Central Bank Weekly 2nd February: Previewing RBA, Banxico, RBI; Reviewing FOMC, BoE, Riksbank and BCB

PREVIEWS:

RBA ANNOUNCEMENT (TUE): The RBA is expected to keep its Cash Rate Target unchanged at 4.35% when it holds its policy meeting next week with money markets pricing a 91% expectation for no change to the Cash Rate and just a 9% expectation for a 25bps cut. This will be the first meeting since the revamp at the RBA took effect in which the central bank switched to just 8 meetings a year from the previous 11 meetings although the meetings will now be held over two days and the post-meeting statement will be issued by the board instead of the RBA Governor. Furthermore, RBA Governor Bullock will conduct a press conference to explain the decision after each board meeting which will begin an hour after the policy announcement, while the central bank will also release its quarterly Statement on Monetary Policy at the same time as the outcome of board meetings in February, May, August and November instead of the following Friday. As a reminder, the RBA unsurprisingly kept the Cash Rate unchanged at the last meeting in December and reaffirmed its forward guidance that whether further tightening is required to ensure that inflation returns to the target in a reasonable timeframe will depend upon data and evolving assessment of risks, while it also repeated that the board remains resolute in its determination to return inflation to target and will do what is necessary to achieve that outcome, as well as noted there are still significant uncertainties around the outlook. The commentary from the central bank lacked any major hawkish surprises which some were anticipating given the more forceful comments on inflation from RBA Governor Bullock in the weeks leading up to the meeting. The upcoming meeting is also not expected to involve any policy tweaks although market participants will get a slew of commentary from the policy statement, quarterly SoMP and press conference to scrutinise for clues on future policy.

BANXICO ANNOUNCEMENT (THU): Banxico's private sector analyst poll reveals an expectation that headline inflation will end this year at 4.17%, revised up from the 4.0% seen in the previous poll, as strong wage growth fuels inflation gains; the forecast for core inflation, however, was left unchanged at 4.06%. Many analysts do not expect headline inflation to fall back into the Banxico's 2-4% tolerance band until later this year. Accordingly, the timing may not be right for the central bank to cut rates next week. Analysts still see the Banxico's benchmark rate ending this year at 9.25%. Moody's says that although most LatAm economies are expected to report declining inflation rates for January, indicative of an overall improvement in their economies, not all are showing positive trends; Mexico's CPI is seen rising, which should result on Banxico maintaining its policy rate at 11.25% in February.

RBI ANNOUNCEMENT (THU): The RBI is expected to keep its Repurchase Rate unchanged at 6.50% and maintain its stance of remaining focused on the withdrawal of accommodation when it concludes its 3-day policy meeting next week which will be the final policy decision in the current financial year. As a reminder, the RBI kept rates unchanged at the previous meeting in December with the decision made through a unanimous vote and 5 out of 6 MPC members voted in favour of maintaining the policy stance of remaining focused on the withdrawal of accommodation to ensure that inflation progressively aligns to the target while supporting growth. MPC external member Varma once again expressed reservations on the policy stance part of the resolution as he believes a stance is not needed at all at this stage and stated that if there is a stance, it should be neutral. Nonetheless, the rest of the MPC remains aligned in their focus on the withdrawal of accommodation and RBI Governor Das also noted that they have to remain highly alert to any signs of generalisation of price impulses that may derail the ongoing process of disinflation, while he also stated that they have to remain vigilant and ready to act effectively in their journey towards the 4% inflation target.

REVIEWS:

FOMC REVIEW: The Fed left rates unchanged at 5.25-5.5%, as expected, but made key changes to its statement, which now reflects a more balanced outlook on rate cuts vs rate hikes. Its description of economic growth was upgraded, now describing economic activity as "expanding at a solid pace" (vs "slowed from its strong pace in the third quarter" in the December statement). The reference to the US banking system being "sound and resilient" and its commentary that tighter financial and credit conditions will likely weigh on the economy were both removed. It added a line noting that the risks to achieving its employment and inflation targets were moving into better balance. The statement also removed guidance that "in determining the extent of any additional firming that may be appropriate" to a more dovish/balanced view that "in considering any adjustments to the target range", but it added a hawkish caveat that it "does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably towards 2%." Language on the balance sheet was maintained, as expected. In his post-meeting remarks, Fed Chair Powell said the policy rate was likely at its peak for this cycle, and it will likely be appropriate to begin reducing rates "sometime this year" if the economy evolves as expected; Powell offered the caveat that the Fed was prepared to maintain its current policy rate for longer, if needed. The Fed Chair said reducing rates too soon, or too much, could reverse the progress the central bank has made in lowering inflation, but at the same time, reducing rates too late could unduly weaken the economy. Powell said inflation has "eased notably," noting that risks to achieving the Fed's goals were moving into better balance. The Fed chief added that low inflation readings in H2 2023 were welcome, but it needs to see continued evidence in order to gain confidence that it was returning to target. Powell stated that a March rate cut was not likely, and was not policymakers' base case; but he conceded that it remains to be seen, and will all depend on how the economy evolves - even so, he does not think policymakers will have enough confidence by March. Powell believes that it will be appropriate to reduce rates some time this year, a view held by almost all on the Committee, adding that the Fed's December projections (which pencil in three rate cuts in 2024) were a good benchmark of where the FOMC is on the rate path. If the Fed saw an unexpected weakening in the labour market, however, Powell said that would certainly call for cutting sooner. In wake of the policy announcements, Bank of America's analysts pushed back their call on Fed rate cuts. "Powell significantly raised the bar for a March cut by saying, 'I don't think it is likely that the committee will reach a level of confidence by the time of the March meeting'," BofA writes, "based on the outcome of the January FOMC meeting, we now look for the rate cut cycle to begin in June -- and expect 25bps rate cuts in June, September, and December, this would mean 75bps of rate cuts this year -- and we retain our view of 100bps of rate cuts in 2025." BofA also pushed out its expected timing of the QT slowdown announcement, and now sees this happening at the May meeting (vs its previously expectation for an announcement in March). "In addition to altering the timing of tapering, we also adjust the path of QT slowdown," it writes, "we no longer expect a USD 15bln/month taper in the US Treasury redemption cap at each FOMC meeting, instead, we now expect a reduction in the Treasury redemption cap from USD 60bln/month to USD 30bln/month, and for this to remain open-ended."

BCB REVIEW: Brazil’s Central Bank cut its Selic rate by 50bps to 11.25%, as expected, while committee members unanimously anticipate further reductions of the same magnitude in the next meetings. The BCB noted this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process, whilst the total magnitude of the easing cycle throughout time will depend on inflation dynamics, expectations and projections, output gap and balance of risks. BCB suggested the current context requires serenity and moderation in the conduct of monetary policy, and the global environment remains volatile and local economic activity remains consistent with the expected scenario of deceleration. Following the decision, analysts at Goldman Sachs said, "We expect the Copom to cut the Selic rate by 50bp at the two next two meetings (Mar-24 and May-24)".

RIKSBANK REVIEW: Overall, a dovish hold from the Riksbank with rates kept at 4.0% accompanied by a widely flagged increase to bond sales. However, this was to just SEK 6.5bln (prev. 5.0bln) shy of SEB’s 7-8bln consensus. The main development was the view that inflationary pressures are going to continue to decline ahead and as such the risk of inflation becoming entrenched has lessened. Given this, the board said that rates will likely be cut sooner than November's forecasts indicated (Nov. implied no 2024 cut) and added additional dovishness by stating "If the prospects for inflation remain favourable, the possibility of the policy rate being cut during the first half of the year cannot be ruled out.". Albeit, this was caveated a touch by the assessment that contractionary policy is still needed currently. Next, we look to the minutes on February 7th to see if any members provided a specific meeting/period for the first reduction and thereafter the March MPR for a formal update to the forecasts; for reference, the likes of SEB forecast the first cut in May.

BOE REVIEW: As expected, the MPC opted to stand pat on rates, keeping the base rate at 5.25%. However, the decision to do so was unexpectedly a three-way split with Haskel and Mann voting for a 25bps hike, whilst Dhingra supported a 25bps cut. The policy statement saw policymakers ditch prior guidance that “further tightening” could be required. However, the MPC maintained the judgement that monetary policy will need to be “sufficiently restrictive” for “sufficiently long” and for an “extended period”. The accompanying MPR revealed that the Bank now expects inflation to reach its 2% target in Q2 2024 vs. previous view of Q4 2025. That being said, the two year inflation view is at 2.3% (i.e above target) which suggests that policymakers think the current market pricing is too dovish to be compatible with its inflation mandate. From a growth perspective, the MPC sees GDP as 'broadly flat' in Q4 [unchanged view] and sees 'broadly flat' GDP over the coming quarters. At the follow up press conference, Governor Bailey noted that inflation is heading in the right direction but “is not there yet” when it comes to lowering rates. Despite attempts by journalists, Bailey refused to get drawn into speculation over when the MPC will cut rates and stressed the Bank’s data dependency. That being said, the Governor noted that the MPC does not need to see inflation back at target to cut rates, it needs to see evidence that it is heading back to target. With regards to the follow-through of prior actions, Bailey remarked that so far, two thirds of the impact of prior tightening has been felt. When it comes to the MPC eventually lowering rates, Bailey was careful to note that even if rates were cut, policy would still be restrictive. Overall, the BoE is clearly in wait-and-see mode but via its macro projections suggested that market pricing was perhaps too dovish. Despite initially moving in a more hawkish direction, market pricing is pretty much where it was pre-release with the first cut priced by June and around 110bps of easing seen by year-end.