Central Bank Weekly: Previewing PBoC LPR, BoC and CBRT; Reviewing ECB, PBoC MLF, SARB

PREVIEWS

PBOC LPR (MON): The PBoC is expected to maintain its benchmark Loan Prime Rates next week with the 1-year and 5-year LPR to be kept at the current levels of 3.45% and 3.95%, respectively. The likelihood for China to maintain its benchmark rates follows the central bank's decision to keep its 1-year Medium-term Lending Facility rate at 2.50% as this serves as a fairly accurate leading signal for the intentions regarding the LPRs which are the rates that most new loans and mortgages are referenced on. The central bank is also seen to be focusing on short-term liquidity measures which was evident in the increased injections during this week's 7-day reverse repos announcements, while it was reported earlier this month that it would conduct temporary overnight repos or reverse repos based on market conditions to keep banking system liquidity reasonably ample and to increase the accuracy and efficiency of open market operations. Furthermore, industry sources cited by PBoC-backed Financial News stated 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 which suggests a lack of urgency to adjust the benchmark LPRs. Nonetheless, future rate adjustments cannot be ruled out given recent data releases including a contraction in imports, as well as softer-than-expected CPI and Retail Sales data which suggest weak domestic demand, while GDP data for Q2 also missed estimates and House Prices have continued to contract. As such, if the data continues to deteriorate, it could stoke slowdown concerns and warrant support measures, while analysts cited by Shanghai Securities News recently noted that China may see a window to cut its interest rates or RRR at the end of Q3 or in Q4 to support its economy.

BOC ANNOUNCEMENT (WED): The current analyst poll has not been released yet, but money markets currently assign an 80% probability of a rate cut in July after soft data while ING, RBC, and Scotia all look for the BoC to follow up with another 25bp rate cut after cutting by 25bp in June. Recent data has been on the cool side, inflation continued to ease with the average of the BoC core measures rising 2.6% Y/Y in June, down marginally from the prior 2.63%, albeit this was revised down from 2.70%. Meanwhile, the June jobs report was soft with the unemployment rate ticking up to 6.4% from 6.2%, above the 6.3% forecast. The monthly employment change was also disappointing, falling by 1.4k, with a decline of 3.4k full-time jobs, and a gain of 1.9k part-time jobs, well beneath the expected 22.5k and prior 26.7k. The latest business outlook survey saw that most respondents expect inflation to return close to target in 2-3 years, while outlooks were mostly unchanged from the prior quarter, remaining more pessimistic than average. The share of firms reporting labour shortages is at near survey lows, but only a few firms plan to reduce headcounts. On prices, firms expect the growth of their input prices and selling prices to slow, suggesting that inflation will continue to decline over the coming year. A soft labour market and more signs of cooling price pressures ahead opens up the door for another rate cut in July. Looking ahead, markets are fully pricing in two 25bp rate cuts this year, with a 60% probability of a third. The focus of this meeting will be on the rate decision, but any guidance on rates in the statement will also be key. This meeting will also be accompanied by the latest Monetary Policy Report, which will also be used to gauge how the BoC expects the economy to perform, which may provide insight into their future easing process. ING is of the view that the BoC cut rates again in July, and expects a further 50bp of rate cuts thereafter. The desk acknowledges the rise in the unemployment rate and sub-forecast inflation led the bank to shift its view to expect a rate cut at the upcoming meeting.

CBRT ANNOUNCEMENT (THU): The CBRT is likely to maintain its rates at its meeting on Tuesday, which has been rescheduled from the usual Thursday announcement. Expectations for the Weekly Repo Rate to be maintained at 50.00% come amid the cautious policy stance widely telegraphed by the central bank and its governor Karahan. Turkey's inflation slowed in June, sparking talks of potential rate cuts. Despite speculation of a rate cut due to slowing inflation, Karahan stressed maintaining a cautious stance and emphasized that policy actions must align with hitting the inflation target in 2025 and beyond. The central bank projects inflation to decrease to 38% by the end of 2024, 14% in 2025, and 9% in 2026. Some suggest the central bank aims to see clearer improvements in inflation expectations before easing policy.

REVIEWS

ECB: As expected, the ECB opted to stand pat on rates following the 25bps reduction in June. In the accompanying policy statement, the Governing Council reaffirmed that it will keep policy rates sufficiently restrictive for as long as necessary to achieve its goals. Furthermore, policymakers will continue to maintain a data-dependent approach and not pre-commit to a specific policy path. At the follow-up press conference, President Lagarde said incoming data points to the economy growing in Q2, though likely slower than Q1. On the inflation front, this is expected to fluctuate around current levels for the remainder of the year before declining towards the target over H2-2025 owing to weaker unit labour costs and other factors. In the Q&A segment, Lagarde noted that the discussion on the Governing Council was very much a case of "on the one hand" and "on the other hand", with the ultimate policy decision being a unanimous one. Lagarde was also keen to stress that the ECB is data-dependent but not specific data point-dependent. Regarding the path ahead, Lagarde kept her cards close to her chest, suggesting that the September meeting is "wide open". In terms of market pricing, a September rate cut is priced at around 68% with 44bps of easing seen by year-end. Overall, the ECB will see where the data guides them ahead of the September meeting with ING making the point that given that the Eurozone is not in recession, this is not a typical rate-cutting cycle, and therefore the ECB will not be on autopilot. Sources in the wake of the meeting were mixed, Bloomberg reported that ECB officials are considering if only one more cut is feasible in 2024, and added that with inflation pressures still lingering, officials are becoming less confident that a path for two further reductions is realistic. BBG sources further added they do not want investors to assume that a move in September is a done deal. Nonetheless, Reuters sources suggested that ECB hawks are open to a September rate cut, provided upcoming data confirm disinflation is underway. Both Reuters and Bloomberg sources mentioned that after the ECB's strong commitment in June to lower rates, the ECB wants to refrain from committing to a September move, stating that all options are on the table for that meeting.

PBOC MLF: PBoC maintained its 1-year Medium-term Lending Facility rate at 2.50% for this month's MLF operation, as widely expected, and announced CNY 100bln of loans under the facility which was slightly less than the CNY 103bln maturing but coincided with an increased liquidity effort via an injection of CNY 129bln via 7-day reverse repos. The central bank also followed through with additional notable liquidity injections this week for a total net CNY 1.17tln for the week via OMO which is the biggest weekly net cash injection since January and suggests a preference for using short-term liquidity measures for the time being and follows a previous report by PBoC-backed Financial News citing unnamed industry sources 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. Furthermore, the PBoC had announced earlier this month that it will conduct temporary repos or reverse repos based on market conditions effective from July 8th whereby the tenors of the temporary repos or reverse repos will be overnight loans to keep banking system liquidity reasonably ample and to increase the accuracy and efficiency of open market operations which further suggests the unlikelihood of immediate major policy adjustments.

SARB: As expected, the SARB held its Repo Rate at 8.25%. The accompanying statement highlighted that inflation expectations remain uncomfortably above the 4.5% objective. Though, both headline and core inflation forecasts were subject to modest downward tweaks for 2024 and 2025; albeit, this development is caveated by the inclusion of language suggesting that the “balance of risks is assessed to the upside”. Over the medium term (seemingly next year, judging by the CPI forecasts) inflation is seen stabilising at the 4.5% target point. In short, an as-expected hold from the SARB with no indication that they are ready to begin dialling back the restrictive stance with “inflation expectations still uncomfortably above the 4.5% objective”. As a reminder, the June Reuters survey pointed to the SARB remaining on hold until November, i.e. no move at the September gathering. Following the decision/statement, the ZAR experienced some modest appreciation with USD/ZAR easing from c. 18.20 to 18.1650.