newsquawk

Central Bank Weekly 21st July: Previewing FOMC, ECB, BoJ; Reviewing RBA minutes, PBoC

PREVIEWS:

FOMC POLICY ANNOUNCEMENT (WED): The Fed is expected to lift rates by 25bps to 5.25-5.50% at its July confab, with traders looking for clues as to whether this is the central bank's last rate rise of the cycle, or whether it is likely to fire an additional hike at a future meeting, in line with its own projections. SGH Macro's Fedwatcher Tim Duy explains that "market participants are caught in the grips of a Goldilocks narrative as recession fears are once again pushed into the future while inflation suddenly looks vanquished." Ahead, Duy says that if growth firms in Q3, as incoming data suggest, then another hike will remain on the table, adding that even a temporary period of inflation could sideline the Fed, especially if growth slows to something clearly below potential, which he says is around 1.8%. "The Fed will, however, lean towards pulling off that second rate hike - we should not dismiss that possibility too easily," Duy writes, "we can easily envision that second hike if growth remains firm, but what we can't see yet is the data to support an increase in the SEP projected terminal rate in September, although a rebound of inflation could also easily make that happen."

ECB POLICY ANNOUNCEMENT (THU): As judged by market pricing and surveyed analysts, the ECB is once again expected to deliver a 25bps hike which would take the deposit rate to 3.75%. The decision to move on rates again will be based on the GC's view that inflation "is projected to remain too high for too long", which prompted President Lagarde to declare at the June meeting that there was still "more ground to cover" and the ECB is "not done" on rate hikes. Since the prior meeting, headline inflation has cooled to 5.5% from 6.1%, however, the super-core metric ticked higher to 5.5% from 5.3%. With this in mind and officials from the Bank widely flagging a 25bps hike, the actual rate decision itself will likely pass with little fanfare. Instead, focus for the release will be on any accompanying guidance or hints about what tightening (if any) will be delivered from September onwards. On which, reporting from Bloomberg has suggested that the toughest challenge policymakers are set to face will be how to keep the September meeting an open one by avoiding "strong signals of either another hike or a pause". As a guide, the policy statement currently includes the line "interest rates will be brought to levels sufficiently restrictive to achieve a timely return of inflation to the 2% medium-term target and will be kept at those levels for as long as necessary". Market pricing for September puts the chance of another 25bps move at around 50/50 in the wake of comments from hawkish GC member Knot (and partly as a result of global rate pricing on the back of soft UK inflation data) who refrained from putting a September hike on the table by suggesting that rate increases beyond July are "possible" but "not a certainty". President Lagarde's best course of action will likely be to stress the Bank's data-dependence given that come September the Bank will have seen the release of July and August inflation reports and will be armed with their latest macro projections.

BOJ POLICY ANNOUNCEMENT (FRI): The Bank of Japan will conduct its latest 2-day policy meeting next week and will likely keep policy settings unchanged, with rates to be kept at -0.1% and YCC maintained to flexibly target 10yr yields at 0% within a +/- 50bps target band. The central bank will also release its latest Outlook Report which contains Board members' median forecasts for Real GDP and Core CPI, while press reports have noted expectations that the BoJ could raise the inflation forecast above the 2% target level at the upcoming meeting, which if confirmed, could be seen to pave the way for further policy normalisation. There was also some speculation about a potential tweak in policy with former BoJ Director Hayakawa expecting an adjustment to yield curve control this month by potentially raising the 10yr ceiling to 1.0%. Reuters sources on Friday suggested the Central Bank is leaning towards maintaining its yield control policy at the next meeting. Many policymakers see no immediate need for action as the 10-year yield is trading stably within the 0.50% cap. Despite this, there is consensus that the yield curve control needs to end at some point, though the timing is not yet decided. Sources added that the BoJ is expected to revise up core inflation forecasts for FY23, albeit FY24 & FY25 forecasts are expected to be largely in-line with current projections. Rhetoric from the central bank continues to suggest a lack of urgency to tweak policy as Governor Ueda recently stated there is still some distance to go before sustainably achieving the 2% inflation target and the Bank has been patiently maintaining easy policy, while he added that unless the assumption on the need to sustainably achieve the 2% target changes, the narrative on monetary policy will not change. Ueda previously stated that responding to an inflation undershoot after a premature rate hike is more difficult than responding to an overshoot and that they have not changed policy because Japan's inflation is not considered sustainable now. Other officials have also suggested a preference to keep policy steady with Deputy Governor Himino stating that they must guide policy flexibly and the best approach is to maintain ultra-easy monetary policy, while Deputy Governor Uchida also said they will maintain YCC from a perspective of sustaining easy monetary conditions and there's still a long way to go before deciding to hike rates. The recent data releases have been mixed which favours a patient approach as Household Spending and Machinery Orders have contracted, while the latest BoJ quarterly Tankan survey mostly topped estimates and showed Japanese large manufacturers' sentiment improving for the first time in seven quarters. Furthermore, latest inflation data showed a slight acceleration and remained above the 2% price target, but is not expected to trigger a shift in policy given the central bank's view that inflation will slow in the middle of the current fiscal year.

REVIEWS:

RBA MINUTES: According to the latest RBA Minutes, the Board considered holding rates steady or hiking by 25bps, adding that although there was a strong case for both, the arguments for a pause were more convincing. Overall, Board members felt that the current level rates were clearly restrictive and will continue to strengthen, whilst also noting that there is already a risk that unemployment will rise more than needed. Further to this, the Bank highlighted that mortgage payments were already at historical peaks (9.4% of income) and will continue to climb even as rates stand pat. The RBA reinforced the "pause" argument, after citing the inverted yield curve as an indication of tighter conditions and slower growth ahead. On the other hand, some members considered the risks of waiting too long for inflation to return to target. The case for a hike was also assessed due to little spare capacity in the economy and in view of the labour market remaining very tight, which was confirmed by the most recent jobs data, with employment growth elevated at +32.6k (exp. +15k), albeit cooling from the prior 75.9k rise, whilst the unemployment rate dipped to 3.5% (exp. 3.6%). Following the release, markets are now pricing in a 25bps hike in August, at 41%, up from the pre-jobs data 34%. Looking ahead, the Board agreed that some further tightening may be required and would reconsider raising rates at the next meeting, after assessing how inflation and the economy evolves. Westpac thinks the decision in August will be balanced, mentioning that the "ongoing tightness in the labour market, particularly as job vacancies remain historically elevated, will make the case for further tightening well justified", though the bank acknowledges the shape of the yield curve and the downside risks to the economy, as strong arguments for another pause.

PBOC LPR: The PBoC unsurprisingly maintained its Loan Prime Rates with the 1-Year LPR kept at 3.55% and 5-Year LPR held at 4.20%. The decision to maintain benchmark lending rates for loans and mortgages was widely expected given that the central bank had also left the 1yr MLF rate unchanged earlier in the week which serves as a bellwether for its intentions for the Loan Prime Rates, while the PBoC was also anticipated to refrain from adjustments as it had only just cut its short-term funding rates and benchmark LPRs in June for the first time in 10 months following a spate of weaker-than-expected data. Nonetheless, future monetary policy support is expected during H2, including potential RRR cuts, along with fiscal measures to stimulate the economy during the ongoing slowdown, while Chinese agencies have already announced various support efforts and the PBoC recently eased cross-border funding rules for firms and financial institutions which would enable more inflows.