Central Bank Weekly 8th March: Previewing PBoC MLF; Reviewing BoC and ECB

PREVIEWS:

PBOC MLF (FRI): The PBoC will conduct its Medium-term Lending Facility operation next Friday with the central bank likely to maintain the 1-year MLF rate at the current level of 2.50%. As a reminder, the PBoC unsurprisingly kept its 1-year MLF rate unchanged last month during a CNY 500bln operation vs CNY 499bln of MLF loans maturing to "maintain banking system liquidity reasonably ample". Furthermore, the central bank’s unwillingness to adjust its shorter-term funding rates is evident in the lack of adjustment to the 7-day reverse repo rate since August last year, while the central bank also surprised markets last month with its benchmark Loan Prime Rates in which it maintained the 1-year LPR at 3.45% (exp. 5bps cut), but delivered a deeper than anticipated cut for the 5-year LPR which was lowered by 25bps to 3.95% (exp. 10bps reduction), with the latter the reference rate for mortgages in China. This was viewed as a targeted measure to support China’s troubled property sector alongside the various efforts that had previously been announced to revive demand in the industry which has been in a crisis since 2020 and was once a key driver of the country's economic growth. Furthermore, the central bank has continued to signal future action as PBoC Governor Pan recently noted that the PBoC still has sufficient room for monetary policy and that there is still room for cutting RRR. Analysis at ING suggests “Given that the tone on monetary policy at the Two Sessions was kept unchanged - continuing to highlight “prudent monetary policy” - the probability of a cut next week has fallen somewhat.”

REVIEWS:

BOC REVIEW: The Bank of Canada left rates unchanged at 5.00%, as expected. It largely reiterated its guidance, disappointing those looking for clues on when the central bank will be ready to cut rates. The statement repeated the council is still concerned about the risks to the outlook for inflation, particularly the persistence in underlying inflation. It also repeated that policymakers wanted to see "further and sustained easing in core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour". Within Governor Macklem's opening remarks, he stressed that it was still too early to consider lowering its policy rate, and the BoC needs to give higher rates more time to work through the economy. The Governor noted that recent inflation data does suggest policy was working as expected, but future progress on inflation is expected to be gradual and uneven, while upside risks remain. He also repeated concerns over shelter prices, stating that they remain elevated, and is still the biggest contributor to overall inflation. Macklem also thinks that inflation is unlikely to return to 2% this year. On the path for rate cuts, he reiterated that the central bank cannot put the timing of rate cuts on a calendar, though it will not lower rates at the pace they were raised. Overall, the update was absent of any new dovish inclinations despite the softer inflation report; money-markets no longer fully price a rate cut by June, but still assign an approximately 80% chance of a cut by then. Looking ahead, with around 80bps of rate cuts priced for this year (vs around 88bps before the meeting).

ECB REVIEW: As expected the ECB opted to stand pat on rates as policymakers continue to monitor progress towards the Bank's inflation mandate. Furthermore, guidance on rates was reaffirmed as stating that "rates will be set at sufficiently restrictive levels for as long as necessary". This served as a disappointment to some who had been hoping that policymakers would insert some language suggesting that discussions on the policy normalisation process had begun. However, the accompanying macro projections did offer something to the doves with the 2024 and 2025 inflation forecasts lowered, leaving the latter matching the Bank's 2% target. From a growth perspective, 2024 was cut to 0.6% from 0.8% with next year's forecast held at 1.5%. At the follow-up press conference, Lagarde noted that, whilst inflation is continuing to move lower, it remains elevated due to wage pressures and therefore the Bank is not yet "sufficiently confident" when it comes to meeting its target. In terms of the policy path beyond the March meeting, Lagarde stated the Bank will know a little more in April but a lot more in June. When it comes to the discussions held today, Lagarde stated that today's policy decision was unanimous, there was not a discussion over rate cuts but the GC has begun discussing dialling back its restrictive stance with the view that the Bank will not wait until the 2% inflation target is reached in order to cut rates. In terms of the lie of the land after the meeting, market pricing is little changed with a June cut still near-enough fully priced in with a total of 93bps of easing seen by year-end.

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