Central Bank Weekly June 16th: Previewing BoE, PBoC LPR, SNB, Norges Bank, Minutes from RBA and BoC; Reviewing FOMC, ECB, BoJ

PREVIEWS:

RBA MINUTES (TUE): Desks will be dissecting the minutes for more colour surrounding the RBA's latest hike. To recap, the Central Bank surprisingly raised the Cash Rate Target by another 25bps to 4.10% (exp. 3.85%), while it reiterated that the Board remains resolute in its determination to return inflation to target, and some further tightening of monetary policy may be required. It also repeated that inflation in Australia has passed its peak, but at 7% is still too high and it will be some time yet before it is back within the target range. The Bank stated that this further increase in interest rates is to provide greater confidence that inflation will return to target within a reasonable timeframe, as well as noting that recent data indicates that upside risks to the inflation outlook have increased and the Board has responded to this. Following the decision, analysts at Deutsche Bank suggested markets should price in more than just one additional rate hike.

PBOC LPR (TUE): The PBoC is likely to cut its Loan Prime Rates next week with the 1-Year LPR, which most loans are based on, currently at 3.65% and the 5-Year Loan Prime Rate, the reference rate for mortgages, currently at 4.30%. Expectations for the PBoC to cut its benchmark lending rates follow the recent developments in China where the Big 4 banks and other lenders reduced their deposit rates at the request of authorities in Beijing to support the economy after a spate of weaker-than-expected data releases. Soon afterwards, the PBoC cut its 7-day Reverse Repo rate by 10bps for the first since August, which was then followed by similar cuts to its Standing Lending Facility and the 1-year MLF rate which serves as a fairly accurate precursor for the central bank's intentions for its benchmark lending rates. The ongoing growth concerns have prompted other support measures from Beijing with the state planning agency pledging that China will steadily lower loan interest rates and introduce targeted tax and fee reduction policies in science and tech, as well as guiding financial institutions to raise medium and long-term loan issuance for the manufacturing industry, while sources also noted that China is said to be weighing broad stimulus with property support and rate cuts which the State Council may discuss this Friday.

BCB ANNOUNCEMENT (WED): Brazilian Central Bank is expected to maintain the Selic rate at 13.75%, once again, which comes after the hold at 13.75%, as expected, in the prior meeting. However, in a dovish twist the BCB said that "although a less likely scenario, will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected." Accompanying commentary noted it will "assess if its strategy to maintain the Selic rate for a long period will be sufficient to ensure the convergence of inflation to target." Since then, ICPA inflation data for May fell to 3.94% Y/Y (exp. 4.04%, prev. 4.18%), with M/M dipping to 0.23% (exp. 0.33%, prev. 0.61%), which led Pantheon Macroeconomics to add "with inflation at its lowest rate since late 2020, and leading indicators pointing to a benign outlook in the near term, it is opening the door for rate cuts as soon as Q3." Since this data, BCB Chief Neto said inflation started to fall earlier and has been falling reasonably lately, but will have inflation between 4.5-5% this year, better than we had expected, but core inflation is still high. In response to government calls for rate cuts, the Chief further noted he hopes every day they can cut rates but stressed need to do it with credibility. Lastly, and most recently retail sales, albeit for April, rose 0.1% M/M (exp. 0.2%, prev. 0.8%) and 0.5% Y/Y (prev. 3.3%). As such, Pantheon noted it is a "relatively decent start to the year confirming that lower inflation, the boost from the BRL rebound, and government cash transfers, are offsetting the drag from tighter financial conditions, at least for now and at the headline level." Overall, it concludes, risks remain tilted to the downside, and some of the retail sales details are confirming that increased borrowing costs are starting to bite but the good news is that we expect these downside forces to ease from late Q3 onwards, as the COPOM begins cutting interest rates.

BOC MINUTES (WED): The minutes will be eyed for commentary around an appetite for further rate hikes after the central bank hiked by 25bps at its June confab. Expectations in June were split between a hike or an unchanged rate. The BoC noted the decision to lift the overnight rate was based on the view that monetary policy was not sufficiently restrictive to bring supply and demand back into balance and return inflation sustainably to the 2% target level. However, it did remove language from April that it was prepared to raise rates further if needed. In a following speech by Deputy Governor Beaudry, he noted the Bank is taking it one meeting at a time and that nothing is determined looking forward when asked whether the BoC has a bias to further tightening. Nevertheless, the latest poll via Reuters found that 20/25 analysts expect another 25bp hike in July, taking its key rate to 5.0%, while all those surveyed said there is a larger risk of the terminal rate being higher than expected. The last monetary policy statement noted that the labour market remained tight and excess demand in the economy looks to be more persistent than anticipated, although the May Canadian jobs report was a shock disappointment (-17k, exp. +23k), so commentary on the labour market will also be eyed, albeit given the data came after the meeting, it is unlikely the jobs report was incorporated into the decision. Analysts at Oxford Economics suggest the BoC needs to see wage growth slow to 3-3.5% to be confident of inflation returning sustainably to target.

BOE ANNOUNCEMENT (THU): 64/64 economists surveyed by Reuters expect the BoE to raise rates by another 25bps, taking the Base Rate to 4.75%. Markets concur with a 25bps hike priced in and a small chance of a 50bps move. The expectation for the Bank to deliver further tightening stemmed from the April inflation release which saw the headline Y/Y fall to 8.7% from 10.1%, but not meet market expectations for a decline to 8.2%, whilst the core reading rose to 6.8% vs. expectations that it would hold steady at 6.2%. The release was then followed up by a jump in headline earnings growth in the 3M/YY period in April to 6.5% from 6.1%, whilst the unemployment rate unexpectedly fell to 3.8% from 3.9% (consensus was for an increase to 4.0%). In terms of commentary from the MPC, Governor Bailey has stated that the Bank has put more inflation persistence into its models and food inflation is taking a lot longer to come down than expected. Elsewhere, known-hawk Mann has stated that services inflation is a concern and inflation expectations remain high. With a June hike nailed-on, attention will be on any guidance provided by the Bank. As it stands, existing guidance notes that "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required". In terms of market pricing, a total of 125bps (including June) is currently expected. However, many analysts suggest that this looks a bit aggressive with 50bps further hikes judged to currently be the base case. Note, the upcoming release will not be accompanied by a MPR and therefore, the MPC will not have an explicit quantitative means by which they can push back on this pricing. It remains to be seen if the policy statement will push back on such an aggressive rate path.

SNB ANNOUNCEMENT (THU): Expected to continue the tightening cycle from the current 1.50% policy rate in order to bring inflation back into the 0-2.0% target band from the May 2.2% YY figure. Further tightening is expected given that inflation remains above forecast alongside the tone of recent SNB commentary. On the latter, expectations for a hike were cemented by hawkish remarks from Chairman Jordan, speaking after May's CPI, that inflation is more persistent than thought and both second- and third-round effects are being seen. Additionally, Jordan made clear furthering policy tightening is on the cards by adding that "Swiss rates are relatively low, and it is not a good idea to wait for inflation to increase and then having to hike". Currently, market pricing looks for a 25bp hike to 1.75% which would be a step-down from the recent 50bp pace that would be merited by the marked pullback from the prior in May's CPI data; albeit, inflation is ultimately still above target. However, the domestic economy is experiencing a relatively mixed performance with the ZEW in particular highlighting areas of concern. Overall, the above remarks from Jordan mean the SNB is unlikely to be dissuaded from further tightening, though the trajectory for inflation means the peak is near and thus the prudent magnitude is likely to be 25bp.

NORGES BANKS ANNOUNCEMENT (THU): Forecast to hike by 25bp to 3.50% from 3.25%, a move which would chime with the guidance from May and is justified as a balancing act between a CPI resurgence and surprisingly soft growth data; though recent releases mean 50bp cannot be dismissed. On the growth data, SSB points out that "there might be indications that increased interest rates and inflation are starting to have an impact on disposable income. The decline in April appears in parts of the economy that are affected by changes in household purchasing power.". While 25bp is expected, the mentioned resurgence in price pressures across the board within May's CPI release arguably merits a 50bp hike. Finally, the Regional Network report was constructive on the growth front overall, and as such seemingly provides the Norges Bank with enough cover to continue tightening and adds further credence to those calling for 50bp. Rates aside, accompanying guidance will be crucial as the current repo path implies a 3.60% peak and given the above is likely to be lifted to or perhaps even over 4.00%. Additionally, the timing for the first rate cut could be pushed out in order to convey the Bank's conviction in bringing inflation sustainably back to target. As of the March MPR, a cut is not fully implied until around the mid-point of 2025.

CBRT ANNOUNCEMENT (THU): There are currently no expectations for what the CBRT will opt to do at its upcoming meeting – the first under new and first female Governor Hafize Gaye Erkan. Desks have suggested that Turkey may return to more orthodox policies following the fallout from the elections and a record-low Lira. The bets for policy normalisation came in part after the newly-appointed Finance Minister Simsek vowed to restore "rational" policies in Turkey. Analysts have made some big calls for the upcoming meeting, with JP Morgan expecting the CBRT to hike rates from the current 8.5% to 22% on June 22, and the bank expects the rate to be at 30% by year-end, with risks to the upside. Goldman Sachs meanwhile said "fully orthodox" policymakers would raise rates to 40%. That being said, it's important to remember the slew of central bankers fired by President Erdogan in the past for hiking rates against his will, which brought to question the CBRT's independence.

BANXICO ANNOUNCEMENT (THU): The Central Bank of Mexico is expected to leave rates unchanged at 11.25% again at the June meeting after pausing in May and saying it "considers that it will be necessary to maintain the reference rate at its current level for an extended period". The May meeting minutes saw one member suggest it is too early to be considering rate cuts, while another suggested it cannot be ruled out that greater or lesser tightening may be required. The prior meeting did reveal that Banxico considers the economy has begun to undergo a disinflationary process, given that many pressures have eased. However, it repeated that the balance of risks for the trajectory of inflation remain biased to the upside throughout the end of 2024, when it expects inflation to return to the 3% target level. Governor Rodriguez has also repeated the guidance since, saying it is still necessary to maintain the reference rate at its current level for a prolonged period, while Deputy Governor Espinosa noted it is important to keep rates restrictive. Looking ahead, analysts at Pantheon Macroeconomics expect the central bank to turn dovish soon, and open up the door for rate cuts in H2 23. PM note the MXN has performed well recently and if sustained it will help to continue pushing down inflation expectations and actual inflation in the near term. Pantheon suspect Banxico will likely remain on hold over the coming meetings, but gradually adopt a dovish tone as disinflation continues. It is worth noting the last meeting saw Banxico lower its 2023 headline inflation forecasts, while the May inflation report came in cooler than expected and the prior on both headline and core metrics, with M/M CPI declining 0.22%, a welcome sign for the Banxico in its fight against inflation.

REVIEWS:

FOMC & SEP REVIEW: The Fed left rates unchanged at 5-5.25% as expected, but crucially, ramped up its 2023 rate dot forecast by 50bps to 5.6% from 5.1% (range of dots plotted for this year lifted to 5.1-6.1% from 4.9-5.9%), with many expecting just a 25bps increase, firmly keeping the "skip" narrative on the table. The 2024 median dot was raised to 4.6% from 4.3%, 2025 to 3.4% from 3.1%, but the longer term 'neutral' rate left at 2.5% (albeit the central tendency of the estimates increased to 2.5-2.8% from 2.4-2.6% amid speculation around a higher equilibrium rate regime). Driving those increases included a material increase in the real GDP 2023 forecast to 1% from 0.4% in March, with Core PCE forecast rising to 3.9% from 3.6% and the 2023 unemployment projection tumbling to 4.1% from 4.5%.

POWELL PRESSER: In his prepared remarks, Chair Powell said the Fed had covered a lot of ground and the full effects of tightening are yet to be felt. But he caveated that by saying "nearly" all participations see further hikes as appropriate. Powell said "most" policymakers expect subdued growth to continue, adding there are some signs that supply and demand in the labour market are coming into better balance, although demand still substantially exceeds the supply of workers. On inflation, Powell said it remains well above the 2% goal, but has moderated somewhat and warned that reducing inflation is likely to require below-trend growth and some softening of labour conditions. Powell also gave the typical warning that the Dots were not a plan nor a decision, he was "hasten" to add, which was received as dovish at the time, albeit not an atypical statement for the Fed Chair to say.

POWELL Q&A: Probably the most interesting part of Powell's Q&A was a slip of the tongue when describing the decision to not hike, "And I think I think that the skip, I shouldn't call it a skip, the decision makes sense." SGH Macro's Tim Duy believes this was an admission that policymakers are already in favour of a hike in July, but given that Powell had been touting the July meeting as a "live" and data-dependent one, he didn't want to contradict that by inferring a decision had already been made, as the 'skip' label would imply. Further in the Q&A, Powell said the main issue is determining the extent of additional tightening, saying it makes sense for rates to rise at a more moderate pace. He said the Fed did not discuss whether to go to an every-other meeting approach and stressed that a decision about July had not been made, but did note the July meeting came up several times at the FOMC. Powell said the question of speed on rate hikes is separate from the level of rates, saying the Fed is not so far away from the destination, which makes it reasonable to go slower, but noted that a 5.6% terminal rate is pretty consistent with where it was trading before the banking turmoil in March. Powell also warned that, as per the SEPs, not a single person pencilled in a rate cut this year, "nor do I think it is at all likely to be appropriate if you think about it". On the "banking turmoil", Powell said it's too early to see the full extent of the effect. But generally, Powell didn't sound too alarmed, which would be reflective of the lack of any meaningful signs of a sharp credit crunch since March. He did spend some time talking about concerns in commercial real estate, "it feels like it feels like something that will be around for some time as opposed to you know, something that will suddenly hit and, you know, work its way into systemic risk." Finally, on the balance sheet, Powell said it expects the TGA rebuild to likely involve both a fall in RRP and reserves (despite evidence pointing to just the former at this stage), but doesn't think reserves are likely to become scarce in the near term, "or even over the course of the year."

ECB REVIEW: As expected, the ECB delivered another 25bps hike to the Deposit Rate, taking it to 3.5%. The decision to raise rates was once again premised on the judgement that inflation "is projected to remain too high for too long". Going forward, policy decisions will continue to follow a data-dependent approach and on a meeting-by-meeting basis. Perhaps the main takeaway from the initial announcement came from the accompanying macro projections which saw upgrades to headline and core inflation forecasts for 2023 through 2025 with the core 2025 print expected above-target at 2.3%. From a growth perspective, 2023 and 2024 forecasts were revised lower by 10bps. Elsewhere, the GC confirmed that it will discontinue the reinvestments under the asset purchase programme as of July 2023. At the follow-up press conference, when questioned on whether the GC expects to keep raising rates, Lagarde replied that there was still "more ground to cover" and the ECB is not done on rate hikes. Note, Lagarde once again refused to comment on where she saw the terminal rate. In terms of the unanimity of today's decision, Lagarde said the discussion was harmonious and there was a broad consensus. Overall, the decision by the ECB and subsequent commentary was very much as expected, whilst the main takeaway from the release came from the sticky outlook to core inflation which is indicative of further action by the Bank. As such, pricing for Q4 picked up a touch with terminal now seen at around 3.78% vs. 3.75% pre-release. That said, despite Lagarde making it clear that a July hike is on the cards, the odds of such an outcome is only around 65% which is largely unchanged from pricing ahead of the decision. Looking past July, ECB sources via Bloomberg suggested the central bank is set for a tough debate next month on whether a possible September hike is needed, and several officials favour the expected July hike to be the last of the cycle. Elsewhere, Reuters sources suggested policymakers began the debate on "evening out" the interest rate corridor between its three administered rates but discarded a move at this meeting and expect no decision on the matter in July, but they do expect it to gain more relevance later this year. The sources added that ECB staff presented the option of making the spreads between the three rates equal as they were until 2014.

BOJ REVIEW: Matching expectations, the BoJ maintained the Bank Rate at -0.10% and held QQE with YCC parameters, through a unanimous decision. The Board said Japan’s economy will continue to recover moderately, but with core consumer inflation to slow towards the middle of the current fiscal year. However, it did add that uncertainty surrounding the economy remains high. This language only reaffirms previous comments that the BoJ will likely continue to remain patient in terms of tweaking or shifting from easy monetary policy. Ueda maintained familiar language in his press conference, saying more time is needed to meet the 2% inflation target. On the back of the announcement, USD /JPY immediately moved higher from 140.18 to 140.71, whilst the Nikkei experienced a reversal and entered positive territory. This decision came after a slew of mixed data with stronger-than-expected Q1 GDP at 2.7% (Exp. 1.9%), whereas a core CPI print of 3.4% did match expectations. However, CPI Ex. FE YY showed the fastest pace of increase since September 1981, at 4.1%, calling into question the BoJ's projection for inflation to be back below the 2% target by March 2024. Oxford Economics has said that despite these metrics “we believe the BoJ will maintain the status quo for another year or so” adding that they continue to project CPI to cool in the second half of this year.