Central Bank Weekly 4th August: Previewing RBI and Banxico; Reviewing RBA, BoE and BCB

PREVIEWS

RBI ANNOUNCEMENT (THU): The RBI is likely to keep rates unchanged when it concludes its 3-day policy meeting next week with the Repurchase Rate expected to be held at 6.50% in what would be the MPC's third consecutive pause. As a reminder, the central bank unanimously voted to keep rates unchanged at the last meeting in June and it also maintained its policy stance of remaining focused on the withdrawal of accommodation through a 5-1 vote in which external member Varma expressed reservations against the policy stance. The language from the meeting pointed to a lack of urgency to hike rates in the immediate term as it noted the near-term inflation outlook looks more favourable and the full effect of policy rate hikes will be seen in the coming months, while the minutes from the meeting stated that the current level of the repo rate is high enough to keep inflation below the upper tolerance band on a sustained basis. Nonetheless, the central bank has kept the door open for further adjustments in which it noted that the MPC is to remain vigilant on the evolving situation and growth outlook, as well as take further action promptly. It also stated that headline inflation is still above the target and that being within the tolerance band is not enough, which suggests that a surprise hike, though unlikely, cannot be fully ruled out especially given that the latest CPI data showed inflation edged higher in June to 4.81% vs. exp. 4.58% (prev. 4.25%).

BANXICO ANNOUNCEMENT (THU): Banxico's Survey of Expectations poll suggested that Mexican inflation is seen decreasing, growth is set to improve, and the central bank's policies will remain stable, with analysts expecting the key rate to close out this year at 11.00% vs the current 11.25%. This week, Banxico policymaker Jonathan Heath said the central bank has set the right interest rate and does not plan to increase it, even if the Federal Reserve hikes its rates again. After the March hike to 11.25%, it has kept rates steady, and Heath explained that while global inflation pressures are easing, Banxico is more focussed on local price increases; analysts said that Heath's comments suggest that officials might not change the interest rate soon.

REVIEWS

RBA REVIEW: The RBA kept rates unchanged at 4.10% vs mixed views heading into the meeting as a majority of economists had called for a 25bps hike, whilst money markets heavily priced in a pause. Nonetheless, the central bank's language provided little new information as it reiterated that the Board remains resolute in its determination to return inflation to target, but did note that a significant source of uncertainty continues to be the outlook for household consumption. The SOMP mentioned that the board considered hiking rates but decided that there was a stronger case to hold steady, as the full impact of current rates have not yet been felt. The statement added that the Bank now forecasts slower GDP growth of 0.9% (prev. 1.2% YY) by the end of 2023. The decision comes after a surprise cooling in YY CPI of 6% (exp. 6.2%, prev. 7%), whilst the MM statistic 0.8% (prev. 1.2%) experienced the slowest pace of increase since September 2021. The Bank added that this print was consistent with inflation returning to the 2-3% target in late 2025. Though it does note that despite some easing, the labour market remains very tight, with the latest employment growth elevated at +32.6k (exp. +15k), albeit cooling from the prior +75.9k, whilst the unemployment rate dipped to 3.5% (exp. 3.6%). Westpac writes that the Bank is seemingly waiting to see the impact of a tight labour market on inflation, rather than pre-emptively tackling the issue. Looking towards the next meeting, the RBA noted that "some further tightening of monetary policy may be required". Westpac says it is now very likely that the rate has peaked, which is in line with market pricing of a pause at 91% in September. On the other hand, ING is of the belief that the Bank is still sensitive to data and if inflation does surprise to the upside, then the markets should expect another hike. After having forecast a pause for this meeting, the bank's base case is that the RBA will provide one last 25bps hike next month.

BCB REVIEW: The Brazilian Central Bank opted to cut rates by 50bps, on the larger side of expectations, though market pricing going into the event was a coin toss between a reduction of 25bps or 50bps. The decision was not unanimous however, with the Copom voting 5-4; Governor Compos-Neto opted for the larger 50bps cut. It also provided guidance, noting "Committee members unanimously anticipate further reductions of the same magnitude in the next meetings, and it judges that this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process." Pantheon Macroeconomics said "Copom has joined the dovish trend, by cutting the Selic rate by a surprisingly bold 50bps," adding that "this pace is likely to continue in upcoming meetings, but a faster easing cycle cannot be ruled out," as "manufacturing is struggling, but rate cuts are likely to boost private sector demand soon."

BOE REVIEW: As expected, the MPC came to market with a 25bps rate hike, taking the Base Rate to 5.25% and disappointing some outside calls for a larger 50bps move. The decision to raise rates was subject to an 8-1 vote with Dhingra the lone dissenter whilst the magnitude of the rate hike was subject to hawkish dissent from Mann and Haskel who backed a 50bps increase. The decision to move on rates was backed by the consensus view that although recent data outturns had been mixed, some key indicators, notably wage growth, had surprised significantly on the upside. In the accompanying statement, the MPC reiterated that "if there were to be evidence of more persistent pressures, then further tightening ... will be required"; it is worth noting that the MPC judges current policy as restrictive. Moving forward, Bailey stated that the MPC needs to make absolutely sure that inflation falls all the way back to 2%. The forecasts embedded in the accompanying MPR saw the 2023 inflation projection held at 5% whilst the two-year forecast was revised higher to 1.5% from 1.0% but ultimately still seen below target and therefore indicative that the MPC judges the current rate path to be tighter than required to return inflation back to mandated levels. From a growth perspective, GDP is seen at 0.5% per annum from 2023-2025. In the follow-up press conference, Bailey cautioned that continued strength in services prices may suggest high inflation will persist, adding that upside surprises on wage inflation suggest that it will take longer for second-round effects to fade. Bailey refused to get drawn into hypothesizing what will happen next for the Bank Rate and stressed the Bank's data dependency, however, he did note that there is more than one path for rates that would deliver inflation back to target. On the balance sheet, Deputy Governor Ramsden said that the MPC will make a decision on QT in September, however, he personally can see the case for slightly increasing the pace. Overall, the choppy price action in the aftermath of the announcement suggested that there was "something for everyone" in the release, or at least, there is uncertainty over what is to come in the coming months. That said, markets have seen a mild dovish repricing with the terminal now seen at circa 5.7% vs. 5.57% pre-release, likely as a result of the MPC now judging policy to be restrictive. In terms of desk views, ING suggests a "hike in September seems likely, but by November we think the news on services inflation and wage growth should be looking a little better"