Central Bank Weekly 26th July: Previewing FOMC, BoJ, BoE, BCB; Reviewing BoC, PBoC, CBRT

PREVIEWS

BOJ ANNOUNCEMENT (WED): A majority of surveyed economists expect the policy rate to be kept at 0.0%-0.1% whilst money markets are currently pricing a 47% chance of a 15bps hike. The BoJ is also set to announce its taper plans and will release the latest Outlook Report containing board members' median forecasts for Real GDP and Core CPI. 76% of economists expect the BoJ to keep rates unchanged and 59% expect the BoJ to taper bond purchases to around JPY 5tln per month as a first step at the July meeting. Furthermore, economists are split over which month the BoJ will hike rates as 43% think October, 30% think September and only 24% think July, while a recent source report noted the BoJ is to weigh a rate hike at next week's meeting and will have a detailed plan to halve the bond buying in the coming years with purchases to be tapered gradually at a pace near market consensus. The source report also noted that a July rate hike decision is a close call with the consumption outlook key and was also described as a judgement call in terms of acting now or later in the year. A prior source report had also stated that the BoJ is said to see weak consumption complicating its rate decision with officials likely to wait until the last minute to finalise their decision after checking the latest data on markets and economic conditions at next week's meeting with some officials wanting more time to see the data and other officials seeing risks the BoJ could miss the chance to lift rates although sources added that the central bank doesn't intend to cause any major surprise. As a reminder, the BoJ kept its short-term policy rate unchanged at 0.0%-0.1% in the June meeting which was widely expected, although it caught markets off-guard by defying expectations for the central bank to announce an immediate tapering of its bond purchases and instead kicked the can down the road as it declared it is to trim purchases but will decide on a specific bond-buying reduction plan for the next 1-2 years at this month's meeting. Furthermore, BoJ Governor Ueda said during the post-meeting press conference that the reduction of JGB purchases will be a considerable volume and they will start a reduction of JGB purchases immediately after deciding at the July meeting, as well as noting that a July hike is naturally possible depending on the data. The central bank has since held a meeting with bond market participants to provide them with a chance to convey their views before it announces its tapering plans, and received various views from participants on the amount, pace and guidance for the JGB purchase reduction such as trimming purchases to around JPY 2tln-3tln and an opinion that a reduction in the amount of monthly purchases to about JPY 3tln would be a clear message that it is committed to a significant reduction, while some favoured a more forceful approach of trimming purchases to JPY 1tln-2tln and others urged a less aggressive taper to JPY 4tln or even to JPY 5tln before shifting to a larger reduction. However, it remains to be seen what the central bank will actually decide for its bond tapering plans as BoJ officials haven't provided any specific clues of the magnitude of its upcoming tapering and were reportedly more interested in hearing market views in the bond market meetings rather than forming discussions around specific options for bond purchase reductions. Next week's meeting will also include the latest Outlook Report although the board projections will take a back seat to the actual decision on rates and the BoJ's tapering plans.

FOMC ANNOUNCEMENT (WED): The FOMC is expected to keep rates unchanged at 5.25-5.50% in August. While price pressures have eased recently, and there have been signs of a labour market slowdown, officials appear in no rush to cut rates, with some still wanting greater confidence that inflation would fall to target sustainably. Economists and market based pricing expects officials will have this greater confidence by the September 18th meeting, where money markets have fully discounted a 25bps rate reduction to 5.00-5.25%; additionally, money markets fully price the Fed cutting rates again by the end of this year, and are assigning around a 50% probability of a third rate cut. That is in contrast with the Fed's June economic projections, where policymakers pencilled in just one cut this year. The Fed is also facing pressure from former officials who have urged the central bank to cut rates in August. Former NY Fed President Dudley recently revised his 'higher for longer view', arguing that the Fed should begin the cutting now; he said the Fed's efforts to cool the economy were now having a visible effect, noting that most Americans had now depleted what they managed to save from the government's huge fiscal transfers, and they're feeling the impact of higher rates on credit cards and auto loans, while housing construction has faltered, and economic momentum generated by Biden's investment initiatives appear to be fading. Dudley also noted that the three-month average unemployment rate is up 0.43ppts from the low seen in the last 12 months, close to the 0.5 threshold that, as identified by the Sahm Rule, which signals a recession. Dudley also argued that inflation pressures have abated significantly after a series of upside surprises earlier this year, and are not too far away now from the Fed's target.

BCB ANNOUNCEMENT (WED): Money markets are currently largely pricing in the BCB to maintain the Selic rate at 10.5% in July. At its last meeting, the Central Bank unanimously held the Selic rate at 10.5% as expected, putting an end to the seven consecutive meetings of rate cuts. The BCB justified the decision on the uncertain global and domestic scenarios, marked by resilient economic activity, an increase in inflation projections, and de-anchored expectations, all of which require greater caution. BCB Chief Neto also said in July that they paused as food/services inflation could peak while there was also a lot of noise. Moreover, in the meeting, the Central Bank raised its end-2024 and end-2025 inflation forecasts, while recent language suggests it is clear rising inflation and inflation expectations is a concern for the BCB. With regards to recent data, the IGP-10 Inflation Index came in softer-than-expected at 0.45% (exp. 0.82%), while Brazil's Service Sector Growth Y/Y (May) surprised to the upside, and Retail Sales for May saw big beats.

BOE ANNOUNCEMENT (THU): Consensus amongst analysts (49/60) is for the BoE to kick off its rate cutting cycle with a 25bps reduction in the Base Rate to 5.0%. Markets are less sure on the outcome of the decision with the choice between a cut and an unchanged rate seen as a near coinflip. In terms of the vote split for the decision, surveyed analysts anticipate a close 5-4 decision to cut rates (range is between 2 votes for a cut and 6) vs. the 7-2 vote split in favour of unchanged at the June meeting. As a reminder, the June decision for "some" on the MPC was "finely balanced". In terms of economic developments since the prior meeting, headline Y/Y CPI for June remained at the MPC's 2% target, however, the services metric held steady at 5.7% vs. the MPC forecast of 5.1%. Albeit, some of the upside was attributed to volatile hotel prices at a small number of hotels. On the growth front, M/M GDP exceeded expectations, printing at 0.4% vs. Exp. 0.2%. More timely PMI data from S&P Global showed a composite reading of 52.7 with services and manufacturing both in expansionary territory. In the labour market, there has been further signs of loosening, however, headline 3M/YY average earnings remains at an elevated rate at 5.7%. Rhetoric since the prior meeting has been limited. However, what we have heard from the MPC via the likes of Mann, Haskel and Pill has primarily leant in a hawkish direction with Chief Economist Pill's words carrying the largest weight. Pill remarked that "we have to be realistic about how much any one or two releases can add to our assessment." Overall, given the mixed data and lack of clear guidance from some of the core MPC members, any calls by desks are seen as low conviction ones. In the event that the MPC opts to stand pat on policy, they could opt to tweak existence guidance which notes that "…policy will need to remain restrictive for sufficiently long". In terms of market pricing for 2024, two rate cuts are fully priced by year-end. For the accompanying macro projections, ING notes that a decline in market rates since the May MPR, will likely translate into upside revisions to growth and inflation.

REVIEWS

PBOC LPR/RRR/SLF REVIEW: On Monday, the PBoC announced it is to cut the 7-day reverse repo rate (RRR) to 1.70% from 1.80% and will strengthen counter-cyclical adjustment to better support the real economy. PBoC also said it is to lower collateral requirements for the Medium-term Lending Facility Loans from July, while the move is meant to increase the size of tradable bonds in the market and to alleviate pressure on the supply and demand of bonds in the market. The central bank later cut its Standing Lending Facility (SLF) rate by 10bps across all maturities, according to a statement. The cut of the 7-day RRR also prompted banks to reduce their loan prime rates (LPR) and deposit rates. On Thursday, the PBoC unexpectedly cut the 1-year medium-term lending facility (MLF) rate by 20bps, lowering it from 2.5% to 2.3%. Earlier in the month, the MLF rate was kept unchanged. The timing surprised markets as the MLF typically follows a monthly schedule, with most desks expecting changes in the next month. The 20bp cut to the MLF was larger than the recent 10bp cuts to the 7-day reverse repo rate and bank LPRs, with desks suggesting this larger cut could support banks' interest margins and may lead to further reductions in the LPR. Analysts at ING suggest the recent actions suggest the 7-day reverse repo rate may be taking on a new role as the primary policy rate. The desk adds that "While cuts are still relatively modest in size, they should still be more effective in supporting the economy relative to reserve requirement ratio (RRR) cuts. In particular, the MLF continues to see significant usage and it should have a more direct and immediate impact on actual lending rates to the real economy."

BOC REVIEW: The Bank of Canada cut rates by 25bps taking its policy rate to 4.50%, as was expected by the majority of analysts although some had been looking for the BoC to keep rates on hold. Within the statement, the BoC noted that risks to the inflation outlook are balanced, whilst removing language that referred to the BoC being more concerned about upside risks. However, it noted that it is assessing opposing forces on inflation, with ongoing excess supply lowering inflationary pressures, although shelter and some other services inflation is holding inflation up. Looking ahead, the BoC said decisions will be guided by incoming information and their assessment of their implications for the inflation outlook. The MPR saw the BoC revise down its Q2 24 CPI forecast to 2.7% from 2.9%, with Q3 CPI seen at 2.3%. The BoC doesn't see CPI returning to the midpoint of their target range until 2026 however, with 2025 CPI projections raised to 2.4% from 2.2% in April. Its estimate of the nominal natural rate was unchanged vs April at 2.25-3.25%, while it estimates the output gap between -0.75% and -1.75%, vs the April projection of -0.5% and -1.5%. BoC Governor Macklem noted there was a clear consensus to cut rates by 25bps, and that if inflation continues to ease broadly in line with their forecast, it is reasonable to expect further rate cuts, although the timing will depend on how the BoC see these "opposing forces" playing out. Overall, it was a dovish rate decision, cutting by 25bps again, with the Governor signalling more cuts are coming while the statement removed language the BoC is concerned about upside risks to inflation, while Macklem highlighted an increase in weight to the downside risks. Forecasts were more mixed in the MPR, but the BoC lowered its Q2 CPI forecast with Q3 CPI seen at 2.3%. Looking ahead, data will dictate rate decisions from the BoC, but money markets are currently pricing in a c. 50% probability of another cut in September. With 42bps being priced in by year-end, fully pricing in at least one more rate cut this year, with a decent probability of another. Analysts at RBC are of the view there will be two additional rate cuts this year, leaving the overnight rate to a "still restrictive" 4% by the end of 2024. With rates ending the year at 4%, it leaves rates above the BoC's estimate of the neutral rate, which has remained between 2.25-3.25% for the past two quarters.

CBRT REVIEW: The Turkish central bank maintained its policy rate at 50% as expected. The bank said it expects disinflation to strengthen following a positive trend in June, though temporary inflation increases are anticipated in July due to price adjustments and supply-side factors. The CBRT said it remains vigilant about inflation risks and will maintain a tight monetary stance until a significant and sustained decrease in underlying monthly inflation is observed. The bank said it has implemented additional measures for FX loans to support macro-financial stability and the monetary transmission mechanism and will continue to introduce macroprudential measures as needed. Economists forecast a gradual decline in Turkey's annual inflation, predicting it will fall to 42.95% by year-end and further decrease through 2025. A cautious rate-cutting cycle is expected to begin in December.