# MARKET ANALYSIS

Ad-hoc research into market moving events from our in-house analysts



**RANsquawk Central Bank Weekly Monitor – 8 December 2017**

- **Fed: 25bps hike priced in, tax plan may boost growth view**
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**FEDERAL RESERVE: 25bps hike priced in, tax plan may boost growth view**

- Money markets have been pricing in a 25bps FOMC hike at its 13 December meeting for some time, which would take the Federal Funds Rate target range to 1.25-1.50%, and represent the third hike this year (and fifth of the hiking cycle). Minneapolis Fed's Neel Kashkari is likely to continue to dissent to rate hikes, while there will also be attention on Chicago Fed's Charles Evans, who has recently cautioned on hikes.
- "The Minutes for the November meeting and recent Fedspeak show growing concern about inflation among FOMC participants, but not enough to stay their hand at this meeting," writes UBS. The October CPI data will have given the FOMC ammunition to go ahead with its hike, and the November data, which is also to be released on Wednesday, is likely to be little changed, analysts believe. UBS thinks that the ongoing recovery in inflation from its transitory weakness will be reflected in its statement.
- The FOMC is due to update its economic projections, and there may be scope for upward revisions to those estimates made in September. Presently, analysts are more optimistic than the Fed with regards to growth and inflation; with regards to the rate of joblessness, the market and the Fed's views are more-or-less in-line from 2018 onwards. It is worth noting that, in September, the FOMC was unable to include any of the proposed fiscal stimulus into its projections; while there remains uncertainty about the exact impact the recent tax cuts are likely to have on the US economy, many are in agreement that there may be limited upside potential at the very minimum.
- "With the tax cut, the recovery in inflation, and the lower unemployment rate, the dot plot will show more hiking," UBS writes. "We think they could move the median up to four hikes next year, with the level of the funds rate 50 basis points higher in 2019 and 2020 than was the case in September," and adds that an overshoot of the funds rate over the neutral rate, which was barely noticeable in September, will be more pronounced.
- The post-meeting press conference with Chair Janet Yellen will be her last, and she is expected to strike a balanced tone regarding future policy, reiterating her view that the FOMC will tighten policy gradually (as the incoming Fed Chair Powell recently endorsed in his confirmation hearing).

**EUROPEAN CENTRAL BANK: No fireworks expected; growth and inflation profile may be raised**

- After the ECB announced in September that it would continue with its asset purchase programme – at a reduced rate of EUR 30bln per month beginning in January 2018, extending through to September 2018 – the central bank is expected to stand pat on policy. In terms of the composition of purchases, the ECB may allude to corporate bond purchases taking up a larger share of its bond buying programme, as it approaches the limits imposed on holding certain amounts of country-specific sovereign debt. The Eurozone inflation profile still remains fragile, and as such, the central bank will likely reiterate its guidance that rates will remain on hold well after the asset purchase programme has concluded.
- The central bank is also due to update its economic projections. HSBC notes that since the central bank's last economic projections, oil prices have risen around 20%, which may see the ECB raising its inflation forecast by 0.3ppts in 2018 and 0.1ppts in 2019.the ECB will also publish its first 2020 forecast, and HSBC predicts that will be at 1.8% - close to, but still below the ECB's inflation goal. In terms of growth, the central bank may revise up its forecasts for 2018 and 2019 on the back of ongoing strength in leading indicators, HSBC says. Elsewhere, forex traders will be keeping an eye on the ECB's assumed EUR rate (it assumed 1.18 in September).

**BANK OF ENGLAND: Watching the hawks**

- After lifting the Bank Rate for the first time in a decade at the November meeting – undoing the 'emergency cut' post Brexit referendum – and with no fresh economic projections due, nor any post-meeting press conference, the BOE meeting is unlikely to see fireworks. However, traders should keep an eye on the vote split, with some expecting that Ian McCafferty and/or Michael Saunders to keep up the hawkish momentum and vote to lift rates again.



- The dissenters at the November meeting were Sir Jon Cunliffe and Deputy Governor Sir David Ramsden, who opted to keep rates unchanged based on the view that the Bank's forecast for wage growth were 'too optimistic' over the forecast horizon. In addition to these concerns, the MPC were overall wary about the ongoing Brexit risks.
- Since November, data hasn't suggested any major up-tick in activity, analysts have noted. The BoE is therefore likely to operate in a cautious manner going forward, and as such, markets aren't looking for another hike until Q4 2018.

**BANK OF JAPAN: Kuroda rules out early tightening**

- BOJ Governor Haruhiko Kuroda was this week forced to deny that the central bank is flirting with tighter policy anytime soon. Since November, speculation has been rife that the BOJ was perhaps tilting towards tightening monetary policy, after a speech Kuroda delivered where he discussed reversal rate theory, which led some to speculate about the Bank's commitment to QQE.
- However, this week, Kuroda dismissed those concerns, arguing that the BOJ will continue with its brand of loose policy until inflation objectives have been achieved. "We view BoJ's comments as a signal that further easing is no longer being considered, in the absence of any sharp appreciation in the yen," writes Oxford Economics. Additionally, the consultancy sees four reasons why the BOJ is likely to maintain its policy rate (-10bps) and a 10-year yield target of 'around 0%':
- "1) First, the BoJ remains committed to achieving its 2% inflation target and indeed overshooting 2% to boost inflation expectations, 2) Second, our baseline is consistent with lower bond purchases in the future, 3) Third, the current yield curve is a delicate compromise between demand for lower yields from the monetary policy perspective and demand for higher and steeper yields from a financial stability perspective, and 4) 'fine-tuning' the yield curve will not solve the structural problems of the Japanese banking system."
- The consultancy, therefore, believes that the central bank's policy settings will be maintained for at least the next couple of years.

**SWISS NATIONAL BANK: Another week, same SNB**

- The SNB will likely keep its monetary policy settings on hold when it concludes its meeting on 14 December.
- In a recent address SNB President Thomas Jordan noted that "the franc remains highly valued, and policy is still aimed at weakening the franc despite the recent reduction in value" – a continuation of his recent rhetoric. "Although the Swiss franc has weakened further over the past three months, we doubt that the Swiss National Bank (SNB) will sound any more relaxed about the exchange rate in its policy statement next week," Capital Economics writes. "Admittedly, the ECB's gradual shift towards policy normalisation that it announced in October has taken some of the upward pressure off the franc. But after moderating its language on the currency in September, the SNB will not want to jeopardise the gradual uptrend in inflation by letting its guard down further."

**BANK OF CANADA: Cautious tone, but still on a tightening bias**

- The BOC held rates this week, as was expected, but adopted a distinctly cautious tone, and although it has been interpreted as a new 'neutral bias', RBC is of the view that the tilt still remains towards tightening (as indicated by the phrase within the statement that "higher interest rates will likely be required over time"). It would appear as though the reason for the uncertainties centre around "the economy's sensitivity to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation." Elsewhere, the Bank noted the ongoing diminishing slack in the labour market following the stellar jobs report for November.
- BOC Governor Stephen Poloz will deliver remarks on 14 December, likely the last of the BOC communications of 2017. "Indications are that the speech will touch on what the central bank is pre-occupied with going forward, which could include the evolution of consumption growth given elevated household debt levels, NAFTA uncertainty and the aforementioned labour market slack."

**RESERVE BANK OF AUSTRALIA: Patience is the word**

- This week, the RBA held rates at 1.50% as was unanimously expected, and the tone of its statement was in line with recent speeches. HSBC's RBA watcher suggests that the central bank is in no hurry to adjust policy, and given that is the last meeting of the year, with the next being in February, "there was little to motivate any change in tone."
- The statement saw only subtle changes; the central bank still sees growth rising to 3% in the next few years, and expects inflation to pick up as the economy strengthens. But there were some additions to its views of the labour market, with the central bank stating that "some employees are finding it more difficult to hire workers with necessary skills," while also noting that "wage growth remains low" and rising household debt is a "source of uncertainty" for future consumption.
- HSBC expects the tightening of the labour market to mean that wage growth will pick up "modestly," going forward. "In short, our view is similar to the RBA's, but we see the pick-up in underlying inflation arriving more quickly than the central bank is currently forecasting."

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**RESERVE BANK OF NEW ZEALAND: Will the government share the RBNZ's view?**

- The RBNZ acting Governor Spencer delivered a speech where he speculated over the reasons why inflation was lagging the mid-point of the RBNZ's 1-3% band, and how the central bank is responding to the weakness. "RBNZ expects that both domestic and imported inflation will pick up over the coming years," Westpac writes. "And with this in mind, they are mindful that trying to boost inflation now could cause unnecessary instability in other economic outputs down the line." Westpac also notes that it might impact household debt levels, and as a result, "the RBNZ believes it's appropriate to keep rates low for some time yet, but isn't looking to cut rates anytime soon."
- "Essentially, the RBNZ is aiming to gradually increase the rate of inflation. This aims to avoid an overshoot that would require higher interest rates, which would likely be negative for growth and employment in the longer term," Westpac says.
- However, the issue is whether the new government shares the RBNZ's approach; Westpac doubts this is the case. "When unemployment is higher than normal, the RBNZ's approach implies a gradual decline to avoid the risk of an overshoot," but, "the Government's intended 'maximum employment' mandate would argue for a rapid reduction in unemployment in these circumstances."
- Westpac adds "This may not have much bearing on what happens with monetary policy over the next few months. However, The Finance Minister has indicated that he wants the next Governor, who'll step into the ring after the March OCR review, to place greater weight on labour market conditions, with the aim of supporting employment growth."

**NORGES BANK: Focus is on the rate trajectory**

- The conclusion of the Norges Bank policy meeting on 14 December marks a busy day for central bank activity (given the ECB, and BOE meetings fall on the same day). However, the central bank is not expected to adjust rates, and therefore, traders will be focussing on comments around the trajectory of the rate path. "The September rate path contained a first hike in June 2019. The big question is whether Norges Bank wishes to indicate a first hike as early as in 2018," Nordea says, arguing that a weaker NOK – 4% weaker than the central bank had projected; additionally, lower unemployment, higher oil prices and other activity indicators provide ammunition for a hawkish tilt.
- "However, we think Norges Bank will see the latest NOK weakening as partly temporary and base its forecast at a somewhat stronger level than the current one," Nordea says, "add to this that Norges Bank, as at the previous two meetings, will claim that the low level of rates argues for a more moderate upward revision of the path than a strict interpretation of the developments since September." And Nordea concedes that "housing prices have been marginally on the weak side and there are signals from housebuilders that housing investment will drop more than previously forecast." But the bank concludes that "you cannot disregard the fact the developments since the September report in sum argue for both higher output gap and higher inflation. The new rate path will consequently be raised and indicate an earlier first hike. All in all, we end up with a path that is in line with a first hike in January 2019."

**RIKSBANK: Mixed signals**

- The Riksbank Governor Stefan Ingves downplayed concerns about the weakening momentum within the housing market, and reiterated his view that the SEK was likely to strengthen. But it was the comments from the Deputy Governor Henry Ohlsson which may have been more interesting going into the Riksbank's meeting the week after next.
- Ohlsson adopted a mixed view: on the one hand, he suggested that QE could be extended at that meeting, however, he then went on to question whether that would be an appropriate approach, noting that while developments on the inflation front have been encouraging, it needs to be at target for some time in order to 'anchor' the central bank's credibility. He then went on to suggest that rates could be lifted earlier than the Riksbank has currently pencilled in.