Central Bank Weekly 25th August 2023: Previewing ECB Minutes; Reviewing Fed Chair Powell, PBoC LPR, CBRT and BoK

PREVIEWS

ECB MINUTES (THU): As expected, the ECB pulled the trigger on another 25bps hike, taking the deposit rate to 3.75%. Aside from the decision itself, focus for the statement was on the modest adjustment to the Bank's language on future decisions whereby the key ECB interest rates will be "set at" sufficiently restrictive levels for as long as necessary vs. the previous wording of "brought to". Elsewhere, the GC also opted to set the remuneration of minimum reserves at 0% (vs. prev. matching the deposit rate). In the follow-up press conference, Lagarde stated that policymakers were unanimous in their stance. When initially questioned over whether she thinks the Bank has more ground to cover, she said the decision will be based on the data and the GC is "open-minded". When pressed on the matter later during the press conference, Lagarde stated that at this moment in time she "would not say so" with regards to there being more ground to cover; given the mixed interpretations of this statement, it will be interesting to see if the account can provide any greater clarity on the matter. On the balance sheet, Lagarde remarked that a reduction had not been discussed and there would be no trade-offs between rates and QT. Overall, the main takeaway ahead of the September meeting was that the ECB was happy to either pause on rate hikes or carry out further tightening, however, any decision to do so would be based on how the data plays out between now and then. On which, it is worth noting that the inflation data the morning of the release may well tip the balance for the September meeting which is a near-enough coin flip between unchanged and a 25bps hike after the soft PMI data for August prompted a dovish repricing last week. With this in mind, and as is often the case, the account of the previous meeting will be deemed stale and pass with little in the way of fanfare.

REVIEWS

PBOC LPR REVIEW: The PBoC disappointed market expectations regarding its Loan Prime Rates in which it defied the consensus for 15bps cuts and instead delivered a modest 10bps rate cut for the 1-Year LPR to 3.45% from 3.55% and surprisingly maintained the 5-Year LPR at 4.20%. There were widespread expectations for 15bps reductions to both following the prior week's unexpected decision to reduce the 1yr MLF rate by that increment, to 2.50% which serves as a bellwether for the central bank's intentions for the benchmark LPRs, while the PBoC also unexpectedly lowered 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. Furthermore, the decision to keep the 5-Year LPR unchanged, which is the reference rate for mortgages, was a shock and spurred some confusion given the recent numerous pledges by the central bank and government agencies to support the property sector.

FED CHAIR POWELL REVIEW: Powell largely towed a similar line to his July FOMC press conference, but since then there has been a range of Fed views on whether the Fed has done enough. Fed's Harker towed the line of the Fed has "probably done enough" (Dovish), while Collins said the Fed "may be at or near that point" (Neutral), or Bowman's view (in early August) that additional hikes will "likely be needed" (Hawkish). Powell seems to have taken the Collins/Neutral approach, expressing the Fed will proceed carefully when deciding to hike again, or hold steady, stressing the Fed will decide the next rate moves based on data. One thing all Fed speakers, and Powell, appear to be in agreement to is that they intend to hold rates until they are confident inflation is moving sustainably down to 2%. There has been a lot of discussion on the neutral rate recently and whether expectations for that rate have shifted higher, Powell did not provide a concrete view on the matter, saying the Fed cannot be certain what the neutral rate level is. It is worth noting the June SEP's median longer run rate view remained at 2.5%, but the central tendency shifted higher to 2.5-2.8% from 2.4-2.6%, while the range increased marginally to 2.4-3.6% from 2.3-3.6%, and we are set to receive new projections at the September 20th meeting for a clearer view of the neutral rate among the whole FOMC. Within the speech Powell was cognizant that monetary policy faces risks on both sides and stressed the economic uncertainty calls for agile monetary policy making ahead. The Fed Chair warned that above trend growth could warrant more Fed rate hikes, as could signs that the labour market is not cooling, however, he said that the Fed expect the labour market rebalancing to continue. Powell is also attentive to signs the economy is not cooling as expected, and he reiterated that lowering inflation will likely require softer labour markets, acknowledging there is evidence of tighter financial conditions contributing to slower growth in this cycle too. On wages, Powell said wage growth continues to slow, albeit gradually, but nominal wage growth must ultimately slow to a rate that is consistent with 2% inflation, noting real wage growth has been increasing as inflation falls. Powell did not want to commit to further rate moves, adding it is challenging to know when a sufficiently restrictive stance has been achieved and there are also uncertainties around the effects of policy lags, but stated the "wide range of estimates of these lags suggests that there may be significant further drag in the pipeline". Meanwhile, he added that in the current cycle, the decline in job openings without an increase in unemployment is welcome, but historically unusual and appears to reflect large excess demand for labour. Meanwhile, Powell stated that he sees evidence inflation is becoming more responsive to labour markets tightness. He warned doing too little could allow inflation to become entrenched, and ultimately require more work to do on policy at a high cost to employment but also that doing too much could do unnecessary harm to the economy.

BOK ANNOUNCEMENT REVIEW: The BoK kept its base rate unchanged at 3.50%, as expected, with the decision unanimous and the Bank said it would maintain a restrictive policy stance for a considerable time. It noted that domestic economic growth is expected to improve gradually, and it maintained its 2023 GDP growth and inflation forecasts, at 1.4% and 3.5%, respectively, but cut its 2024 GDP forecast to 2.2% from 2.3%. BoK Governor Rhee said 6 out of 7 members wanted to keep the door open for one more hike and it is too early to talk about a rate cut, but the Bank does not want to rule out the possibility of a cut within this year. Furthermore, Governor Rhee said uncertainty is very high regarding US monetary policy and it is undesirable to comment on whether South Korea can cut interest rates before the US, while he also noted Interest rates are at the upper end of the neutral range, or higher.

CBRT REVIEW: Whilst the median forecast pointed to a hike of 250bps, the CBRT opted to go 500bps above expectations and raise rates by 750bps, bringing the One Week Repo Rate to 25% (vs exp. 20%). ING notes that despite the larger-than-expected hike, the forward guidance remains unchanged so the decision can be attributed to the three new Monetary Policy Committee appointees. The accompanying commentary attributed recent inflation trends to higher oil prices, the strong course of domestic demand, and cost pressures stemming from wages and exchange rates which implies year-end inflation close to the upper bound of the Bank’s forecast range. The Committee decided to continue the monetary tightening process to establish the disinflation course as soon as possible and still anticipates that disinflation will be established in 2024. Despite the surprise hike, JP Morgan raised its year-end Turkish inflation forecast to 62% (prev. 57%), slightly above the latest CBRT survey findings, which see CPI at 59.5%. JPM announced it expects 250bps interest rate hikes at each meeting to the end of the year, revising its year-end forecast to 35% (prev. 30%). The much larger-than-expected hike has also spurred speculation regarding the CBRT governor’s future at the Bank, given the track record of President Erdogan and his tolerance (or lack of) for high rates.