Central Bank Weekly - 24th January 2025

Previewing FOMC, ECB, BoC, Riksbank, BCB; Reviewing BoJ, PBoC, Norges, CBRT

PREVIEWS

FOMC ANNOUNCEMENT (WED): The FOMC is expected to hold rates at between 4.25-4.50% at its January 29th confab, according to all 103 economists surveyed by Reuters. Since the last policy meeting in December, incoming economic data has generally been positive, where the BLS jobs data surprised to the upside, while inflation has cooled. A hold will also allow officials to consider the policies of the new US administration, where risks include tariffs, tax cuts, and the deportation of some immigrants. The central bank is expected to trim rates by 25bps in March, according to 61 of the 103 surveyed, while money markets price in just 7bps of easing at the March meeting, implying a 28% probability of a 25bps rate cut. Currently, money markets are fully pricing just one rate cut in 2025, with the first one likely to come by July. Through the end of the year, money markets are pricing in 40bps of easing, implying a 60% probability for a second rate cut. The Reuters survey found that 65 of the 102 surveyed expect two or fewer rate cuts this year, taking the Fed Funds Rate to 3.75-4.00%. This is in fitting with the Fed's own projections by the end of this year. On inflation the Fed does not see core inflation falling back to target until 2027; analysts have suggested that there are inflationary risks from the policies of the new administration, and 40 of 49 who answered the question in the Reuters survey see risks that inflation is higher than they expected, rather than lower. "If they deliver anything close to what they promised on the tariff front, then we are going to probably see a stalling of disinflationary pressures, where the Fed is not going to be cutting," Barclays said, adding that "at minimum not as rapidly as they did last fall, but also the possibility that they could be on hold for quite a while."

RIKSBANK ANNOUNCEMENT (WED): The Riksbank is expected to deliver a 25bps cut to 2.25%; as it stands, money markets fully price in such a move. It can be noted that there are some risks of a hold, given that SEK continues to remain at weak levels and some positive developments in economic sentiment and housing activity. As a reminder, the Riksbank cut rates by 25bps as expected, and was a little hawkish on the margin, given the comment that monetary policy affects the economy with a lag, which argues for a more tentative approach. The rate path indicated that the policy rate will be cut again during H1-25; the minutes of that meeting highlighted that Deputy Jansson believed the “2025 cut needs to come quite early in the year, in January or possibly at the meeting after that in March”; Governor Thedeen took a more data-dependent approach. In terms of data, inflation in December printed 0.2% below the Riksbank’s forecast for Core CPIF Y/Y, a result which argues for a cut in January and potentially presents downside bias to the policy path. And finally on FX, EUR/SEK has been trading sideways since the last meeting, with traders ultimately awaiting updates regarding Trump tariffs; ING posits that this uncertainty should allow the Riksbank to lean dovishly.

BOC RATE DECISION AND MPR (WED): The Bank of Canada is expected to cut rates by 25bps to 3.00% on Wednesday 29th January, according to 25 out of 31 analysts, with the rest expecting a pause. The poll was conducted before December data, which saw soft inflation metrics and a subdued BoC business outlook survey. However, the survey was conducted between 7-27th November 2024 - therefore it is quite dated and conducted before the BoC's 50bps rate cut in December. Nonetheless, the December inflation data was softer than expected with the average of the three BoC core measures at 2.3%, within the 1-3% target range, and close to the centre - which will be a welcome sign for the BoC. Although a soft report, analysts highlighted the details suggest a higher-than-expected proportion of the GST break was captured by the data. Overall, cooling inflation and a slowing economy support the case for more easing, although there is tremendous uncertainty with the threat of Tariffs from US President Trump overhanging the economy, to which Canada has vowed to respond with tit-for-tat measures. At the prior meeting, alongside a 50bps rate cut, the BoC signalled a slowdown of easing ahead, which makes sense given the current rate of 3.25% matches the upper-end of the BoC's own estimate of the neutral rate, 2.25-3.25%. At the upcoming meeting, we will also see the updated MPR, which could see an update to the neutral rate estimate, as well as economic forecasts to incorporate the potential impact of US President Trump's proposed 25% tariffs for Canada and Mexico. In terms of reaction, ING highlights that the BoC plays a secondary role for the loonie, with the focus all on Trump tariffs. The desk writes "Should Trump scale back the tariff threat, then there is an approximate 2% downside room to cover for USD/CAD. Should tariffs be imposed in the near term, we expect a dovish repricing in BoC expectations to compound with a greater risk premium and take USD/CAD well above 1.45."

BCB ANNOUNCEMENT (WED): The BCB is expected to hike rates by 100bps to 13.25% on 29th January, according to all 38 economists surveyed by Reuters. Looking ahead, analysts expect rates to hit 14.25% in March, and then to peak at 15% in Q2 25. At the December meeting, the BCB hiked its Selic rate by 100bps to 12.25% in a unanimous decision, in what was a greater than the expected 75bps hike, in light of a more adverse inflation scenario. In the accompanying statement, the committee said it sees hikes of the same magnitude at the next two meetings, so as such the central bank is expected to hike by another 100bps next week. Within Brazil, there is conflict between the monetary and fiscal side, as there is the loose fiscal side of President Lula, and a spokesman for him said the decision to hike rates in December goes against what the nation needs. In addition to the 100bps rate hike, it also then conducted USD 30bln in spot FX market intervention through reserves to try and support the BRL. In recent data, on Jan 16th Brazil’s seasonally adjusted economic activity index, the IBC-BR, rose 0.1% M/M in November (exp. 0.0%). Given it is a rough monthly proxy for GDP, Pantheon Macroeconomics note it is now indicating that activity in Q4 2024 lost momentum, due mostly to the drag from tighter financial conditions, and high inflation, despite the resilience of the headline numbers. Moreover, Pantheon thinks the Brazilian economy won’t be able to defy the drag from external and domestic shocks, and that industrial sentiment and consumer confidence are rolling over, due to weakening domestic fundamentals and an uncertain external outlook. Ahead, PM expects growth momentum to continue to ease in 2025, to about 2.0%, down from 3.5% in 2024, as higher interest rates, unfavourable financial conditions and reduced fiscal stimuli will be key drags.

ECB ANNOUNCEMENT (THU): Expectations are for the ECB to deliver a 25bps cut in the Deposit Rate to 2.75%, according to all analysts surveyed by Reuters; markets assign a 96% chance of such an outcome. The economic backdrop to the upcoming meeting has seen an expected uptick in headline Y/Y inflation to 2.4% from 2.2%, core Y/Y hold steady at 2.7% and services inflation nudge higher to 4.0% from 3.9%. At this stage, policymakers have looked through the uptick in inflation and continue to expect a return to target in 2025. Greater concern remains on the growth outlook. However, on a mildly encouraging footing, flash PMI data for January saw the Composite metric move back into expansionary territory. The accompanying report noted “The private sector is back in cautious growth mode after two months of shrinking”. Note, that Q4 GDP data is not available until the morning of the announcement. Clouding the economic outlook at this stage is the looming threats of EU tariffs from the Trump administration with the President declaring that the US will straighten out the deficit with the EU through tariffs or by buying US oil and gas. At this stage, President Lagarde has refrained from drawing any conclusions from the prospect of tariffs on the EU, according to remarks at Davos. However, policymakers are cognizant of the looming risks to the growth outlook. In the immediacy, there is little pushback from members of the GC on whether a 25bps cut will be enacted next week given that policy is currently still viewed as restrictive. Looking beyond the upcoming meeting, markets see an additional 63bps of loosening by year-end with the terminal rate seen at around 2%; a level which some desks view as neutral. A further deterioration in the growth outlook and a moderation in inflation could see pricing slip closer to 1.50-1.75%. ING posits that such levels could also come to fruition in the event of a more dovish Fed.

REVIEWS

PBOC LPR REVIEW: PBoC announced that the Loan Prime Rates were maintained at their current levels for the third consecutive month with the 1-year LPR kept at 3.10% and the 5-year LPR held at 3.60%. This was widely expected due to several factors including recent currency weakness which effectively lessens space for the PBoC act considering that it has been attempting to contain the currency's depreciation through its regular much firmer-than-expected daily CNY reference rate fixes, while the recent data releases also pointed to a lack of urgency for a rate adjustment as Chinese GDP, Industrial Production and Retail Sales surprised to the upside with GDP Y/Y for Q4 at 5.4% (exp. 5.0%) which contributed to China achieving its 5% growth target for 2024. Furthermore, the return of Donald Trump to the White House and tariff-related uncertainty is another argument for maintaining a patient approach and keeping the powder dry, while the central bank has also shown a preference of utilising liquidity in making adjustments through its regular short-term open market operations rather than by adjusting lending rates.

NORGES BANK REVIEW: The Norges Bank policy meeting provided no surprises, they opted to keep rates unchanged at 4.50%, and in the statement, Governor Bache reiterated "The policy rate will likely be reduced in March". Being an interim meeting, the central bank did not release forecasts or rate path adjustments. CapEco thinks the path of inflation will allow the Bank to move "a bit more quickly", cutting by 25bps once per quarter until the policy rate reaches 3% in the middle of 2026. EUR/NOK saw modestly choppy trade after the announcement, slipping to lows of 11.7269 from pre-announcement levels of around 11.74.

CBRT REVIEW: The CBRT cut the Weekly Repo Rate by 250 bps to 47.5%, as expected. This was an almost certain outcome, with all economists surveyed by Reuters expecting a cut of this magnitude. The statement noted that "while the underlying trend of inflation decreased in December, leading indicators point to an increase in January, in line with the projections." They reiterated their commitment to a tight monetary stance. Language which was identical to remarks made in the last meeting, supporting BofA's forecast which sees the policy rate going down to 30% by year-end through 7 cuts of the same magnitude. For reference, the lira was unreactive to the rate decision.

BOJ REVIEW: The Bank of Japan delivered a widely expected 25bps rate hike to lift its short-term interest rate to 0.50%. The Bank reiterated that it will continue to raise rates if the economy and prices move in line with forecasts and that it will conduct monetary policy as appropriate from the perspective of sustainably and stably achieving the 2% inflation target. The central bank stated that inflation expectations have risen moderately and the chance of Japan's economy moving in line with the forecast is heightening, as well as noted that many firms are saying they will offer solid pay hikes in this spring's wage talks. The decision by the central bank was not unanimous as Nakamura dissented to the rate hike decision. Furthermore, the Outlook Report projections were somewhat varied as Core CPI forecasts were lifted across the entire horizon period to the disappointment of those anticipating a "dovish hike", while the Real GDP projection was cut for Fiscal 2024 but maintained for the following years after. More action was seen during the presser in which BoJ Governor Ueda began with a hawkish tilt given his comments around spring wage talks (board judged that spring wage talks will result in strong hikes again this year. Growing number of firms expressed intentions to continue increasing wages steadily) and his judgement that markets have been stable post-Trump. However, this was superseded by comments on the policy path (no pre-set idea on future adjustments & no preconceived ideas around the scope/timing of the next rate rise) - a remark which sparked a dovish move across JPY assets - potentially as participants were looking for an explicit nod to March, or another meeting, given the hawkish elements of his initial commentary and upward revisions to the CPI forecasts.