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Central Bank Weekly June 23rd: Previewing BoJ SOO, Riksbank; Reviewing BoE, PBoC LPR, SNB, Norges, Minutes from RBA & BoC

PREVIEWS:

BOJ SOO (MON): The BoJ will release the Summary of Opinions from the June 15th-16th meeting where the central bank maintained its ultra-easy policy settings, as widely expected, with the Bank rate kept at -0.10% and QQE with YCC left unchanged at the current parameters to target 10yr JGB yields at around 0% within a +/-50bps band. The BoJ's statement from the meeting provided very little in the way of fresh insight as it maintained the view that core consumer inflation is likely to slow the pace of increase towards the middle of the current fiscal year and noted that inflation expectations are moving sideways after heightening. Furthermore, its language on the economy was mixed in which it noted that Japan's economy is picking up and is likely to continue recovering moderately, but also stated that uncertainty is very high, which is supportive of the view that the Bank will continue to take a cautious and patient approach. The commentary from BoJ Governor Ueda at the post-meeting press conference also pointed to a lack of urgency to tweak policy as he stated that more time is needed to meet the 2% inflation target and warned that responding to an inflation undershoot after a premature rate hike is more difficult than responding to an overshoot, but also noted they are weighing the benefits and side-effects of YCC and will update regarding the progress of the review of past policies on the BoJ website starting from July.

RIKSBANK PREVIEW (THU): The Swedish Central Bank is expected to hike by 25bp to 3.75%, with SEB judging risks around the decision as being broadly neutral given market pricing is essentially entirely for a 25bp move. However, 50bp cannot be dismissed given the ongoing SEK depreciation and the hot May CPIF. Thereafter, these factors mean the Policy Path will likely see an upgrade to imply some further tightening by end-2023, though a typical 25bp increment may not be fully priced to provide optionality, in fitting with the approach of previous gatherings. Rates aside, bond divestments could be used as another tightening tool and perhaps a compromise for 25bp rather than another 50bp hike. On this, SEB expected the current SEK 3.5bln/month pace to increase to SEK 6-7bln/month; and while it is unclear how the summer sale pause will be addressed, divestments of some form are likely. Analysts at Nordea suggest that the Riksbank is likely to raise the policy rate by 25bps to 3.75% in June due to the ongoing depreciation of the SEK exchange rate. The bank predicts a further 25bps hike in September, peaking the policy rate at 4.00% this year. To further tighten monetary policy, Nordea expects the Riksbank to increase government bond sales volumes from SEK 3.5 bln to SEK 5bln per month after the summer. “Another potential measure is extending the maturity of Riksbank certificates. This could raise market rates and make investments in SEK more attractive to foreign investors.”, according to the Swedish bank.

REVIEWS:

BOE REVIEW: Following the hotter-than-expected May inflation data yesterday which saw headline Y/Y CPI print at 8.7% vs. the MPC forecast of 8.3%, the BoE opted to deliver a 50bps hike in the Bank Rate to 5%. Heading into the release, consensus (polling was taken ahead of Wednesday's inflation report) was in favour of a 25bps adjustment, whilst market pricing was a near coin flip between 25 and 50bps. The decision to exceed analyst estimates was based on the judgement that "the second-round effects in domestic price and wage developments generated by external cost shocks were likely to take longer to unwind than they had done to emerge". Not everyone on the MPC subscribed to this view with Dhingra and outgoing external member Tenreyro opting for an unchanged rate on the basis that goods inflation is expected to fall sharply and the lagged effect of existing tightening. Elsewhere, the Bank opted to maintain guidance that "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required". Note, some outside calls ahead of the meeting floated the idea that the Bank could reintroduce its "forceful" language around further policy measures. On the labour market (which was a factor in the hawkish expectations for today), the Bank notes "indications of future pay growth from the KPMG/REC survey and the Bank's Agents suggest that AWE growth will ease over the rest of this year". On the housing market, the statement noted "as set out in the May Report, the greater share of fixed-rate mortgages means that the full impact of the increase in Bank Rate to date will not be felt for some time". In terms of where we go from here, the MPC expects inflation to fall "significantly" over the course of the year, however, market pricing is indicative of further action to come with a 25bps hike for August priced at 69% and a total of 100bps of hikes forecast by December. In terms of desk views, Pantheon Macroeconomics suggests that such a path looks too aggressive and instead expects just 50bps of further tightening. In

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wake of the rate decision, Governor Bailey said we are not seeking to precipitate a recession and are not signalling what will come next on rates. On inflation, said the pattern of persistent and rather sticky inflation is seen in other countries too.

RBA MINUTES REVIEW: The minutes from the June meeting stated that the Board considered a rate rise of 25bps or holding steady and reconsidering at a later meeting, while arguments were finely balanced, but it decided that the case for an immediate hike was stronger. The minutes did not signal that there will be a follow-up July hike. Hence, market pricing for a July rate increase fell to 42% from a pre-release level of around 58%. In terms of other main points, the minutes suggested the case for the hike was focused on the increased risk that inflation would take longer to return to target than had been expected. The Board also reaffirmed its willingness to do what is necessary to bring inflation back down to target. Furthermore, members noted that consumer spending had softened significantly, with both higher interest rates and high inflation weighing on household purchasing power. The release also highlighted that lags in the transmission of monetary policy heighten the risk that past tightening could lead to a sharper economic slowdown. As a reminder, the RBA surprisingly raised the Cash Rate Target by 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. Since the meeting, RBA Governor Lowe delivered a speech in which he said it is too early to declare victory in the battle against inflation and the June rate increase followed information suggesting greater upside risks to the Bank's inflation outlook. The next meeting is slated for the 4th of July.

PBOC LPR REVIEW: The PBoC lowered its Loan Prime Rates (LPRs) as expected, with the 1yr rate cut by 10 bps to 3.55% (exp. 3.55%, prev. 3.65%), while the 5yr rate was also lowered by 10bps, to 4.20% (exp. 4.15%, prev. 4.30%). The easing was unsurprising after the central bank recently delivered similar cuts to the 7-day reverse repo rate (13th June), standing lending facility and 1yr MLF (15th June), with the latter serving as a fairly accurate precursor for the PBoC's intentions for benchmark lending rates. Some had expected a deeper 15bps cut to the 5yr LPR which most new mortgages are based on, as press reports had previously noted that analysts anticipated the Loan Prime Rates to be cut asymmetrically. Analysts continue to flag China's sluggish recovery from its zero-COVID-related hit, with several desks cutting their GDP forecasts for 2023 – the latest names including Nomura, Goldman Sachs and Citi. Analysts at ING anticipate more cuts to follow, although in iterations, suggesting that "more will likely follow in the months ahead as the economy continues to struggle". The Dutch bank reminds us that China's monetary policy framework differs from those of other major central banks – "The 7-day reverse repo rate and the 1Y MLF are set with a view to driving money market rates and credit/bond market rates. Loan prime rates are the rates on which mortgage yields are based. The standing lending facility rate (SLF) is equal to the 7-day repo rate plus 100bp, and is the cap for the interest rate corridor, while the 7-day reverse repo forms the floor. Deposit rates for savers are notionally set by banks but within ranges indicated by the PBoC - the so-called window guidance."

SNB REVIEW: The SNB hiked its Policy Rate by 25bps to 1.75% and maintained it cannot be ruled out that additional rises will be necessary. This was in line with analyst expectations, though disappointed some looking for a 50bps hike - note, ahead of the release, 23/33 polled thought the June hike would be the last, given the trajectory of inflation, though the SNB will likely remain data dependent. Market pricing heading into the announcement saw the terminal rate at around 2.13% in March 2024 and it is now seen at 2.21%. The decision to hike by 25bps was a result of recent inflationary developments and subsequent commentary from officials at the Bank with Chairman Jordan stating that inflation is more persistent than thought with both second- and third-round effects being seen. The reason to step down to a 25bps increment was likely based on the marked pullback from the prior in May's CPI data. The hawkish takeaway from the release came via the higher inflation forecasts for 2024-2025, which could be indicative of a higher for longer regime. On FX, the SNB said in the current environment, the focus is on selling foreign currency. Analysts at ING suggest the hawkish revisions to forecasts spell more hikes ahead for the Swiss central bank – "The fact that the ECB is likely to be more aggressive than previously expected – probably raising rates again in July and September – should further reinforce the SNB's decision. After September, the SNB rate is likely to remain at 2%, with a rate cut looking unlikely between now and 2026.", the desk said.

NORGES BANKS REVIEW: Norges Bank opted for a larger-than-expected 50bps hike to 3.75% (vs exp. 25bps hike to 3.50%) and said the current assessment of the outlook and balance of risks implies that the policy rate will most likely be raised further in August. The inflation path was raised throughout the projection horizon with the end-of-year forecast 100bps above the March forecast and the decision to hike by 50bps also to arrest the NOK's slide and combat higher-than-expected inflation. Heading into the release, the prior repo path implied a peak of 3.6% by year-end, this has now been revised to 4.21% with a peak of 4.25%. In terms of the outlook for 2024, the end-year rate is now viewed at 3.98% vs. the March forecast of 3.45% which suggests around 25 bps of cuts in 2024. Analysts at Wells Fargo expect both Norges, and the SNB, to raise rates further through September, while the desk also sees the risk of more extended ECB monetary tightening rising.

BOC MINUTES REVIEW: The BoC minutes noted that the Governing Council (GC) agreed to assess the need for future rate hikes based on data after deciding to hike at the June 7th meeting. The GC debated whether to keep rates on hold

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in June and signal a hike was likely in July, however it felt enough data had been accumulated to convince them a more restrictive monetary stance was needed, adding data since April tipped the balance of risks to the inflation outlook to the upside. The BoC expresed concerned that 3mth measures of core inflation were not showing a downward trend, and agreed the economy remained clearly in excess demand and the rebalancing of supply and demand is taking longer than expected. It also felt more recent data suggested additional momentum in household sector demand, noting housing resale prices had increased for three consecutive months. After the BoC dropped guidance that said it is prepared to raise rates further, the June meeting minutes noted the Bank agreed to assess the need for further policy increases based on the incoming data, seemingly taking a data-dependent stance completely. Money markets are currently pricing in another 25bp hike in July with a 70% probability and just a 30% chance of rates being left unchanged, and that is after the dismal Canadian jobs report in May just two days after the BoC's hike. Nonetheless, the April Retail sales data came in well above expectations and showing signs of a strong consumer, albeit a month behind the jobs report. Producer Prices and Raw Materials prices saw steep declines, but attention will be on the Canadian CPI report next Tuesday ahead of the June jobs report on July 7th, before the July 12th BoC.

BCB REVIEW: The Brazilian Central Bank maintained its Selic rate at 13.75%, as expected, and for the seventh consecutive meeting, but it did remove the reference to the possible resumption of the tightening cycle if the disinflationary process does not proceed as expected. Further within the release, the Copom said the current scenario demands patience and serenity in conducting monetary policy and stated that various measures of underlying inflation remain above the range compatible with meeting the inflation target. The Bank lowered its 2023 CPI forecast to 5.0% (prev. 5.8%) and cut its 2024 CPI forecast to 3.4% (prev. 3.6%). On the path ahead, Rabobank still thinks the easing cycle is more likely in the November meeting, but the bank does recognise that if inflation expectations recede faster towards 3.0%, then the easing cycle can begin one meeting before (September). Nonetheless, in the immediacy BCB Minutes (Tues) and the Q2 '23 quarterly inflation report (Thurs) next week should disclose further details on the outlook for inflation and state of the economy.

CBRT REVIEW: The CBRT opted to raise its One-week Repo Rate to 15% from 8.50% (exp. 21%, analyst ranges between 12.5-30%). USD/TRY rallied to fresh all-time highs as the hike fell well short of most estimates, while Reuters sources also suggested the CBRT Governor is to meet with bank executives on Friday. The central bank said monetary tightening will be further strengthened as much as needed in a timely and gradual manner until a significant improvement in the inflation outlook is achieved. The Committee decided to begin the monetary tightening process to establish the disinflationary course as soon as possible, to anchor inflation expectations, and to control the deterioration in pricing behaviour, as recent indicators point to an increase in the underlying trend of inflation. The CBRT said it will continue to take its decisions in a predictable, data-driven and transparent framework. To increase the functionality of market mechanisms and strengthen macro-financial stability, the Committee will simplify and improve the existing micro- and macroprudential framework.

BANXICO REVIEW: Banxico kept rates unchanged at 11.25%, as expected, but noted in order to achieve an orderly and sustained convergence of headline inflation to the 3% target, it considers that it will be necessary to maintain the reference rate at its current level for an extended period. Nevertheless, it downgraded its headline CPI forecasts for the rest of this year and Q1 ’24. Numerically, Q2 was downgraded to 5.7% (prev. 6.0%), Q3 to 5.0% (prev. 5.2%), Q4 to 4.6% (prev. 4.7%), and finally Q1 ’24 to 4.1% (prev. 4.2%). However, Banxico added that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. In wake of the decision, Deputy Governor Heath towed a familiar line that the Bank will do all that is necessary to bring inflation back to target. Pantheon Macroeconomics chimes in saying they believe rates being on hold for a prolonged period until inflation consistently falls towards target and the balance of risks improves “will happen over the second half of the year.” Adding, “underlying inflation pressures are falling rapidly, and both leading indicators and survey data suggest that the inflation picture will continue to improve over the next three-to-six months.” Nonetheless, the consultancy expects economic activity to soften across the H2 with a US recession posing a real threat. Concluding, PM expects a dovish shift in the Fed’s monetary policy to open the door for Banxico rate cuts, from Q4 onwards or perhaps even in late Q3.

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