Central Bank Weekly 6th October: Previewing FOMC minutes, ECB minutes; reviewing RBA, RBNZ, BoJ SoO, RBI, Riksbank minutes

PREVIEWS

FOMC MINUTES (WED): At its September meeting, 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 at 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 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."

ECB MINUTES (THU): Defying the consensus (which was deemed as somewhat stale given hawkish source reporting by Reuters earlier in the week), the ECB opted to pull the trigger on a 25bps hike to all three of its key rates, taking the deposit rate to 4.0%. The accompanying statement noted that the GC now judges that rates "have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target". Furthermore, "rates will be set at sufficiently restrictive levels for as long as necessary". Elsewhere, no tweaks were made to the parameters of its APP or PEPP, with reinvestments in the latter set to continue "until at least the end of 2024". For the accompanying macro projections, 2023 inflation was upgraded to 5.6% from 5.4%, 2024 (in-fitting with source reporting by Reuters) raised to 3.2% from 3.0% and 2025 lowered to 2.1% from 2.2%, but still ultimately seen just above target. Growth projections for 2023-25 were lowered across the board. At the follow-up press conference, Lagarde cautioned that the economy is likely to remain subdued in the coming months and price pressures remain strong. During the Q&A, the President stated that, whilst some members favoured a pause in rates, today's decision was backed by a "solid majority"; details of the breakdown in views will be of note for market participants. In a follow-up question, Lagarde noted that the GC has not discussed PEPP reinvestments. When questioned on the path of rates beyond September, Lagarde, in an attempt to embed some optionality for the Bank, stated that she is not saying that the ECB is at peak rates.

REVIEWS

BOJ SOO REVIEW: During the September meeting, some members advocated for the continuation of patient and gradual easing, while others expressed concerns about a potential slowdown in inflation. Members acknowledged that inflation had exceeded 2%, but this was primarily attributed to firms passing on higher import costs. They also noted signs indicating the possibility of a positive cycle involving rising wages and inflation. Some members even suggested that next year's wage growth might surpass the current year. Despite recent fluctuations in FX and oil prices, there was a consensus that inflation might not slow down significantly and could exceed expectations. Regarding the Yield Curve Control, members generally agreed that there was no immediate need for further adjustments, as long-term interest rates remained stable. One considered Japan to be getting closer to achieving its price target, and the latter part of the fiscal year was deemed crucial for assessing next year's price outlook; however, they couldn't determine the timing of any policy tweaks, which would depend on future economic and price conditions. Even if the BoJ were to end Negative Interest Rate Policy, monetary conditions would remain accommodative, given the presence of negative real interest rates, a member said. Lastly, members stressed the importance of preparations for an exit strategy, with potential clarity expected between January and March on achieving the 2% inflation target in a sustained and stable manner.

RBA REVIEW: The RBA unsurprisingly kept the Cash Rate Target at 4.10%, as expected, while it also stuck to its familiar rhetoric in which 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. Furthermore, it stated that returning inflation to the target range within a reasonable timeframe remains the Board's priority and recent data are consistent with inflation returning to the 2–3% band over the forecast period, while it also stated that inflation in Australia has passed its peak, but is still too high and will remain so for some time yet, as well as noting significant uncertainties around the outlook. The language from the central bank at Governor Bullock's inaugural meeting at the helm was pretty much a carbon copy of the comments during Lowe's leadership and further bolsters the view of policy continuity. Analysts were on watch as to whether the change in leadership would mean a change in communication. "As expected, the Bank has delivered continuity in spades. While the Governor has changed, the RBA's internal decision-making processes have not. The establishment of the Monetary Policy Board in 2024 will be the next major potential departure point for the RBA's outlook. But while there remains a chance rates will go a little higher, our forecast is for rates to be on hold for the next year", says CapEco.

RBNZ REVIEW: The RBNZ decision to keep the OCR unchanged was widely anticipated as money markets had been pricing as much as a 90% likelihood for no change in rates, while the statement lacked any major deviations or hawkish surprises as it reiterated that the Committee agreed the OCR needs to remain at a restrictive level, as well as commenting that interest rates are constraining economic activity and reducing inflationary pressure as required. Furthermore, it acknowledged a near-term risk that activity and inflation do not slow as much as needed, although the Committee noted that inflation is still expected to decline to within the target band by H2 2024. "The changes to the language in the attending statement were incrementally hawkish in our view", say the analysts at Goldman Sachs, adding that looking ahead "our base case is the RBNZ will remain on hold at 5.5% going forward as inflation trends lower, before starting a gradual easing cycle in November 2024. But we see the risks as skewed towards the RBNZ needing to hike above 5.5% at some stage in late 2023 or early 2024, with upside risks associated with a fiscal easing and rising house prices outweighing downside risks from a slowdown in China and weaker dairy prices."

RBI REVIEW: The RBI kept the Repurchase Rate unchanged at 6.50%, as expected, while it maintained the stance of remaining focused on the withdrawal of accommodation with 5 out of 6 members voting in favour of the policy stance. Governor Das said they have identified inflation as a major risk to macroeconomic stability and remain focused on aligning inflation to the 4% target with the MPC highly alert and will take timely measures as necessary. However, Das commented that headline inflation is to see further easing in September and the silver lining is declining core inflation, as well as noting that the transmission of past rate hikes is thus far incomplete. Furthermore, the central bank maintained its FY24 CPI forecast, at 5.4% and FY24 GDP growth forecast at 6.5% with risks said to be evenly balanced.

RIKSBANK MINUTES REVIEW: Overall, the minutes are in-line with the policy meeting with members looking for further tightening. Interestingly, within this there is some reference to the possibility that the path needs to be tighter than is currently implied. As a reminder, the path is indicative of a circa. 40% chance of another hike before Q3-2024 from the current level. However, this hawkishness is somewhat offset by Governor Thedeen's remark that there does not need to be a hike at the next gathering, explaining that further tightening can come at a later stage; albeit, he adds that he does not think that the Riksbank is at its peak. Rates aside, and despite the ongoing SEK weakness the minutes do not feature a discussion around any potential FX-specific measures that could be introduced. An omission which is interesting given the ongoing SEK depreciation, heightened commentary on the currency and the recent FX reserves hedging, a development which sparked pronounced appreciation alongside the September gathering despite the Riksbank reminding that this is not a monetary policy related measure.