Central Bank Weekly - 20th December 2024

Reviewing FOMC, BoJ, BoE, Norges, Riksbank, PBoC LPR, Banxico

REVIEWS

FOMC: The Federal Reserve cut rates by 25bps, as expected, to 4.25-4.5% in an 11-1 split, with Hammack voting to leave rates unchanged. The statement was little changed from the November meeting but added in considering the "extent and timing" of additional rate adjustments (prev. In considering additional adjustments), Fed will assess incoming data, evolving outlook and balance of risks, signalling a slowing of easing ahead. The further hawkish skew came in the updated SEPs whereby the median dot plot for 2025 and 2026 FFR forecasts were lifted above expectations. Recapping, the median 2025 and 2026 dot rose to 3.9% (prev. 3.4%, exp. 3.6%) and 3.4% (exp. 3.1%, prev. 2.9%), respectively, while 2027 and longer run median dot plots rose to 3.1% (prev. 2.9%) and 3.0% (prev. 2.9%), as expected. As such, the 2025 median dot plot looks for just two cuts in 2025, but the FOMC were more aligned this time round - four members see rates above the median, and five see rates below, but ten were in line with the median. Elsewhere, Core PCE inflation is now seen at 2.5% for 2025 (exp. 2.3%, prev. 2.2%) and 2.2% for 2026 (exp. 2.0%, prev. 2.0%). Forecasts for the unemployment rate were largely as expected, with all horizons, ex-longer run, seen at 4.3%, although 2027 was expected. In Chair Powell's pre-prepared remarks, following the rate decision, he stated the Fed is squarely focused on two goals, and that the economy is strong, the labour market remains solid, and inflation is much closer to the 2% goal. The Chair added that the policy stance is now significantly less restrictive, and going forward they can be more cautious, something which was indicated from the updated SEPs and statement tweak. In the Q&A, Powell said that today's decision was a "closer call", but the "right call", suggesting there was a discussion surrounding holding rates at this meeting. Powell added risks are two-sided, and trying to steer between those two risks. On the statement change, Powell stated that "extent and timing language" shows the Fed is at or near the point of slowing rate cuts, and the slower pace of cuts reflects that expectation. Powell said that cuts they make in 2025 will be in response to data and as long as the labour market and economy are solid, they can be cautious as they consider further cuts. In addition, looking to US President-elect Trump's term, Powell said some people did take a very preliminary step and incorporated conditional effects of coming policies in their projections. Continuing to look ahead, Powell said the Fed will be looking for further progress in inflation to make those cuts, and added that from here is a new phase, and the Fed is going to be cautious about further cuts. After the meeting, Goldman Sachs said despite the hawkish message from the dots, they kept their more dovish baseline forecast of three more cuts in March, June, and September 2025 unchanged, though added a bit more probability weight in their Fed scenario analysis to an outcome with a higher terminal rate.

BOJ: The BoJ opted to maintain its rate at 0.25% as expected, via an 8-1 vote; Board Member Tamura dissented, calling for a 25bps hike to 0.50%. The accompanying statement noted that Japan's economy is recovering moderately, albeit with some weaknesses, and reiterated that uncertainty regarding the economic and price outlook remains high. Overall, the rate decision aligned with expectations and sources, with a majority anticipating the BoJ would hold rates steady, leaving those expecting a hike disappointed. The statement itself was rather vague, and traders quickly turned their focus to Governor Ueda's press conference - which often provides additional insight. The presser began with modest JPY strength as Ueda addressed factors impacting domestic prices. However, this movement proved minimal and short-lived as the discussion turned to wages and the need for more data – key points of focus for BoJ policymaking. A dovish and cautious tone emerged when Ueda expressed the need for "one more notch" to decide on tightening. While Ueda did not explicitly define what "one more notch" referred to, he added that it was difficult to determine whether the January outlook report would be sufficient. When expanding on the term "one more notch", Ueda highlighted the importance of observing next year's wage negotiation momentum – a remark that likely points to the Spring Shunto wage negotiations. Ueda explained that while the negotiations peak in March, it is possible for an outlook to be gauged earlier. He further noted that a clearer picture of wage trends would emerge in March and April. Overall, the press conference has increased the likelihood of rates remaining unchanged at the January 24th meeting, with greater focus now on the March 19th gathering, when details from the Spring wage negotiations will start filtering through. Analysts at ING "expect the BoJ to continue its policy normalisation, with a total of 75bp of rate hikes by the end of 2025 to reach its target rate of 1.0%. We believe January, May, and October should be when these hikes materialise."

BOE: As expected, the MPC opted to hold the Base Rate at 4.75%. The main surprise for the announcement came via the vote split with three dovish dissenters (Dhingra, Ramsden and Taylor) vs. the one expected by analyst consensus. The dissenters based their decision on "The most recent data developments pointed to sluggish demand and a weakening labour market, now and in the year ahead, both of which would see further downward pressure on demand, wages, and prices". However, this view lost out to the majority of six who wished to keep policy unchanged on the basis that "…CPI inflation, wage growth and some indicators of inflation expectations had risen, adding to the risk of inflation persistence". Pantheon Macroeconomics notes that "most of the dovish news is caveated to death in the minutes" and "the MPC is at pains to say they want more data to 'clarify the potential trade-off between more persistent inflationary pressures and greater weakness in output and employment'." Alongside the decision, Governor Bailey noted that the MPC "cannot commit to when or by how much they will cut rates in 2025". As such, the statement reiterated guidance that a "gradual approach to removing monetary policy restraint remains appropriate" and "policy will need to continue to remain restrictive for sufficiently long". In terms of the MPC's assessment of the economy, Bank staff now expect zero GDP growth in 2024 Q4, weaker than the 0.3% that had been incorporated in the November Report, whilst CPI is expected to continue to rise slightly. During a later media round, Governor Bailey stated that market pricing for February is in a "reasonable place" and investors should not "overinterpret" the latest wage data. Overall, there is clearly a rift within the MPC with doves concerned over slowing activity data whilst the rest of the board remains focused on stubborn services inflation and sticky wage growth. Markets currently price a 25bps Feb cut at 46% vs. 44% pre-release (note, Wednesday's FOMC announcement is likely skewing market pricing in a hawkish direction), with a total of 53bps of easing seen by year-end vs. 48bps pre-release.

NORGES BANK: Held the Key Policy Rate at 4.50% as expected, a decision driven by the assessment that domestic activity has been holding up better than expected. The statement now guides us to the first cut "most likely" occurring in March 2025, despite this being the base case among desks heading into the announcement, the explicit guide to March is perhaps somewhat dovish on the margin. However, any dovishness from this was offset by a modest adjustment to the repo forecast, which sees the Q4-2025 projection at 3.80% (vs. Sep. MPR 3.73%) an adjustment which points to three 25bps cuts in 2025, as opposed to the slim probability of four that the September MPR technically pointed to. Modest two-way action was seen in the NOK as it digested the nod to March (dovish) and tweaked repo path (hawkish), though ultimately it settled back towards pre-release levels.

RIKSBANK: In short, a slightly hawkish cut. As expected, the Riksbank cut the policy rate by 25bps to 2.50% and reiterated forward guidance that the rate could be cut again during H1-2025, with the forecasts signalling just one 25bps cut in 2025. A cut which was justified by the view that the economy remains weak, though there are some signs that activity is on its way to a recovery. Furthermore, the statement highlighted that there have been rapid reductions to the interest rate and as monetary policy impacts with a lag this argues for a more tentative approach ahead. Overall, transmission and initial signs of a recovery are seemingly the justification for the expected step down to a 25bps increment from 50bps. The announcement sparked some modest SEK appreciation which was likely a function of outside bets for 50bps unwinding (though, recent global hawkish action had already done this), the line around a "more tentative approach", elevated CPIF forecast for 2025 and the forecasts pointing to just one cut in 2025. Note, the likes of Nordea expect inflation to come in cooler than the Riksbank does and look for a cut in Jan 2025 and then another in May.

PBOC LPR: As expected, the 1-year loan prime rate (LPR) - the benchmark for most corporate and household loans - was maintained at 3.1%. Meanwhile, the five-year rate (a reference for property mortgages) remained at 3.6%. The announcement did not affect markets and was widely expected amid the recent slide in the Yuan, with Chinese authorities attempting to reign it in with the daily Yuan fixings. That being said, desks continue to expect Chinese easing next year. Analysts at OCBC Bank, in 2025, anticipate the 1-year LPR to be reduced by 40bps with a 100bps RRR cut.

BANXICO: The Central Bank of Mexico cut rates by 25bps, in line with expectations, but against a minority of calls for a 50bps rate cut. However, looking ahead, Banxico added a line into the statement to show that "larger downward adjustments could be considered in some meetings, albeit maintaining a restrictive stance", largely due to the progress on disinflation. Therefore, providing progress on inflation continues, Banxico may conduct larger interest rate cuts but maintaining a restrictive stance. Nonetheless, it maintained language that the balance of risks to growth were biased to the downside, and biased to the upside for inflation. The inflation projections were hawkish, with Banxico now expecting headline inflation to return to target in Q3 2026 (prev. Q4 2025), with core seen returning to target in Q2 2026 (prev. Q4 2025). Of course, looking ahead there is a lot of uncertainty on the impacts to the Mexican economy from the upcoming Trump presidency who is threatening tariffs on Mexico and Canada.