maintain its One-week Repo Rate at 8.50%, in line with market expectations. They reiterated their stance that the current rate is sufficient to facilitate recovery from the early 2023 earthquakes. The CBRT's forward guidance was consistent with the previous report, emphasising financial stability concerns due to various factors, including a potential global recession. The domestic outlook is more optimistic, highlighting an expedited recovery in the earthquake-stricken region. They also restated the need for supportive financial conditions in response to the earthquakes, underscoring the alignment of all policy instruments with 'liraisation' targets. Following the first round of elections, the CBRT briefly expanded security maintenance requirements to encompass additional commercial and consumer loans, only to backtrack ahead of the electoral run-off. Despite these actions, increased regulations on daily bank FX transactions and 'liraisation' targets remain in effect. The future of CBRT policy could largely reside with the outcome of the election run-offs – “whether the new administration after the second round of the Presidential elections is to change/revise the new economy model will be a key issue for watchers of the Turkish economy”, say the analysts at ING.

REVIEWS:

FOMC MINUTES REVIEW: The FOMC’s May meeting minutes reflected the mixed nature of Fedspeak seen in wake of the announcement. Whilst Fed policymakers agreed "the extent to which additional increases in the target range may be appropriate after this meeting had become less certain," "some" said that "based on their expectations that progress in returning inflation to 2% could continue to be unacceptably slow, additional policy firming would likely be warranted at future meetings." And while "some" thought more hikes would be needed, "several... noted that if the economy evolved along the lines of their current outlooks, then further policy firming after this meeting may not be necessary," while "many" recognised the need for optionality. On the fiscal circus in Washington, officials had "concerns that the statutory limit on federal debt might not be raised in a timely manner, threatening significant disruptions to the financial system and tighter financial conditions that weaken the economy." Goldman Sachs said the minutes highlighted a range of views on the FOMC, but still suggest that a June pause is the base case; "Since the FOMC’s May meeting, the Fed leadership, including Chair Powell, have emphasized that monetary policy is restrictive and that risks to monetary policy have become more two-sided," the bank writes, "we see these comments as consistent with our expectation for a pause at the FOMC’s June meeting."

RBNZ REVIEW: The RBNZ raised the OCR by 25bps to 5.50% as expected, in a 5-2 vote, and the Monetary Policy Committee discussed the suitability of either a pause or a 25bps hike. The announcement was viewed as a dovish hike as the central bank maintained the peak rate forecast at 5.50%, which signals the end of its hiking cycle, and also omitted its prior language regarding further rate increases. However, it noted that the OCR was set to remain restrictive for the foreseeable future. The RBNZ also said that the level of interest rates is constraining spending and inflation, and forecasts that the economy to enter a recession with negative GDP growth in Q2 and Q3. Further, RBNZ Governor Orr said that the latest data was satisfactory after a long battle, and that it was the first time the Monetary Policy Committee voted on the decision as prior decisions were made by reaching a consensus. He also said that he has seen inflation, core inflation and inflation expectations come down, but as a cautious central bank, it is keeping restrictive monetary policy for some time, which suggests that the RBNZ will likely maintain the current level of rates for a prolonged period.

PBOC LPR REVIEW: The PBoC kept its benchmark lending rates unchanged. The 1-Year Loan Prime Rate, which most loans are based on, was maintained at 3.65%, and the 5-Year Loan Prime Rate, which is the reference for mortgages, was held at 4.30%. The decision was widely expected as the central bank recently maintained the rate on its 1-Year Medium-term Lending Facility, which serves as a fairly accurate precursor to its intentions for benchmark rates, while the Chinese financial press has since reported that the PBoC's Loan Prime Rates are expected to remain unchanged for some time and that the LPR faces little downside risk due to the economic recovery with the necessity of a downward adjustment seen as very low. In addition, the recent weakening trend of the yuan adds to the case for the central bank to refrain from loosening policy to avoid further unwanted pressure on the currency, while the PBoC has previously pledged to keep economic operations within a reasonable range and will give more prominence to stabilising growth, as well as curbing speculation on Yuan rates when necessary. Nonetheless, the potential for future policy support cannot be ruled out given the recent slew of soft data releases from China, including the return of Manufacturing PMI to contraction territory, disappointing Industrial Production and Retail Sales, as well as soft inflation data, with CPI at its slowest pace since February 2021.

SARB REVIEW: The South African Reserve Bank raised its repo rate by +50bps to 8.25%, higher than the +25bps consensus view, citing concerns about inflation due to ongoing power cuts. Although the central bank sees balanced risks to the domestic outlook, it expects the ZAR currency to weaken further. GDP growth forecasts for 2024 and 2025 were left unchanged at 1.0% and 1.1% respectively. While the global growth outlook has somewhat improved, domestic economic conditions remain poor with persistent inflation and elevated financial stability risks. Some analysts argued that this month’s announcement is a signal that the tightening cycle has concluded and are now looking for rate cuts later in the year. A recent Reuters poll revealed analysts predict the SARB is set to cut rates by 25bps in Q1 of 2024, followed by further rate cuts in Q3 2024.

BOK REVIEW: The Bank of Korea maintained its base rate at 3.5%, as expected, in a unanimous vote. Some still frame the announcement as hawkish since six of the even Board members saw the need to keep the door open for one more rate hike – which was up from five at the previous policy meeting. The BoK said that economic growth is to remain weak for some time, and inflation will likely fall considerably before rebounding slightly for the rest of the year, adding that uncertainty is high over the Chinese economy and IT sector. It lowered its 2023 GDP growth forecast to 1.4% from 1.6%, with a weak chip sector and delayed effects from China reopening the main factors behind the slower growth projection. Further, the BoK Governor noted that core inflation is not easing as much as Board members had expected and they had a common opinion that it is premature to talk about a rate cut this year with increased uncertainty regarding whether inflation will approach the 2% target before year-end.