Central Bank Weekly 27th October - Previewing; FOMC, BoJ, BoE, Norges Bank and BCB. Reviewing; ECB, BoC and CBRT

PREVIEWS

BOJ ANNOUNCEMENT (TUE): The BoJ is poised to end its two-day meeting on October 31st, with the announcement due at any point during the Tokyo lunch break. The meeting comes at a time of pressure in Japanese financial markets as the 10yr JGB yield hovers comfortably around 85bps and USD/JPY rose above 150.00, while the BoJ resorted to unscheduled bond operations, suspected FX intervention alongside Japanese officials providing an abundance of jawboning. The BoJ rate and forward guidance are expected to be maintained, but there is growing speculation that a tweak to YCC could be announced. Bloomberg sources on October 24th suggested the BoJ is said to see little need to change forward guidance, citing officials; adds is considering whether to tweak YCC given US yield concerns, while the discussion over YCC is reportedly not due to the growing risk of upward price fluctuations, but the impact on Japanese yields from upside in US rates. The sources suggested officials see there being little need to remove the following line from its guidance "If necessary, we will not hesitate to take additional monetary easing measures." On the possible YCC tweak, the Dutch bank ING suggests: “It is possible that the BoJ might lift its 10Y JGB target from the current level of around 0% to 0.25% or to 0.5% (the current formal upper limit of 10Y JGB) to reflect the current market conditions. Bringing the anchor year of the yield forward from the current 10Y to 5Y is also a possible option. Or the BoJ could make changes to its forward guidance. It would be more effective to signal to the market that the BoJ is gradually moving toward normalisation. If such changes come with a higher outlook for inflation in FY23 and beyond, it would give a clearer signal to the market.” As a reminder, at the July meeting (when YCC was tweaked), the BoJ left its rate unchanged and kept QQE with Yield Curve Control to target 10yr JGBs at 0% with a +/-50bps range, but shifted to a more flexible approach in which it will guide YCC via its fixed rate operations for 10yr JGBs to be conducted at 1.0% (prev. 50bps), and slightly widened the range of its purchase amounts as well.

FOMC POLICY ANNOUNCEMENT (WED): The FOMC is all but certain to leave rates unchanged at 5.25-5.50% on Wednesday, and focus instead will fall on guidance for the December meeting; there are no new SEPs at the upcoming meeting. Money markets, and many Fed officials, are of the opinion that the Fed is done with rate hikes, with the central bank "proceeding carefully" to let cumulative tightening continue to work through as inflation trends lower and the labour market rebalances. However, the latest economic growth resurgence in Q3 is what is keeping tail risk skewed to further hikes in the near term (20% hike probability priced for December currently) as concerns linger of a possible episode of demand-led reflation. The resilient economic and consumer data has also pushed out the pricing of the first full 25bp rate cut back to July 2024, with doves (who are the only ones to pose the topic of easing) noting any rate cuts wouldn't be until late next year, that follows the September SEPs showing the 2024-end median rate dot hiked by 50bps to 5.00-5.25%. Fed Chair Powell, in his pivotal Economic Club of New York appearance on October 19th, said incoming data over recent months had shown "*ongoing progress toward both of our dual mandate goals*", noting that the unwinding of pandemic-related distortions and restrictive monetary policy "*are now working together to bring inflation down*", with the Fed Chair seemingly satisfied with current policy settings. Powell didn't take alarm to the hot-leaning September CPI report either, saying, "*the path is likely to be bumpy and take some time*". The speech was gauged as a confirmation of no hike at the November meeting whilst also seen raising the bar for a hike at the December meeting as the Fed deviates from its September Dot Plot that had one more rate hike pencilled in for this year.

BCB POLICY ANNOUNCEMENT (WED): Since the prior meeting, when the central bank delivered a back-to-back 50bps rate cut, Brazil’s benchmark inflation index, the IPCA, rose by 0.2% M/M in October, in line with the consensus, while the Y/Y rate edged higher to 5.1% (exp. and prev. 5.0%). Following the release, Pantheon Macroeconomics noted “inflation pressures remain under control, thanks to the lagged effect of still-high interest rates, rapidly weakening economic activity and lower fuel prices”, allowing headline CPI inflation to end the year at around 4.7%. Overall, PM believes amid a multitude of reasons the inflation picture will remain benign in the very near term, allowing the COPOM to cut rates boldly at the next few meetings. However, elevated geopolitical risk, hurting the BRL and commodity prices, is now a significant threat. Before the inflation data, Brazilian Finance Minister Haddad, on 20th October, said the Bank is concerned about the level of economic activity, knowing that inflation is converging to target over time and the decision to already cut rates was correct, as the growth slowdown is already underway. Meanwhile Chief Neto, when speaking on October 18th, noted he never said anything regarding the probability of future rate cuts being higher or lower and still sees 50bps moves as the appropriate pace.

BOE POLICY ANNOUNCEMENT (THU): 61/73 economists surveyed by Reuters expect the MPC to stand pat on rates, with markets assigning a circa 90% chance of such an outcome. Expectations for no change follow suit from the MPC's decision in September to pause its rate hiking campaign via a 5-4 vote (dissent came from Cunliffe, Greene, Haskel and Mann) after August CPI data came in cooler than expected with services inflation falling to 6.8% from 7.4% (vs. MPC exp. 7.2%). Since the last meeting, September's CPI data saw headline Y/Y rate hold steady at 6.7%, whilst the services print ticked higher to 6.9% from 6.8%. Nonetheless, expectations are for a step lower in price pressures for the October release as "last year's steep increase in household energy bills drops out of the annual comparison", according to ING; a view which has also been put forward by Governor Bailey. Elsewhere, headline earnings growth in the 3M/YY period to August slowed to 8.1% from 8.5% and the unemployment rate dipped to 4.2% in August vs. the MPC forecast of 4.1%. That being said, due to data collection issues at the ONS, the numbers are being treated with great levels of caution by the market. As such, the lack of notable hawkish developments since the prior meeting will likely see policymakers continue to sit on their hands. In terms of the arithmetic on the MPC, it is a guessing game in trying to gauge the vote split for the decision, particularly given that dissenter Cunliffe is set to be replaced by Sarah Breeden. However, even in the event that all policymakers are in agreement that rates should be held at current levels, the policy statement will likely continue to reiterate that "further tightening would be needed if evidence of more persistent inflation pressures is seen". Looking beyond the upcoming meeting, polling from Reuters suggests that economists expect the first rate cut from the MPC won't come until at least July. For the accompanying MPR, those polled by Reuters believe that inflation will average 2% in 2025, 2.2% in 2025 and with a return to target not coming until Q2 2025. On the growth front, polling suggests that Britain will avoid a recession, but the outlook remains weak with 2024 annual growth seen at just 0.4%.

NORGES BANK POLICY ANNOUNCEMENT (THU): Expected to leave rates on hold at 4.25%, in-fitting with guidance from the September meeting which pointed to one final hike most likely taking place at the December gathering and presented a slightly hawkish tone. Since then, commentary has been limited but September's inflation release was markedly softer than expected and serves to underscore expectations for an unchanged decision in November, in addition to calling into question the necessity for a final December hike. However, it is unlikely that the Norges Bank would be willing to walk back on guidance this early and as such a repeat of the language in September can be expected; though, it will be interesting to see how, if at all, the Bank assesses the latest CPI release.

REVIEWS

BOC: The BoC left rates unchanged at 5.00% as expected while it maintained guidance that it is prepared to hike rates further if needed and acknowledging that inflationary risks have increased. Meanwhile, the MPR saw inflation forecasts lifted while growth prospects for 2023 and 2024 were revised lower but 2025 saw a marginal revision higher. It also now expects inflation to return to target by the end of 2025, vs its assessment in July of mid-2025. It noted that near term inflation expectations are still high and there is a risk they could become a driver of wage-and price-setting behaviour. With guidance maintained, money markets are now assigning a c. 40% probability of a hike by March. Within the press conference both Macklem and Rogers pushed back on the idea of rate cuts anytime soon, while they were quizzed on the move higher in bond yields and its impact Rogers just noted it is something they consider, among many other factors. Meanwhile, BoC Governor Macklem himself suggested Canada will likely see two or three quarters of small negative growth, but he is not predicting a deep recession with steep contraction and major job cuts. Looking ahead, RBC does not expect there to be any additional hikes from the BoC, with data showing signs of a softening economy. The desk expects the overnight rate to be held at 5% through H1 2024 with modest cuts from Q3 '24.

ECB: As expected, the ECB opted to call a "pause" in its hike campaign by keeping all three of its key rates unchanged. The Governing Council judges that rates are sufficiently restrictive to return inflation to target and noted that past interest rate increases continue to be transmitted forcefully into financing conditions. In terms of the economic outlook, the statement reiterated that inflation is still expected to stay too high for too long, and domestic price pressures remain strong. On the balance sheet, despite some outside expectations for a potential bringing forward, the ECB reaffirmed that reinvestments under PEPP will run until "at least the end of 2024". At the follow-up press conference, Lagarde offered a downbeat assessment in which she believes the economy will remain weak in the coming months and tighter financial conditions are weighing on the Eurozone. In terms of the policy decision, Lagarde revealed that today's actions were unanimously approved, adding that there was no discussion of an early end to PEPP reinvestments or adjustments to minimum reserves. However, ECB sources via Reuters later noted that policymakers agreed to debate the PEPP reinvestment end date in early 2024 and to debate minimum reserves as part of the framework review in the Spring. The sources added that the expectation was that reinvestments would not end abruptly and the ECB would follow the sort of gradual approach it did with the APP. In terms of what lies ahead for the Bank, the President noted that just because policymakers opted for a pause today, it does not mean they won't necessarily hike in the future, but did note that the transmission of previous hikes will be felt into Q1 2024 and possibly beyond. Overall, the ECB has put itself in a position to take stock of existing actions, whilst continuing to keep options open for further adjustments to the upside. At this stage, Lagarde stated that discussion of rate cuts is premature, however, from a markets perspective, the first full 25bps cut is seen in July 2024.

CBRT: The CBRT hiked its benchmark weekly repo rate to 35.0% from 30%, as expected, following a 500bp hike in September and a 750bp hike in August. The Bank said monetary tightening will be further strengthened as much as needed in a timely and gradual manner until a significant improvement in the inflation outlook is achieved. It also warned that geopolitical developments pose risks to the inflation outlook via higher energy prices given Turkey's vulnerability as a large importer. Despite the policy efforts, the Lira remains at its record weakest levels vs the Dollar in the wake of the decision, with USD/TRY currently north of 28.15 vs the 18.70 rate it entered the year at. The rate hike also came a day after President Erdogan spoke in support of Hamas, which hit domestic stocks particularly hard and risks complicating the outlook for investors in Turkey, although his decision to send Sweden's request for accession to NATO to Turkey's parliament earlier in the week was seen as a positive for Ankara's relationship with the West.