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Central Bank Weekly 22nd September: Previewing Banxico; Reviewing Fed, BoE, SNB, BoJ, Riksbank and Norges Bank

PREVIEWS

BANXICO: The prior Banxico meeting saw the central bank leave rates unchanged, as expected, while it reiterated its guidance that it considers it will be necessary to maintain the reference rate at its current level for an extended period. Therefore, it is likely that Banxico will keep rates unchanged at 11.25% once again on Thursday. However, there will be particular attention to the guidance at this meeting. The latest August inflation data saw the 12-month headline and core metrics cool from the prior, in line with expectations. Meanwhile, the latest half month September data saw headline M/M cool marginally from the prior, as did the Y/Y. The M/M core however accelerated a touch but was in line with expectations, while the Y/Y core eased from the 1st half of August. Economic activity in July meanwhile slowed and missed analyst expectations. Analysts at Pantheon Macroeconomics expect Banxico guidance to change on the back of the data, and they see the September meeting as a prime opportunity for them to do so. Pantheon also believes that the Banxico will be able to start cutting rates gradually in late Q4.

REVIEWS

RBA MINUTES REVIEW: The RBA minutes from the September 5th meeting stated they considered raising rates by 25bps or holding steady, and the case for the latter was stronger, while recent data did not materially alter the economic outlook. The release suggested some further tightening of monetary policy may be required should inflation prove more persistent than expected, while the economy still appears to be on a narrow path by which inflation returns to target and employment grows. Furthermore, members recognised the value of allowing more time to see the full effects of past tightening on the economy. The minutes suggested policy moves will be guided by incoming data and the assessment of risks, while the Board is concerned about productivity growth not picking up as anticipated and services inflation remaining sticky. Members noted that the labour market remains tight, but could be at a turning point. To recap the meeting in question, the RBA kept rates unchanged at 4.10%, as widely expected, and this was the last with Governor Lowe at the helm, while the accompanying rhetoric provided no surprises as it reiterated that some further tightening of monetary policy may be required and the Board remains resolute in its determination to return inflation to target. The RBA also stated that higher interest rates are working to establish a more sustainable balance between supply and demand in the economy and will continue to do so, but added that inflation is still too high and will remain so for some time yet. Furthermore, it said the pause will provide more time to assess the impact of the increases in interest rates to date and the economic outlook, but noted increased uncertainty around the outlook for the Chinese economy due to ongoing stress in the property market and that the outlook for household consumption also remains uncertain.

FOMC REVIEW: The Fed voted unanimously to keep interest rates steady at 5.25-5.50%, in line with expectations. The central bank upgraded its language about the economy, stating it's growing at a "solid" pace instead of "moderate". It also recognised that job gains have slowed recently, but are still strong. Policymakers continue to believe that inflation is high, and the unemployment rate is low. In its updated economic forecasts, it raised expectations for real GDP growth in 2023 and 2024, and lowered its unemployment rate projections. Inflation is expected to be 3.3% in 2023, 2.5% in 2024, and 2.2% in 2025 for headline PCE. Core inflation is projected at 2.6% in 2023, 2.6% in 2024, and 2.3% in 2025. The "dots," were revised hawkishly, and the central bank still sees a further rate hike this year, whilst for next year, it now only sees the prospect of 50bps rate cuts (vs 100bps in its previous SEP). During his press conference, Fed Chair Powell emphasised the central bank's cautious approach, though noted strong economic growth and tight labour markets. Powell mentioned that inflation remains above the 2% target, but has eased slightly. He said that most policymakers believe another rate hike is likely, even though markets are sceptical. Powell declined to discuss when rate cuts might happen and suggested the neutral rate may have risen in the short term, contributing to the economy's resilience. Overall, the Fed's message is one of cautious optimism, with an eye on inflation and a willingness to adjust policy as needed. However, its updated projections have drawn scepticism; Capital Economics notes that in order to justify its higher rate projections in future years, officials have had to upgrade economic forecasts quite significantly. "We doubt that economic growth will be anywhere near that strong over the next 12 months – with a mild recession or near-recession still the more likely outcome," CapEco writes, "most notably, even though the three-month annualised rate of core PCE inflation is on track to fall to around 2.4% in August, the median projection is still as high as 2.6% in 2024 and 2.3% in 2025, and only in 2026 does it finally drop back to the 2% target." CapEco's economists argue that if the Fed is

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right about the economic outlook, then rates can stay higher for longer, but "we just don't believe those forecasts," it says, adding that "the real economy will be considerably weaker and, regardless, core inflation is going to fall back to target much more quickly – under those circumstances, we still expect rate cuts of closer to 200bps next year."

PBOC LPR REVIEW: The PBoC maintained its benchmark Loan Prime Rates with the 1-Year LPR kept at 3.45% and 5-Year LPR held at 4.20%, as expected. The wide expectations for the PBoC to keep its benchmark rates unchanged followed last month's reductions in which the PBoC lowered short-term funding rates including the 1-year MLF by 15bps, but then delivered a more modest cut of 10bps to the 1-year LPR and surprisingly kept the 5-Year LPR unchanged, which is the reference rate for mortgages, resulting in some confusion given the numerous pledges by the central bank and government agencies to support the property sector. Nonetheless, the entirety of the cuts including a more recent RRR reduction, combined with a slight improvement in China's data releases suggests less urgency for the central bank to act immediately, while it would also want to avoid stoking a fresh bout of currency pressure.

BCB REVIEW: The BCB lowered its Selic rate by 50bps to 12.75%, the second consecutive cut and indicating a shift toward a more relaxed monetary policy to stimulate the economy. All nine board members supported this decision. The decision was motivated by a more dovish stance due to easing inflation pressures. Despite mentioning increased domestic and external uncertainties, they foresee continued rate reductions in the next meetings. Pantheon Macroeconomics said the central bank is expected to continue cutting rates by 50bps increments at upcoming meetings, potentially reaching a rate of 11.75% by the end of the year. The outlook is influenced by expectations of low inflation and economic growth, but uncertainties regarding fiscal matters could impact the trajectory of rate cuts.

BOC MINUTES REVIEW: The BoC minutes noted that the Governing Council (GC) did not want to raise expectations of a near-term reduction in rates at the September 6 policy meeting, with members only debating between a hike and a pause. The Bank added that given the uncertain path forward for core inflation, tighter policy should be considered, highlighting that the lack of progress in underlying inflation remained a significant concern. The two main considerations were that it was possible that not enough time had passed for policy to have a sufficient impact; and that the rate was not yet restrictive enough to slow demand and relieve inflation pressures. Members also suggested that core inflation was proving to be sticky, noting that there had been little progress since the July announcement, despite consumer demand weakening markedly in Q2. Turning to the inflation outlook, the BoC agreed that higher prices for oil and gasoline would drive inflation higher over the next few months. The release also brought attention to the tight labour market, and highlighted that recent easing is attributed to lower job vacancies as opposed to job losses. Overall, the minutes were hawkish leaning, with the Bank stressing its concern over the lack of progress in slowing core inflation, emphasising its readiness to raise rates if needed. Since the last meeting, Canadian inflation came in hotter than expected. The headline rose to 4.0% (prev. 3.3%, exp. 3.8%), though the rise was largely attributed to recent rises in gasoline prices. Looking at the BoC's core metric, it rose to 4.27% (prev. 4.10%), with Deputy Governor Kozicki noting that the underlying trend shown by the core measures was inconsistent with bringing inflation down to the 2% target level. Additionally, the labour market continued to remain tight in August, with the unemployment rate remaining at 5.5% (exp. 5.6%), whilst the employment change saw a large rise to 39.9k (prev. -6.4k, exp. 15k). Having digested recent data, money markets have priced in a nearly equal split between a 25bps hike and pause for the October 25 meeting.

SNB REVIEW: Elected to defy the majority of desk views and circa. 65% market pricing by leaving its policy rate at 1.75% vs. expectations for a 25bp hike; though some respondents and the remaining 35% of the market looked for such an outcome. The hold was justified by the observation that the significant tightening of monetary policy in recent quarters is countering remaining inflation pressures. But, interestingly, the accompanying inflation forecasts were largely unchanged across 2024 and CPI does not return to the 0.0-2.0% target band until Q1-2025. It remains to be seen if further tightening will take place at the December gathering when the assessment will undoubtedly, barring any other unforeseen events, focus on what impact the recent energy upside and the June rental reference rate increase has had on prices; on the latter, the rental increase is not observable within inflation data until the November report due on December 4th before the following week's policy announcement. A view echoed by Chairman Jordan subsequently who said they will decide "in December" if further action is merited. Finally, the SNB reiterated its language around the CHF and intervention stating that it remains willing to be active in the foreign exchange market as necessary and the focus is on selling foreign currency. Interestingly, in the Q&A section Jordan described the Franc as having had a "nominal overvaluation", a line which drew attention as the SNB has steered clear of currency descriptions in recent gatherings. However, this assessment is not particularly surprising given the CHFs YTD performance.

RIKSBANK REVIEW: The 25bp hike to 4.00% was as-expected, but the accompanying policy rate forecasts only infer around a 40% chance of a hike as of Q3-2024 from current levels, and as such a marked initial dovish reaction was seen. Additionally, pressure perhaps stemmed from the lack of any measures to address the SEK's pronounced weakness from a monetary perspective, given EUR/SEK was printing all-time lows in the sessions before the announcement. However, around five minutes after the monetary policy release the Riksbank unveiled that it is going to be hedging FX reserves by selling USDs and EURs from September 25th for four-six months. A move that is designed to limit the Bank's financial losses if the SEK appreciates and is not being undertaken for monetary purposes. Following

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the announcement, marked SEK appreciation occurred with the initial dovish move entirely unwound and resulted in EUR /SEK falling to an 11.7582 trough. Note, the Riksbank also announced that it will now hold eight meetings a year and every other gathering will have an MPR/new forecasts.

NORGES BANK REVIEW: As expected, Norges Bank hiked by 25bp to 4.25%. In addition to this, the accompanying verbal guidance points to one more policy hike which is “most probably” to be delivered in December. In-fitting, the repo path was lifted to a Q1-2024/Q2-2024 peak of 4.44% (exp. ~4.35%, prev. ~4.20%); alterations which imply a rate peak at 4.50% compared to the 4.25% desks were expecting pre-release. Though most expected the Norges Bank to ascribe further probability to additional tightening. On the NOK, there were some outside expectations for the path to be lifted much more significantly to imply a peak near 4.75% given currency pressures, but interestingly the statement regards the Krone as being “somewhat” stronger than projected in June. Overall, the decision to hike was as expected and while the statement/path and market reaction took a hawkish slant it is becoming clear that barring an economic shock occurring the Norges Bank is near the level it will ultimately hold rates at for a prolonged period of time i.e. a higher for longer approach.

CBRT REVIEW: The CBRT opted to match market expectations with a 500bps hike to 30%. The Bank said tightening will continue until a significant improvement to the inflation outlook is achieved, and will be further strengthening as much as needed in a timely and gradual manner. The CBRT also said it will continue to simplify and improve the existing micro and macroprudential framework. The release noted inflation readings were above expectations in July and August. Analysts at CapEco suggest the central bank is “now doing what many investors had hoped they would by raising interest rates sharply and taking a more serious stance against inflation”, and “All of this is helping to maintain investor optimism in the policy shift and keeping Turkey’s sovereign dollar bond spreads near multi-year lows.” CapEco suggests a lot more tightening needs to be delivered, as the desk expects rates to rise to at least 35% by year-end.

BOE REVIEW: Heading into this week, 64/65 surveyed economists by Reuters expected the BoE to hike the Bank Rate by 25bps to 5.5%. However, this overwhelming consensus was derailed by the August CPI report, which saw headline Y /Y CPI fall to 6.7% from 6.8% (vs. exp. 7.0%), core CPI drop to 6.2% from 6.9% (vs. exp. 6.8%) and the all services print decline to 6.8% from 7.4% (vs. MPC exp. 7.2%). As such, markets shifted expectations in a more dovish direction to a near coin-flip at one stage heading into the announcement. In the end, the MPC opted to stand pat with the Bank rate held at 5.25% via a 5-4 vote and the majority consisting of Bailey, Broadbent, Dhingra, Ramsden and Pill. The unchanged camp justified their vote on the basis that "there were signs that the labour market was loosening", whilst those in the hike camp consisted of Cunliffe, Greene, Haskel and Mann amid the judgement "..overall there was evidence of more persistent inflationary pressures". Despite today's decision, the MPC opted to keep some optionality over further moves by reaffirming that "further tightening would be needed if evidence of more persistent inflation pressures is seen". Furthermore, the statement reiterated that "policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target". In terms of the economic outlook, "CPI inflation is expected to fall significantly further in the near term, reflecting lower annual energy inflation". However, services inflation is projected to remain elevated in the near term, with some potential month-to-month volatility. On the growth front, "Bank staff now expect GDP to rise only slightly in 2023 Q3. Underlying growth in the second half of 2023 is also likely to be weaker than expected". Alongside the rate decision, the MPC opted to reduce the stock of gilts by GBP 100bln (exp. ~80bln) in the 12-months starting October. Overall, as noted by ING, there is only "one set of inflation and wage data before November’s meeting, so there’s not a huge amount for the Bank to go on". As such, "If there's enough in the recent data to convince the Bank to pause this month, then we suspect the same will be true in November". After the decision, BoE Governor Bailey, in several journalist interviews, noted the job is not done yet but he is not going to predict what the next move will be. He did add that the MPC has not had any discussion about cutting the bank rate. However, he did note that some on the MPC say more hikes are needed to curb prices. Bailey expects the next noticeable drop in UK inflation will be in the October data (released in November).

BOJ REVIEW: The BoJ kept policy settings unchanged, as expected, with rates held at -0.10% and the parameters of QQE with YCC maintained to target 10yr JGB yields at 0% within a +/-50bps target band, while it also retained its forward guidance and stated that it will patiently continue monetary easing. The statement from the BoJ provided very little in the way of new information and refrained from any hawkish surprises, which put the emphasis on Governor Ueda's press conference where he stuck to the dovish script by reiterating that they will not hesitate to take additional easing if necessary and the BoJ needs to patiently continue its easy policy. Furthermore, he stated they will mull policy adjustments if the price goal is in sight and will end YCC and NIRP when the BoJ judges that the achievement of 2% inflation is visible, but added that they are not currently in a position to decide on the order of change in policy tools.

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