Central Bank Weekly - 25th Oct

Previewing BoJ; Reviewing PBoC LPR and BoC

PREVIEWS

BOJ ANNOUNCEMENT AND OUTLOOK REPORT (THU): The Bank of Japan is likely to keep its policy settings unchanged at next week's meeting with money markets currently pricing around an 82% probability for the short-term policy rate to be kept at 0.25%, while the central bank will also release its latest Outlook Report with board members' median forecasts for Real GDP and Core CPI. As a reminder, the BoJ refrained from any major surprises at the last meeting in September as it kept its short-term policy rate at 0.25% as unanimously forecast and provided very little in the way of clues for future policy in its statement. Furthermore, it noted that they must be vigilant to the impact of financial and FX market moves on Japan's economy and prices, while BoJ Governor Ueda said during the post-meeting press conference it is appropriate to increase rates if trend inflation heightens in line with their forecast. A major development since the last meeting was the change of leadership following the LDP presidential election in which Shigeru Ishiba succeeded Fumio Kishida as the head of the ruling party to become Japan's PM and although he was seen as the more hawkish candidate vs run-off rival and Abe protege Takaichi. This hawkish perception has since been toned down as he stated after a meeting with BoJ Governor Ueda that they are not in the environment for an additional rate hike, while Governor Ueda told the PM that the BoJ will adjust degree of monetary easing if outlook is realised, but added they will take careful steps to determine that as it takes time. Comments from other officials have also suggested that rates are likely to continue rising but with a lack of urgency for an immediate hike as Board Member Noguchi stated they must patiently maintain loose monetary and that the BoJ will likely gradually adjust the degree of monetary support while cautiously examining whether inflation stably hits 2%, accompanied by wage gains. Board Member Adachi also noted that conditions are already in place for the BoJ to start normalising monetary policy and should raise rates in several stages to achieve smooth policy normalisation, but added that they must avoid drastic policy change that could stoke fear of a return to deflation and warned hiking rates at a rapid pace after the inflation target is met could cause a big shock to the economy. Furthermore, a recent source report stated the BoJ is increasingly aware that there is little need to rush into further interest rate hikes at this month's meeting amid uncertainty surrounding the outlook for overseas economies and financial markets but won't rule it out in the future.

REVIEWS

PBOC LPR REVIEW: PBoC announced a reduction in the Chinese Loan Prime Rates with the 1-year LPR lowered by 25bps to 3.10% vs. Exp. 3.10-3.15% and the 5-year LPR cut by 25bps to 3.60% vs. Exp. 3.60-3.65%. The reduction in the benchmark 1-year LPR which most new loans are based on and the 5-year LPR which is the reference rate for mortgages, was widely expected following the slew of recent policy support measures by China's central bank and government departments including the announcement of a 50bps RRR cut late last month and a reduction in the 7-day reverse repo rate by 20bps to 1.50%, while the PBoC had also previously lowered the 1-year MLF rate by 30bps to 2.00% and said it will guide LPRs lower. Furthermore, the PBoC instructed banks to reduce interest rates on existing mortgages by October 31st and it was also reported that Chinese banks will reduce rates on as much as CNY 300tln of deposits with the major banks lowering interest rates on fixed deposits by 25bps. This had already paved a clear path for a reduction in the LPRs, while PBoC Governor Pan had noted the prior week that the LPRs were expected to drop by 20bps-25bps and reiterated that they may further lower RRR this year by 25bps-50bps based on market liquidity.

BOC REVIEW: The Bank of Canada cut rates by 50bps, in line with most analyst forecasts and market pricing, taking the rate to 3.75% from 4.25%, making the fourth consecutive rate cut from the BoC, but the first of a 50bps magnitude. The BoC characterised the 50bps move as a way to support economic growth and keep inflation close to the middle of the 1-3% target range. Looking ahead, it noted that if the economy evolves broadly in line with the latest forecasts, they do expect to reduce the rate further, however the timing and pace will be guided by incoming information and their assessment of its implications for the inflation outlook. The BoC committed to further easing, but left optionality open with the "meeting by meeting" line. After recent soft inflation reports, the BoC noted that the bank's preferred measure of core inflation is now below 2.5%, and that inflationary pressures are no longer broad based, seeing business and consumer inflation expectations largely normalized. With the BoC noting the cut was to boost growth and with inflation within the 1-3% target, it appears they have declared victory on inflation and they are satisfied with the progress made and would like to keep it at current levels. The MPR saw the 2024 and 2025 CPI forecasts lowered, while 2024 and 2025 growth forecasts were unchanged, while the 2024 Q4 forecasts saw Y/Y CPI ease to 2.1% from 2.4%, core inflation rise to 2.1% from 2.0%, while GDP rose to 2.3% from 2.1%. It also maintained its estimate of the neutral rate between 2.25-3.25%, while the output gap estimate was also unchanged at -0.75-1.75%. When looking ahead to gauge future easing from the BoC, it will be key to watch how growth compares with the latest forecasts in the MPR, as more downbeat growth may see markets start to price a 50bps rate cut as more likely, as the BoC still have room to neutral - a 50bps cut from now would take the bank to the top end of the neutral rate. However, as ING point out, recent labour market data has been strong, and as a result they believe that a 25bps move is slightly more likely. However, on the flip side, OxEco expects growth to deteriorate ahead and look for another 50bps rate cut in December.