newsquawk

Central Bank Weekly: 21st February 2025

Previewing PBoC MLF, BoK, ECB Minutes; Reviewing RBA, RBNZ, PBoC LPR and FOMC Minutes.

PREVIEWS

PBOC MLF (TUE): The medium-term lending facility (MLF) is now less of note after last year's PBoC policy review suggesting the MLF will play less of a role in guiding markets, although desks expect a transition phase of at least a year in total. "The MLF will likely fade into the background, and at one point may cease to exist," said HSBC after the policy review. ING at the time suggested, "The focus is not about rushing to phase out the MLF but rather directing more attention toward the short-term rate as a main policy tool". That being said, many desks are of the view the PBoC could cut its main policy rate, the 7-day Reverse Repo Rate (RRR) by some 40-50bps in 2025. ING still expects a 7-day RRR cut in Q1, albeit likely after the annual parliamentary meeting in March. "Given the pivot to the 7-day reverse repo rate as the primary policy rate, we don't expect any change to the MLF this month," says the Dutch desk.

BOK ANNOUNCEMENT (TUE): The Bank of Korea is expected to cut rates with a recent Reuters poll showing 35 out of 36 economists surveyed forecast the BoK to cut its base rate by 25bps to 2.75%. As a reminder, the BoK surprised markets at last month's meeting where it defied expectations for a 25bps cut and instead kept its base rate at 3.0%, while it announced it is to expand the cap on the temporary special loan for small to medium businesses to KRW 14tln. Despite the surprise pause, the language from the central bank was dovish as BoK Governor Rhee said the need for further cuts is higher now that downside risks to economic growth have heightened. Furthermore, all board members said a rate cut would be necessary but took consideration of dollar-won FX rates fluctuating due to political turmoil, while he emphasised that the rate decision was not because dollar-won rates were at a certain level, but because political uncertainties have been impacting the FX rates. Rhee also stated that six board members said they are open to rate cuts in the three-month ahead window, as well as noted it would be appropriate to wait until domestic political turmoil stabilises and some certainty comes from the new US administration before changing policies. Furthermore, the BoK said it will determine the timing and pace of any further base rate cuts to mitigate downside risks to economic growth and acknowledged consumption weakened and construction investment has been sluggish. The language clearly points to incoming rate cuts, while recent key data releases also support the argument for a cut after GDP in Q4 missed forecasts with the advanced GDP Q/Q at 0.1% vs. Exp. 0.2% (Prev. 0.1%) and Y/Y at 1.2% vs. Exp. 1.4% (Prev. 1.5%).

ECB MINUTES (THU): As expected, the ECB pulled the trigger on another 25bps rate cut, taking the Deposit Rate to 2.75%. The policy statement saw the GC reiterate that it will retain its meeting-by-meeting and data-dependent approach whilst not pre-committing to a specific policy path. Despite the easing, policymakers still saw policy as "restrictive". In terms of the economic assessment, the statement noted that the economy is still facing headwinds but demand should pick up over time. Elsewhere, inflation was seen as "high" but has developed in line with expectations and the disinflation process is well on track. At the follow-up press conference, the overall lack of overtly dovish signals from Lagarde in her opening remarks elicited a hawkish reaction within the marketplace. However, as the Q&A segment got underway, this move faded as Lagarde noted the decision was unanimous and there was no discussion of the terminal rate. Elsewhere, Lagarde noted that the debate about neutral rates is "entirely premature" and cannot say if rates will go below neutral. As always, given the time lag between the meeting and the publication of the account, the markets will deem the release as somewhat stale. However, markets will be on the lookout for any clues to see if there is a growing view on the Governing Council that aligns with recent comments from Germany's Schnabel that the Bank is getting closer to the point at which it needs to look at whether and how much further it can cut interest rates.

REVIEWS

RBA ANNOUNCEMENT REVIEW: RBA delivered a widely expected 25bps rate cut to lower the Cash Rate to 4.10% which was the central bank's first rate reduction since 2020, while it stated that underlying inflation is moderating and the outlook remains uncertain, as well as noted that sustainably returning inflation to the target is the priority and the board will continue to rely on data and evolving risk assessments to guide decisions. RBA also said the board is more confident that inflation is moving toward the midpoint of the 2–3% target range but added that upside risks remain and the central bank remains cautious on prospects for further policy easing. The RBA simultaneously released its quarterly statement on monetary policy which noted that inflation and GDP have been softer than expected, while the labour market remains strong and domestic financial conditions are restrictive, with rates above neutral. It also acknowledged a wide range of estimates for the neutral rate, with some estimates declining, while its projections for Real GP and CPI assumed a cash rate of 4.0% in June 2025, 3.6% in December 2025, and 3.4% in June 2026. Furthermore, RBA Governor Bullock provided some hawkish-leaning remarks at the post-meeting press conference where she stated that it is clear high rates have worked and cannot declare victory on inflation yet, as well as noted that the strength of the jobs market has been surprising and further rate cuts implied by the market are not guaranteed.

RBNZ ANNOUNCEMENT REVIEW: RBNZ delivered its third consecutive jumbo 50bps rate cut and the fourth straight rate reduction in the current cycle which was widely expected, while the central bank noted that rates were reduced further as inflation abates and if economic conditions continue to evolve, there is scope to lower the OCR further in 2025. The RBNZ also stated that the committee has the confidence to continue lowering rates and economic activity remains subdued but noted that a recovery is expected over this year. Furthermore, the central bank lowered its rate projections with the June 2025 forecast lowered to 3.45% from 3.83% and the March 2026 forecast was cut to 3.10% from 3.43%, as well as projected rates to stay at 3.10% through to March 2028. RBNZ Governor Orr commented during the press conference that the OCR path projects 50bps by mid-year at around July and suggested two 25bp cuts with April and May 'about right', while Orr also noted the following day after the meeting that he expects the cash rate will be around 3% by year-end and there would have to be an economic shock to cut by 50bps again.

FOMC MINUTES REVIEW: The FOMC's January meeting minutes showed broad consensus on holding rates steady as economic conditions evolve. While inflation risks remain, most participants highlighted the need for further progress before adjusting rates. Labour market and economic activity were solid, but financial conditions had tightened, particularly in bond yields and mortgage rates. There was much focus on commentary which noted that various participants said it might be appropriate to consider pausing or slowing balance sheet runoff until resolution of debt ceiling dynamics, and many noted that, after the conclusion of balance sheet runoff, it would be appropriate to structure asset purchases to move maturity composition closer to outstanding stock of Treasury debt. The minutes were also cognizant of the impacts of potential changes in trade and immigration policy, which has the potential to hinder the disinflation process, and there was a decent amount of focus on upside risks to inflation. A "couple" were worried that it may be difficult to distinguish between relatively persistent changes in inflation and more temporary changes that might be associated with the introduction of new government policies, which some analysts said could indicate a willingness of some officials to look through any one-off price increases from tariffs may not be shared more broadly on the Committee. Overall, analysts said that the minutes highlighted that the Fed was in no rush to cut rates further. Goldman Sachs said it now expects the FOMC to slow the pace of balance sheet runoff by stopping Treasury runoff at its May meeting (previously, it was pencilling in a June update); GS continues to expect the runoff to end at the end of Q3.

PBOC LPR REVIEW: As expected, the PBoC maintained its Loan Prime Rates (LPRs) with the 1-year LPR at 3.1%, and the 5-year LPR at 3.6%. As a reminder, the 1-year LPR influences corporate loans/most household loans, while the 5-year rate serves as a benchmark for mortgage rates. That being said, many desks are of the view the PBoC could cut its main policy rate, the 7-day Reverse Repo Rate (RRR) by some 40-50bps in 2025. ING still expects a 7-day RRR cut in Q1, albeit likely after the annual parliamentary meeting in March.