Central Bank Weekly 12th July: Previewing PBoC MLF, SARB, ECB; Reviewing Fed Chair Powell, RBNZ and the BoJ Bond Meeting

PREVIEWS:

PBOC MLF (MON): The PBoC is expected to maintain the medium-term lending facility (MLF) rate at 2.50% and reduce some liquidity in the banking system during its upcoming operation on Monday, according to a Reuters survey. In a poll of 35 market participants, 97% anticipate no change in the 1-year MLF rate, with only one predicting a slight reduction. The PBoC's recent introduction of a new cash management mechanism and comments from Governor Pan Gongsheng suggest a shift in focus towards using the seven-day reverse repo rate as the primary policy tool, diminishing the MLF rate's significance. Since the last Loan Prime Rate (LPR) setting on 20th June, it was reported that the PBoC will make clear it will start to use a short-term interest rate as its main policy rate after reducing the importance of the MLF rate as a policy benchmark, according to PBoC-backed Financial News citing unnamed industry people. Back to the poll, 80% of respondents expect only a partial rollover of the CNY 103bln MLF loans due this month, as loosening cash conditions reduce demand for these loans. For reference, the next LPR fixing is slated for July 22nd.

ECB ANNOUNCEMENT (THU): Expectations are unanimous amongst economists that the ECB will stand pat on rates with markets assigning a 92% chance of such an outcome. As a reminder, at the prior meeting, the ECB cut rates for the first time since September 2019, with the accompanying statement noting that the "Governing Council is not pre-committing to a particular rate path". Since the June announcement, headline HICP ticked lower to 2.5% from 2.6%, with ING making the observation that sticky services inflation at 4.1% kept “core inflation too elevated for another imminent rate cut”. From a growth perspective, Q2 GDP will not be available until July 30th, however, more timely PMI metrics from S&P Global saw the EZ-wide manufacturing print fall to 45.8 from 47.3, services nudge lower to 52.8 from 53.2, leaving the composite at 50.9 vs. prev. 52.2. In the labour market, the unemployment rate remains at its historic low of 6.4%. Rhetoric from officials has suggested a move lower in rates this month is unlikely with President Lagarde stating officials are in no hurry to cut rates again after June’s move and the central bank requires additional reassurance that inflation is headed back towards 2% before it cuts rates further. Hawks on the GC have been more explicit in their views with ECB’s Knot stating that there is no reason to cut in July, adding that the next truly open meeting is in September. As such, it looks like the upcoming meeting will largely be a non-event with policymakers set to sit on their hands and see how data plays out between now and September. On which, market pricing currently assigns a roughly 80% chance of a cut with a total of 46bps of easing seen by year-end.

SARB ANNOUNCEMENT (THU): Likely to once again keep the Repo Rate at 8.25%. In June, the rate was maintained with the statement noting that considerable uncertainty remains around long-term inflation while being more optimistic on the medium-term view, stating that they see CPI stabilising at the 4.5% objective in Q2-2025. The main update since the last SARB announcement has been the final tally of election results and the agreement between ANC and the Democratic Alliance to form a government of national unity. On the data front, May’s CPI printed in-line with the prior and newswire consensus at 5.2% Y/Y, markedly above the 4.5% mid-point of the 3-6% SARB target band. The latest Reuters poll, released in June, has respondents looking for the SARB to remain on hold until November.

REVIEWS:

FED CHAIR POWELL TESTIMONY REVIEW: Chair Powell largely stuck to the script at the Senate and House testimonies, repeating that more good data would strengthen the Fed's confidence on inflation returning to target, although he acknowledged that elevated inflation is not the only risk the Fed faces – a nod to concerns around the labour market. On which, Powell noted that labour market conditions have cooled considerably, and the labour market is fully back in balance now. Powell did not give any signal about future policy moves, but he repeated that the Fed will carefully assess incoming data, the balance of risks, and the appropriate policy path in rate adjustments. Nonetheless, in the wake of the testimonies, WSJ’s Timiraos stated that Powell made the beginning of a pivot on interest rate cuts, that might prove more durable than the one that sparked a big market rally at the end of last year. On inflation, Fed Chair Powell echoed the statement, noting they have made considerable progress towards the 2% inflation goal and recent monthly readings show 'modest further progress'. He also stressed that cuts are not appropriate until the Fed gains greater confidence inflation is returning to target but they will continue to make decisions on a meeting-by-meeting basis. Powell also noted that policy is restrictive, but not intensively restrictive, which suggests the neutral rate is a little higher than before, adding the Fed is unlikely to go back to very low rates of the pre-crisis period. He also stated there are significant housing issues in the nation, and although wage increases are still very high, they are coming down to more sustainable levels. Given it was the testimony about the Monetary Policy Report, Powell was testifying on behalf of the Fed as a whole, and not giving his own views. But one nuance is that last week he spoke on how the disinflationary trend is resuming and they are back on the disinflationary path, albeit he did not mention this in the testimony. Nonetheless, nothing has changed the narrative since last week, aside from perhaps a cooler jobs market (but that would support the disinflation argument), so we suspect Powell still holds this view, but perhaps some hawks on the FOMC need more convincing, but after the soft CPI on Thursday, it only further supports the disinflation process.

RBNZ REVIEW: The RBNZ kept the Official Cash Rate unchanged at 5.50%, as unanimously expected, while it maintained its rhetoric that the Committee agreed the OCR will need to remain restrictive although it provided a dovish tilt in which it stated that the extent of this restraint will be tempered over time consistent with the expected decline in inflation pressures. The RBNZ commented that some domestically generated price pressures remain strong although there are signs inflation persistence will ease in line with the fall in capacity pressures and business pricing intentions, while it was also noted that current and expected government spending will restrain overall spending in the economy. The minutes from the meeting revealed that the Committee is confident inflation will return to within its 1%-3% target range over the second half of 2024 and that the appropriate stance of monetary policy was discussed at the meeting. The more dovish-leaning commentary from the central bank pressured NZD with money market rates pricing around a 55% chance for a 25bps cut at the next meeting in August. Furthermore, a note from ANZ Bank suggested that the Monetary Policy Review tilted risks a little further towards the first cut occurring sooner in November rather than ANZ’s forecast of February next year but added that CPI data next week will be more important for the OCR outlook than the rhetoric from the central bank at the meeting.

BOJ BOND MEETING REVIEW: The BoJ held a 2-day meeting with bond market participants this week to provide them with a chance to convey their views before the central bank announces its bond buying tapering plans for the next 1-2 years at its policy meeting on July 30th-31st. The BoJ released the briefing material for the meeting and stated it received various views from participants including the idea to reduce monthly buying to JPY 2tln-3tln or have it at around JPY 4tln, while there was a view that it should be reduced to zero as soon as possible and that it should be reduced to JPY 1tln-2tln/month before going further. There were also suggestions for a rapid reduction, then a gradual one to offset concern and prevent volatility, a step-by-step reduction pace, and to plan reductions over around 2 years to avoid unnecessary volatility. Furthermore, opinions from bond market participants included the idea to taper at a set pace swiftly, taper swiftly and then moderately in several stages, or reduce buying gradually over two years, as well as ideas to maintain the current format of showing bond buying amount in a range of set a single figure instead of a range. However, it remains to be seen what the central bank will actually decide for its bond tapering plans as BoJ officials were reportedly more interested in hearing market views in the bond market meetings rather than forming discussions around specific options for bond purchase reductions.