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Central Bank Weekly 3rd November: Reviewing FOMC, BoJ, BoE, Norges Bank, BCB; Previewing RBA, BoC minutes, Banxico

REVIEWS

FOMC REVIEW: The FOMC left rates unchanged at 5.25-5.50%, in line with both expectations and market pricing, and its statement saw only slight changes. The central bank maintained that "additional policy firming that may be appropriate..." and made a slight upgrade to its description of economic growth, highlighting that economic activity had been expanding at a "strong" pace in Q3, in contrast to the "solid" pace mentioned in September. It also acknowledged that job gains had "moderated since earlier in the year" (compared to the previous "slowed in recent months" language), but it continued to emphasise the strength of job growth and the low unemployment rate. Further, it included a new line to address the recent rise in Treasury yields, stating that tighter financial and credit conditions are likely to have a negative impact on economic activity, hiring, and inflation, in contrast to the September statement, which only acknowledged tighter credit conditions. Chair Powell's post-meeting remarks echoed his previous recent views, and outlined the Fed's commitment to maintaining a restrictive monetary policy. He noted that the full effects of this policy were not yet clear. He described the economy as strong, paying attention to robust growth and labour demand. He stressed that inflation remains high, and tight labour markets have shown some signs of wage growth easing. In the Q&A, he expressed uncertainty about policy and financial conditions, hinting at potential interest rate hikes. He also suggested that the Fed is close to the end of the current rate-hike cycle and is evaluating its approach. Powell confirmed that rate cuts are not being considered, but the focus is on how long to maintain a restrictive policy. Analysts at Goldman Sachs said they continue to think that the hiking cycle is done, noting three key points: "1) The FOMC statement acknowledged the recent tightening in financial conditions, and Chair Powell laid out conditions that seem likely to be met under which the tightening would displace the need to hike; 2) Powell clarified that above-potential growth on its own would not be enough to warrant another rate hike and added that potential growth is currently higher than usual because laour force growth is elevated; 3) Powell downplayed the 1ppts jump in one-year Michigan inflation expectations, a somewhat concerning recent data point, and said, 'it's just clear that inflation expectations are in a good place.'"

BOJ REVIEW: The BoJ maintained NIRP at -0.10% and the 10yr JGB yield target at 0% during its meeting this week, as expected, but widened the reference range to 100bps up or down around the 0% target from +/- 50bps and made YCC more flexible. The Bank said it will regard the upper bound of 1% for the 10-year JGB yield as a reference in market operations and guide them nimbly, while it will flexibly increase JGB buying, fixed-rate operations and collateral fund-supplying operations. Furthermore, it will determine the offer rate for fixed-rate JGB buying operations each time by taking into account market rates and other factors. The BoJ decision was seen to be a modest tweak and less hawkish than source reports had suggested, despite the central bank effectively taking a step towards ending YCC and subsequently ceasing its relentless daily buying operations, although it did announce unscheduled purchases the following day after the meeting. In terms of the latest Outlook Report, the central bank raised its Core CPI forecasts through to fiscal year 2025 with both the FY23 and FY24 views raised to 2.8%, although inflation is seen declining to 1.7% in FY25, while the central bank raised its FY23 Real GDP forecast to 2.0% from 1.3%, but cut the FY24 Real GDP estimate to 1.0% from 1.2%. There was also a recent source report that suggested Governor Ueda will stick to the established pattern and move gradually towards an exit while maintaining the dovish rhetoric and that the next focus is ending NIRP with the timing likely around Spring.

BOE REVIEW: As expected, the MPC opted to stand pat on rates once again after doing so at the last meeting. The decision was subject to dissent from Mann, Greene and Haskel, whilst newly-appointed Breeden replaced Cunliffe's hawkish dissent with an unchanged vote. The decision to stand pat on rates was based on the judgement that since the last meeting, GDP had weakened, the labour market continued to loosen and CPI is expected to decline "significantly" in the coming months. Furthermore, the accompanying MPR noted that "more than half of the impact of higher interest rates on the level of GDP is still to come through". The statement reiterated that "policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target", whilst keeping open the option of further tightening if needed. When it comes to policy easing, Governor Bailey judges that it is "much too early to think about rate cuts". The forecasts embedded within the MPR saw 2023 inflation lowered to 4.75% from 5.0% and 2024 upgraded to 3.25% from 2.5%, with inflation not expected to fall below the 2% target until Q4 2025 (vs. prev. view of Q2 2025). From a growth perspective, GDP is now expected to be completely flat next year. At the follow-up press conference, Bailey didn't add

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too much to the debate surrounding the BoE with the Governor suggesting that now is not the time for complacency when it comes to inflation. However, he did also make the point that policy should not be kept excessively tight for too long. Overall, the MPC is very much in wait-and-see mode to gauge if current tightening efforts are actually sufficient. Although the MPC has kept the door open for further tightening, the market continues to judge that the next move from the Bank will be to lower rates, with the first 25bps reduction in the Bank rate seen in September next year.

NORGES BANK REVIEW: As expected, the Key Policy rate was held at 4.25% and the Bank reiterated guidance towards a hike “likely” occurring in December. However, this was subject to a significant, but prudent caveat given the recent cooler-than-expected inflation readings and multiple reports due between now and that December meeting which will feature updated projections. The tweak has seen the committee add that if they “become more assured that underlying inflation is on the decline, the policy rate may be kept on hold”. An addition which clearly gives rate setters ample optionality going into the final meeting of the year and makes the inflation readings due before that gathering, on November 10th and December 11th crucial. Elsewhere, the statement acknowledged that economic activity has been a little lower than projected, though it is worth caveating we have only received a handful of data points since that last meeting. While on the NOK, the committee notes that its depreciation could contribute to sustaining inflation. Finally, the statement makes clear that irrespective of the December decision “there will likely be a need to maintain a tight monetary policy stance for some time ahead.”

BCB REVIEW: The BCB lowered the Selic by 50bps to 12.25%, in line with market expectations, while its statement was judged to have been tweaked to a more hawkish stance; Rabobank notes that the statement now highlights how global risks (resilience in high core inflation and labour markets, elevated long-term interest rates in the US, new geopolitical risks) require attention and caution in monetary policymaking; the Copom’s inflation view is now for 3.6% in Q4 2024 (prev. saw 3.5%) and 2.0% in Q4 2025 (prev. 3.1%); Rabobank says ahead, the Copom expects to keep this easing pace for the next meetings, so it is keeping its view for 50bps of cut per meeting over the next three confabs, and it thinks the Selic will be cut to 11.75% by the end of 2023, and then to 9.25% by end-2024, but Rabo now thinks there is an upward bias to its end-2024 forecast, based on raised fiscal and external risks. It adds that next week's minutes (7 /Nov) should disclose more details on their outlook on inflation and state of the economy.

PREVIEWS

RBA ANNOUNCEMENT (TUE): The hotter-than-expected CPI data for Q3 and for September resulted in desks changing calls to expect a 25bps hike by the RBA at the upcoming meeting. Analysts expect a 25bps hike to 4.35% from 4.10% after four back-to-back decisions to hold rates from July to October. The PPI and Retail Sales data released since also back this notion, although the Labour Force Report favours a more cautious approach, after employment change missed forecasts, participation unexpectedly fell, but the unemployment rate unexpectedly ticked lower. As of the 2nd of November, the ASX 30-Day Interbank Cash Rate Futures November 2023 contract was trading at 95.805, indicating a 50 /50 expectation of an interest rate increase to 4.35% at the next RBA Board meeting. A hike would mark Governor Bullock’s first rate move. In her post-CPI speech at the end of October, the governor noted that CPI was a little higher than the board expected but was about where they thought it would come. She noted goods prices coming down, but services inflation remaining persistent, while they are still considering whether CPI was a "material" change to outlook. Bullock highlighted the RBA is wary of inflation, and said the bank has made it clear that they may have to hike. “The resilience of the household sector, alongside lingering capacity constraints amid strong population growth, supports the decision to raise rates as well. However, the Board will also recognise that the labour market has turned and the risk of a price–wage spiral is receding. In essence, November’s rate hike decision will be finely balanced”, say the analysts at Westpac. Meanwhile, Oxford Economics says “we think the Q3 CPI data constitute enough of an upside surprise to spur the RBA into action... We now expect to see rate hikes at both the November and December meetings.”

BOC MINUTES (WED): The BoC left rates unchanged at 5.00%, as was expected, and it maintained guidance that it is prepared to hike rates further if needed, acknowledging that inflationary risks have increased. The MPR saw inflation forecasts lifted, while growth prospects for 2023 and 2024 were revised lower, but 2025 saw a marginal nudge upwards. the BoC now expects inflation to return to target by the end of 2025 (prev. vs it was mid-2025 in its July MPR). 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. At his post-meeting press conference, both Governor Macklem and Deputy Governor Rogers pushed back on the idea of rate cuts anytime soon. Both were quizzed on the move higher in bond yields and its impact, Rogers noted it was something it considers among many other factors. Meanwhile, 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, analysts at RBC do not expect any additional hikes from the BoC, with data showing signs of a softening economy. It looks for the overnight rate to be held at 5% through H1 2024 with modest cuts from Q3 2024.

BANXICO ANNOUNCEMENT (THU): The recent Banxico poll shows private sector analysts timed their view of headline inflation this year (to 4.6% from 4.66%), but lifted their core inflation view (to 5.11% from 5.09%). Growth this year is

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seen at 3.29% (lifted from its previous view of 3.2%), while 2024 growth forecasts have improved to 2.0% (vs 1.9% previously). On terms of interest rates, the poll shows private sector analysts predicting that rates will end this year at the current 11.25% (unchanged), while the 2024 view was revised to 9.25% (vs 9.00% in the previous poll). This week, prelim data for Q3 showed growth above consensus (+0.9% vs exp. +0.8%). But Capital Economics still thinks a slowdown is on the cards over the coming quarters, as tight monetary policy takes a heavier toll, and weaker growth in the US weighs on Mexico's external sector. "Q3's outturn means that Mexico's economy is on course to expand by a solid 3.5% over 2023 as a whole, but we doubt that this strength will continue into 2024," Capital Economics writes, "monetary policy is likely to remain tight, with Banxico set to be the last major central bank in the region to begin an easing cycle, and softer growth in the US will weigh on Mexico's external sector," adding that "the slowdown will be cushioned by looser fiscal policy ahead of next year's election, but growth is likely to weaker than the consensus expects, at around 1.8%."

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