Central Bank Weekly - 7th February 2025

Previewing Fed Chair Powell Testimonies; Reviewing BoE, BoJ SOO, Banxico and RBI

PREVIEWS

FED CHAIR POWELL TESTIMONIES (TUE/WED) : In Chair Powell's semi-annual testimony, he is likely to repeat what he said in wake of the latest FOMC rate decision. Since the FOMC, we have had the January PCE and tariff updates from US President Trump. Recapping, Trump initially imposed tariffs on Canada, Mexico, and China whilst sending a warning to Europe, but later delayed tariffs on the former two by 30-days after chatting with their leaders. On China, he announced an additional 10% tariff on top of existing levies on China, with no exclusions. On data, December PCE data was in line with expectations on both headline and core while the consumption data was above the consensus. However, the data likely did little to alter the view of the Fed with Chair Powell largely stressing a no rush approach to future policy changes, particularly with uncertainty ahead due to new Trump policies. On Trump, participants will continue to see how, and if, they affect the Fed and its policy decisions and if Powell has anything new to add, but he will likely continue to reiterate uncertainty ahead. However, despite Trump continually pressing for lower rates, he did say the Federal Reserve was right to pause its rate-cutting path in its decision last week. Further to this, US Treasury Secretary Bessent said he met with Powell and had a very constructive discussion, so participants may look to see if the Chair makes any comments on this meeting. As a reminder, at the latest meeting the FOMC kept rates unchanged, as expected, with the statement removing the language that "inflation has made progress" towards the 2% goal, although Powell later claimed it was a language clean-up, used to shorten the sentence, and was not meant to be viewed as a policy shift. The Fed still sees inflation as "somewhat elevated". As a reminder, Powell said that the Fed does not need to be in a hurry to adjust the policy stance and policy is not on a preset course, something he reiterated throughout the Q&A, even when asked about a March cut. Further, Powell said the Fed got two good inflation readings in a row but still wants to see further progress, but he thinks the Fed can see the pathway for that to happen, particularly as shelter inflation is coming down pretty steadily.

REVIEWS

BOE REVIEW: As expected, the BoE delivered a 25bps cut. The main source of surprise came via uber-hawk Mann, who not only joined the consensus in voting for a cut but out-did a majority of the board by voting for a 50bps reduction (alongside known dove Dhingra). The majority who voted for 25bps had a range of views, with one being that the disinflation process remained on track if you look through the expected near-term pick-up alongside signs of weakening activity and a looser labour market. In terms of the dissenters, one of the two believes a more activist approach at this meeting would provide a clear signal of financial conditions appropriate for the UK "even as monetary policy would need to remain restrictive for some time to anchor inflation expectations". In the accompanying policy statement, the MPC reiterated that policy will be "restrictive for sufficiently long" whilst noting that it will take a "gradual and careful" approach to rate cuts (prev. stated "gradual" approach). Within the MPR, the 1-3yr inflation forecasts were hiked with UK inflation now expected to peak at 3.7% in Q3 2025 (prev. saw a peak of 2.8% in Q3), seen returning to target in Q4 2027. On the growth front, the bank cut its 2025 GDP forecast in half to 0.75%. At the follow-up press conference, Governor Bailey refrained from providing any explicit policy signals whilst stating that the Bank is taking a meeting-by-meeting approach and is not on a pre-set path. Elsewhere, the Governor stated that the coming rise in inflation is almost entirely due to factors not directly linked to the pressures in the UK economy - these factors are expected to be temporary. In a follow-up interview, the Governor cautioned markets into placing too much weight on individual member votes. As the dust settles on the decision, pricing for the next 25bps rate cut has been brought forward to May (vs. June pre-release), whilst markets see a total of 64bps of loosening by year-end vs. circa 59bps pre-release.

BOJ SUMMARY OF OPINIONS REVIEW : BoJ released the Summary of Opinions from the January Meeting where it delivered a widely expected 25bps rate hike to lift its short-term interest rate to 0.50% it 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 Summary of Opinions provided very little in the way of fresh insight as it noted that one member said Japan public's inflation expectations are heightening as inflation exceeds 2% for four straight years and a member said raising rates at this timing would be sufficiently neutral when compared with average market expectations. It was also stated that Japan's economy is resilient enough to absorb potential downside stress from the new US administration's policies and that BoJ's policy flexibility has increased as the Fed is likely to pause on rate hikes. Furthermore, a member said real interest rates remain deeply negative even after a rate hike and need to keep raising rates if the economy and prices are on track.

BANXICO REVIEW: Banxico cut rates by 50bps, in fitting with analyst expectations and prior guidance. Guidance was adjusted to signal further rate cuts of a similar magnitude in meetings ahead, albeit maintaining a restrictive stance. The 50bps rate cut was not unanimous however, with Heath opting for a 25bps rate cut instead. Inflation expectations were broadly left unchanged throughout the forecast horizon, with a slight revision lower for Q1 25 on the headline, but a revision higher for the core - Banxico still expects inflation to return to the 3% target in Q3 26. It also maintained that the balance of risks to growth of economic activity is biased to the downside, while balance of risks for trajectory of inflation remains biased to the upside. With guidance for further 50bps rate cuts, Banxico are clearly in a dovish stance but it is likely the pace of cuts will largely be dictated by the impact of potential tariffs on Mexico and how it affects the data ahead.

RBI REVIEW: RBI cut the Repurchase Rate by 25bps to 6.25%, as expected, via a unanimous vote and unanimously decided to maintain a neutral policy stance in what was the first policy decision under the stewardship of RBI Governor Malhotra, while the Standing Deposit Facility rate was adjusted to 6.0% and the Marginal Standing Facility Rate was set at 6.5% which represents similar 25bp adjustments. The RBI Governor stated that CPI has mostly stayed aligned with the target, barring a few occasions, as well as noted that growth is expected to recover and growth-inflation dynamics will open up space to support growth. He also commented that food inflation pressures should see significant softening, barring supply shocks, and core inflation is expected to rise but remain moderate. The central bank lowered its FY25 real GDP growth forecast to 6.4% from 6.6% and sees FY26 real GDP growth at 6.7%, while it maintained the FY25 CPI inflation view at 4.8% and sees FY26 CPI inflation at 4.2%. Furthermore, Malhotra said exchange rate policy has remained consistent, with intervention focused on smoothing excess volatility and the RBI does not target any exchange rate level or band.