Central Bank Weekly 18th August 2023: Previewing PBoC LPR, Jackson Hole, BoK; Reviewing PBoC, RBNZ, FOMC Minutes, RBA Minutes, Norges Bank

PREVIEWS

PBOC LPR (MON): The PBoC is likely to reduce its Loan Prime Rates next week with the 1-Year LPR and the 5-Year LPRs currently at 3.55% and 4.20%, respectively. This follows the recent surprise decision to lower the 1yr MLF rate by 15bps to 2.50%, which serves as a bellwether for the central bank's intentions for the benchmark LPRs, while the PBoC also unexpectedly cut the rate on its 7-day Reverse Repo operations by 10bps to 1.80%, which was the same magnitude that it cut its Standing Lending Facility rates by shortly after. The surprise easing by the PBoC comes after numerous support pledges by Chinese authorities, including the central bank and the streak of disappointing economic data releases from China which recently slipped into deflation and showed a wider-than-expected contraction in exports and imports, while the latest industrial production and retail sales figures also missed forecasts and prompted several commercial banks to downgrade their GDP growth forecasts for the year.

KC FED'S JACKSON HOLE ECONOMIC SYMPOSIUM (THU): The schedule of events will not be published until the eve of the symposium, but it has been confirmed that Fed Chair Powell will give remarks at the event on Friday. The title of the symposium is "Structural Shifts in the Global Economy". Analysts at Investec say "we are not convinced that Fed members will add that much to the current monetary policy conjuncture, given a fair amount of policy related comments recently, including those in the July meeting minutes," but say the event itself should help guide markets how central bankers globally are thinking about medium-term economic issues. The Fed has retained the optionality to lift rates again, if it needs to, and framed its policy reaction around incoming data. The recent FOMC meeting minutes noted that inflation remains "unacceptably high" and officials continued to see significant upside risks to the inflation profile, keeping a hawkish slant on their policy stance. While some have been warning about the risks that the Committee could accidentally tighten too much, and a number saw economic risks as becoming more balanced. And most officials note the gradual slowdown in economic activity, but still see below-trend growth and a softer labour market as necessary to restoring economic balance. That said, Fed staff no longer see the economy entering mild recession this year, highlighting its resilience in the face of aggressive monetary tightening. SGH Macro's Fedwatcher Tim Duy said the Fed faces a clear messaging challenge at Jackson Hole. "Powell can follow the messaging of recent weeks, which includes the minutes and the June SEP; this messaging has been consistent with market pricing of roughly 10bps more of rate hikes before the Fed cuts rates 100bp in 2024, but that messaging relies on a forecast that is very clearly not working, and a data dependent Fed would respond accordingly." SGH says that if the Fed were to follow the data, he would be highlighting that growth is well above trend, and would be gearing us up for another rate hike at the October or November policy meeting. "If he was really bold, he would note that a growth rate like that estimated by the Atlanta Fed should put a rate hike into play for September, but that feels like too much of a shift when the consensus at the Fed wants to wrap up the rate hike part of the cycle." The upshot, SGH says, is that the data dependent approach would mean that pricing for the October and November meetings was too low. On the other hand, SGH says the Fed chair could lean into the recent messaging; "this path fights the growth numbers and emphasises the expected impacts of policy lags," it explains, "Powell could also cite recent declines in near-term inflation expectations as a reason that policy will tighten further in real terms even if the Fed holds rates steady." That approach, however, would suggest to SGH that inflation expectations are being priced too low. "Odds favour Powell highlighting growth, though by doing so he is raising the risk of recession."

BOK ANNOUNCEMENT (THU): The Bank of Korea is likely to maintain its 7-Day Repo Rate at the current level of 3.50% for the 5th consecutive meeting next week as the continued softening of inflation further reduces the urgency for the central bank to resume its hiking cycle. As a reminder, the BoK unanimously decided to keep rates unchanged at the last meeting in July, although six out of the seven Board members wanted to keep the door open for one more rate hike, while the BoK stated that domestic economic growth is expected to recover gradually with GDP and consumer price inflation this year expected to be consistent with forecasts. The BoK also said it will maintain a restrictive policy stance for a considerable time and monitor financial stability risks, as well as acknowledging that risks to some non-bank financial sectors have increased. Furthermore, BoK Governor Rhee said several Board members expressed concern about the rise in household debt and noted that no Board member had discussed a rate cut so far, while the central bank clarified shortly after that Governor Rhee did not say there will be no rate cut until year-end, which along with the Board's willingness to keep the door open for one more rate hike, suggests the central bank doesn't want to take any options off the table despite the unlikelihood of any rate adjustments in the near term.

CBRT ANNOUNCEMENT (THU): There are currently no forecasts for the CBRT's next move following the 250bps hike seen in July, which ultimately underwhelmed the market's median view of a 500bps hike for that meeting. Nonetheless, analysts expect some sort of hike in August, although the magnitude as ever with the CBRT is uncertain. A policy U-turn at the last two meetings (after Erkan was appointed as Governor in early June) delivered rate increases that fell short of investor expectations. Erkan vowed in July to continue with "gradual and steady rate hikes" following years of Turkish President Erdogan's mission against high rates. In terms of the latest monthly CRBT survey, Turkish End-2023 CPI is now seen at 59.46% (prev. 43.82%), 12-Month CPI at 42.01% (prev. 33.21%), End-2023 USD/TRY is now forecast at 29.8220 (prev. 28.4560) and the 12-Month Repo rate 23.25% (prev. 21.48%). Some desks however caution that a large hike may not spur much action in the Turkish currency, although this was extrapolated from the Russian Rouble and Argentinian Peso reactions following their central banks' respective rate hikes.

REVIEWS

PBOC REVIEW: The Chinese central bank conducted several rate reductions this week in a bid to support liquidity, whilst measures were also taken to support the Chinese stock market. The PBoC conducted CNY 401bln in MLF and unexpectedly cut the 1-year MLF rate by 15bps to 2.50% from 2.65%, while it injected CNY 204bln via 7-day reverse repos with the rate cut to 1.80% from 1.90%. Later that day, the PBoC cut the standing lending facilities rates; 10bps reduction for overnight (now 2.65%), 7-day (now 2.8%) and 1--month maturities (now 3.15%). This came hot on the heels of a slew of downbeat Chinese data which overall underscored weak domestic and foreign demand. "The surprising rate cut was a prompt response to support subdued credit data and China recovery," said Mizuho's Chief Asian FX strategist. On Thursday, the PBoC released its Q2 monetary policy report in which it said it will keep the Yuan rate basically stable, will keep liquidity reasonably ample, and prudent policy will be precise and forceful. One aspect of the release that went under the radar for some was the seemingly new line "will resolutely prevent over-adjustment risks of CNY exchange rate. Next week, the LPR is expected to be reduced in tandem.

RBA MINUTES REVIEW: RBA Minutes from the August meeting stated that the Board considered raising rates by 25bps or holding steady and agreed that the case for holding steady was the stronger one. The Board saw a credible path back to the inflation target with Cash Rate at the current 4.10% level, but agreed it was possible some further tightening may be needed which would depend on data and the evolving assessment of risks. Furthermore, it stated that inflation is heading in the right direction although service inflation is too high and the Board saw plausible scenarios where inflation took longer than acceptable to return to the target. Following the release, analysts at Goldman Sachs "continue to expect one further +25bp rate hike in November, although we are mindful of risks in both directions given the evolving macro outlook and upcoming institutional changes to the RBA Board."

FOMC MINUTES REVIEW: Minutes of the FOMC's July meeting noted that uncertainty surrounding the US economic outlook remains elevated, future policy decisions will be driven by the totality of data. Most officials saw "significant" upside risks to inflation, which could require further tightening. Inflation is still seen as "unacceptably high", and more evidence was needed to be confident of price pressures ebbing. A number warned of risks of accidentally tightening policy too much, and a number saw economic risks as becoming more balanced. Participants said that a gradual slowdown in economic activity appeared to be happening, and they still see below-trend growth and a softer labour market as necessary to restoring economic balance. Fed staff no longer see the economy entering a mild recession this year, now see below-trend growth in 2024 and 2025. Participants said the labour market is still "very tight", although signs are emerging that labour demand is in better balance. Analysts have noted that, since the July meeting, data has come in stronger than expected; Capital Economics said "even if third-quarter GDP growth is at or above potential, we doubt that pace will be sustained into the fourth quarter, when the tax-filing deadline for Californians and the resumption of student loan repayments will act as additional headwinds on top of the tightening in credit conditions," and added that "regardless of what's happening in the real economy, the rapid fading in underlying price pressures means that – unless the Fed begins to cut nominal rates in H1 next year, real rates would rise to threatening levels."

RBNZ REVIEW: The RBNZ maintained its OCR at 5.50% which was widely expected as the money market had been pricing a 99% chance for rates to remain at the current level, while its OCR projections were slightly lifted to suggest it no longer sees chances of a rate cut by December next year. The central bank reiterated that the OCR would need to remain at a restrictive level for the foreseeable future and that the current level of interest rates is constraining spending and hence inflation pressure, as anticipated and required. Furthermore, it noted there is a risk in the near-term that activity and inflation measures do not slow as much as expected. At the post-meeting presser, RBNZ Governor Orr stated the rise in OCR track is not forward guidance and is not a strong signal of our next move, and suggested the RBNZ is wary about doing too much on rates. He also said the current level of rates is constraining inflation and is confident that inflation pressures are coming out now. On Thursday, Orr hit the wires again and said the Cash Rate projection over two years deviates very little from 5.50%, while he also noted there is time to observe, worry and wait on rates. That being said, analysts at Westpac continue to see a 25bps OCR hike in November while suggesting the key indicators they'll be watching in order of importance are 1) The September quarter CPI, 2) the September quarter labour report, 3) business and consumer confidence indicators, and 4) monthly housing market data.

NORGES BANK REVIEW: Matching expectations, the Norges Bank increased its rates by 25bps, bringing the Policy rate up to 4%, through a unanimous decision. The Bank noted that if the economy evolves as currently anticipated, the policy rate will be raised further in September. With this being an interim meeting, the statement did not contain any new rate projections and accompanying commentary reiterated that activity in the economy remains high, and the labour market is tight, though the current policy rate has led to some easing in the economy. The decision came after the most recent CPI data fell to 6.4% (prev. 7%), a drop broadly in-fitting with the Bank's forecasts. Additionally, the previous 50bps hike has led the NOK to come off worst levels and appreciate approximately 1.5% on a trade-weighted basis. In terms of the next meeting, another 25bps hike is all but confirmed, with markets pricing in the hike at a 98% probability. The Committee noted that if the NOK proves to be weaker than previously projected, a higher policy rate than signalled in June may be needed to bring down inflation. Though caveated this by commenting that if inflation declines more rapidly, the policy rate may be lower than envisaged in June. Analysts at ING believe that the Norges Bank will hike once more in September, bringing the peak rate to 4.25%, in-line with the policy rate forecasts provided in the last meeting. Looking further ahead, analysts at CapEco believe that the NOK will rally in the next year, allowing policymakers to begin cutting rates at a more rapid pace in 2024.