Central Bank Weekly 31st May: Previewing ECB, BoC, RBI

PREVIEWS:

BOC POLICY ANNOUNCEMENT (WED): Of the 29 analysts surveyed by Reuters, 22 expect the BoC to cut rates by 25bps to 4.75% at its June meeting; the remaining seven expect the central bank to keep rates unchanged. Meanwhile, money markets are currently assigning a probability around 80% of a rate reduction after weak GDP data. BMO Capital Markets said that the door is open to a cut, but it remains a close call, adding that when the BoC does begin cutting, the cycle is expected to be gradual, with the US Federal Reserve acting as a 'limiter' on how quickly Canadian rates can fall. Meanwhile, the other large Canadian banks - RBC, TD and Scotia, see the central bank beginning to lower rates from July onwards, given that is when the central bank will next update its economic projections. BoC Governor Macklem has suggested that the central bank wants to see the disinflation process continue for longer in order to be confident that progress is being made on bringing price pressures sustainably under control. Ahead, the Reuters poll finds that 14 of the 29 economists surveyed see rates ending this year at 4.00%, while 14 see rates at above 4.25% by the end of this year; only 1 sees cuts taking rates to 3.75%.

ECB POLICY ANNOUNCEMENT (THU): Expectations are for the ECB to lower the deposit rate for the first time since September 2019. Analysts are unanimous in their view that the deposit rate will be lowered from 4.0% to 3.75% with markets assigning a roughly 90% chance of such an outcome. In terms of developments since the prior meeting, inflation in May rose to 2.6% Y/Y from 2.4% with the super-core measure increasing to 2.9% Y/Y from 2.7%, with some of the increases related to base effects. Elsewhere, Q1 Eurozone wages rose to 4.69% Y/Y from 4.45% with the release followed up by an ECB blog stating that “wage growth reflects multi-year adjustment and wage pressures look set to decelerate in 2024”. From a growth perspective, Q1 GDP came in at 0.3% Q/Q vs the prior 0.0%, whilst more timely survey data showed the EZ-composite PMI move further into expansionary territory (52.3 vs prev. 51.7) thanks to a pick up in the manufacturing sector. Elsewhere, the EZ unemployment rate fell to a historic low of 6.4%. As a reminder, the April policy statement noted that if the Governing Council was to gain further confidence that inflation is converging to the target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. Rhetoric since the April meeting has seen President Lagarde remark that the ECB will cut rates soon, barring any major surprises, whilst she is “really confident” that they have inflation under control. Even the hawks on the GC are on board with a reduction in June, with Austria’s Holzmann favouring such a move. However, the clear fight on the GC between the hawks and doves will be what comes thereafter; Holzmann and others have been making the case for pausing on rates in July. Any tweaks to the policy statement, hinting at further action will be of note to the market. Accordingly, focus for the release will be on how pricing beyond June evolves with the next rate cut, which is not fully priced until December (total of 58bps of cuts seen by year-end). However, ING cautions that given the data dependency of the Bank, this debate is unlikely to be resolved next week. For the accompanying macro projections, ING remarks “we expect a slight upward revision of growth and inflation for this year but no changes to the profile and the timing of inflation dropping below 2%”.

RBI ANNOUNCEMENT (FRI): The RBI is expected to keep the 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. The RBI has refrained from any adjustments to the Repo Rate since February 2023, while 5 out of the 6 MPC members voted to keep policy settings unchanged at the last meeting and to maintain the stance of remaining focused on the withdrawal of accommodation in which MPC external member Varma was the lone dissenter who voted for a 25bps cut and for a change in the stance to neutral citing a continued benign outlook for inflation and an unwarrantedly high real rate imposing significant costs on the economy. Nonetheless, the rest of the MPC members preferred to maintain the current policy settings and the central bank has stated that monetary policy must be actively disinflationary with the MPC to remain resolute in commitment to aligning inflation with the target. Furthermore, Governor Das believes that the monetary policy setting is well-positioned with monetary policy transmission continuing and inflation expectations of households are also getting further anchored, while he noted at this stage, they should stay the course and remain vigilant. The recent data releases also suggest a lack of urgency to tweak policy as CPI YY for April remained within the central bank’s tolerance range and continued to edge closer to the 4% target despite printing slightly firmer than expected at 4.83% vs. Exp. 4.80% (Prev. 4.85%), while slowing Industrial Production for March at 4.9% vs. Exp. 5.1% (Prev. 5.7%) also limits the scope for the central bank to make adjustments.

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