G10 Central Bank Monitor

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

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15 DECEMBER 2017

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FEDERAL RESERVE: **Yellen's last press conference flat as the US yield curve**

- Janet Yellen's last press conference as chair provided little by way of new information, and the FOMC's meeting in general was far from exciting. The Federal Funds Rate target was hiked 25bps to 1.25%-1.50%, as was widely expected. The hike trajectory was more-or-less kept intact, with a slight upward revision to the estimate rate profile in 2020; inflation forecasts in 2018 onwards were unchanged; growth was revised up a little due to tax reform (though some were disappointed by the magnitude).
- There were two dissenters calling for rates to be kept on hold – Neel Kashkari and Charles Evans – but while that may have inspired dovish initial price action, both are non-voters in 2018, suggesting their dovish influences will be mitigated as a more hawkish contingent rotates onto the voter's slate.
- Perhaps the most interesting aspect of Yellen's presser was her discussion of the flat yield curve, which she suggested has further scope to flatten, though currently remains within historical ranges. "She said with the term premium quite low, the curve is likely to stay flatter than in the past," RBC notes, "and with the Fed continuing to remove policy, the curve could 'easily invert'," she warned. The outgoing Fed chair played down concerns it might lead to a recession, however, arguing that the relationship between the yield curve and the business cycle may have changed.
- Elsewhere, Yellen continued to sound cautious on inflation. She acknowledged, that the persistent undershoot of inflation may have been her biggest policy regret. She did, however, continue to reiterate that the weakness appears transitory, and inflation will rise to target in the medium-term (though it is worth noting her conceding that the Fed's understanding of price dynamics is "imperfect").

EUROPEAN CENTRAL BANK: Draghi subdues the hawks again, but for how long?

- The ECB managed to say a lot without saying very many new comments of substance. No new guidance was offered regarding the composition of QE in the last nine-months of the current programme, the central bank's easing bias was retained, and new forecasts saw growth upgraded though inflation is still not see hitting target through the forecast horizon, and President Draghi continued to sound cautious on the prospects for inflation.
- While President Draghi affirmed at his press conference that the central bank did not discuss amending its guidance, it was reported after the meeting that there was in fact a debate, with some of the hawks on the Governing Council wanting to signal that the central bank might change its pledge if inflation accelerates, newswire sources reported; "some people wanted to say that if inflation continues to increase, we will be forced to change the forward guidance perhaps," one source said.
- The hawkish murmurs are not dissipating, and with the QE programme set to conclude in September 2018, there seems to be a growing contingent pressing for tighter guidance (over the course of the last couple of months, sources stories have suggested that there are at least six members – Hansson, Weidmann, Lautenschlager, Knot, Coeure, Villeroy – were calling for a more hawkish slant to policy).

BANK OF JAPAN: **Will Kuroda elaborate on 'reversal rates'**

- The BOJ's policy meeting concludes on 21 December, and the central bank is widely expected to stand pat. There will, however, be attention on the post-meeting comments from BOJ Governor Kuroda, and specifically, whether he will elaborate on his ideas regarding "reversal rates" and policy normalisation, after his recent comments.
- "A slim majority of analysts, ourselves included, expect the Bank of Japan to leave policy settings unchanged next year," says Capital Economics, "but a rising number are forecasting policy tightening" after many of the world's major central banks have begun erring towards removing stimulus, as well as the recent concerns expressed by Kuroda with regards to the impact of low policy rates on bank profits, capital and lending.
- However, Capital Economics does not believe that this will prompt the BOJ to raise its 10-year yield target: "The Bank managed to scale back its purchases a year ago even as US yields soared after the US presidential election. The Bank's ability to defend its yield target largely hinges on its credibility, and it has bolstered its credibility by offering to buy an

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unlimited amount of Japanese Government Bonds whenever yields threaten to rise much above the 0% target. In fact, we expect the Bank to reduce its purchases from the current ¥60 trillion per year to ¥40 trillion by end 2019."

- The consultancy adds that, for all the concerns about the potential negative impact of low rates on banks and lending, their profitability has still held up quite well, with lenders offsetting lower interest income by higher income from other sources. "What's more, it isn't clear whether an increase in the 10-year yield target or a shift to a five-year yield target would provide much relief to banks, as most lending takes place at much shorter maturities," CapEco writes.

SWISS NATIONAL BANK: A largely familiar affair, despite better forecasts

- This week's monetary policy meeting at the SNB was a familiar affair, with the central bank once again describing the CHF as "highly valued", while stressing that risks of appreciation are still a factor for price developments. It also reiterated its view that the situation was "fragile," and again stressed the importance of negative rates and forex interventions as tools to control currency moves.
- There were some upward revisions to its forecasts, though they still allude to a cautious central bank: inflation was revised up 0.3ppts to 0.7% due to higher oil prices and CHF weakness, however, the 2019 view was unchanged, and the central bank doesn't see inflation rising above 1% until 2019.
- "The SNB clearly continues to err on the cautious side. We expect that the Bank will stick to this stance until it becomes more confident that the recovery is solid enough to generate stronger domestic price pressures," HSBC says. "the SNB is not likely to hint at a move in policy rates before signs that the strong momentum in exports and in the manufacturing sector is starting to feed through into consumer spending, too."
- HSBC believes that, given the SNB's focus on interest rate differentials between Switzerland and the Eurozone, it is unlikely to hike rates before the ECB has done so. "Indeed, such a move could led to an unwanted revival in upside pressures on the franc. Against that backdrop, we still think that the SNB will not raise its policy rates before the first half of 2019."

BANK OF ENGLAND: Uneventful; Feb meeting to provide more clarity

- The BOE's final meeting of the year was uneventful, with the MPC keeping its policy setting unchanged, as was expected. Interestingly, the vote was unanimous at 9-0 to maintain policy, which Barclays has taken to mean that the BOE is now in "wait and see" mode, with markets looking for the next rate hike in Q4 2018.
- "The MPC judged that on balance, available Q4 indicators have been softer than expected, suggesting that GDP growth in Q4 could end up somewhat below that in Q3," Barclays writes. But on the positive side, the MPC "noted some upside surprises to aggregate demand in the Autumn budget and estimates that the level of GDP could be boosted by about 0.3% over the three-year forecast period, resulting in inflation 0.1ppt higher." The BOE's view on inflation was little changed, though it did concede that it may yet peak, while the labour market was "difficult to assess", which Barclays says highlights a rise in inactivity and the fall in jobs.
- The MPC's assessment of Brexit developments was also interesting: "While in the past the MPC tended to be careful to not overplay downside surprises regarding the Brexit process, this time it was quick to highlight progress made in negotiations since last week," Barclays writes, "it sees the agreement as decreasing the likelihood of a disorderly Brexit and as potentially even supporting household and corporate confidence."
- Barclays' analysts now look to the February's QIR meeting to gain more insight on how policy will develop in the months ahead. "In particular, if data surprises to the upside, the BoE could use the next Inflation Report to prepare markets for the next move (timing). Alternatively, if data prints in line with our more cautious outlook, the rhetoric would not change and we would be looking at May for the next meaningful opportunity for the bank to adjust its communication."

BANK OF CANADA: Happy to let the economy run hot

- Governor Poloz' last comments of the year struck a mixed tone. On one hand, Poloz made the case that the BOC was willing to allow the economy to "run hot" for a while spare capacity is absorbed. But on the other hand, he stated that caution – which has been a theme of BOC's policymakers recently – is not a code word for the Bank remaining on hold.
- "Markets took Governor Poloz's speech hawkishly compared to positioning just ahead of it," Scotiabank writes. Scotia offers some reasons why this may have been the case: Before going into the speech, "it's possible the BoC simply wanted to rein in some of the CAD depreciation over the past week but not necessarily tee up a near-term hike," the bank writes, AND "arguably the most important — and contestable — consideration is that Poloz downplayed NAFTA risks."
- In terms of economic fundamentals, Poloz did not in his speech that "the facts that the economy is operating near its capacity, and that growth is forecast to continue to run above potential, together pose an upside risk to our inflation forecast." Poloz added "With the economy operating near potential, a mechanical approach to policy would suggest that monetary policy should already be less stimulative. However, as we said in last week's interest rate announcement, we still see signs of ongoing, albeit diminishing, slack in the labour market."
- Scotia interprets these comments as guiding against a near-term hike, "especially if the aftermath of the super strong jobs report is a reversal in the next print." Scotia believe that there are three worries Poloz has at the moment: household debt, cyber attacks, and labour slack: "He's putting a lot of emphasis upon the latter as a downside risk to inflation in the

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speech. Don't interpret this list as exhaustive, and the Governor guided against doing so versus just taking them as the issues he wanted to emphasize today."

RESERVE BANK OF AUSTRALIA: Minutes to shed light on FX language tweaks

- The RBA's meeting minutes from the 19 December meeting – where it held the overnight cash rate at 1.50% – should provide some colour around the bank's tweaking of its language regarding the Australian dollar. (December's "The Australian dollar remains within the range that it has been in over the past two years. An appreciating exchange rate would be expected to result in a slower pick-up in economic activity and inflation than currently forecast." versus November's "The higher exchange rate is expected to contribute to continued subdued price pressures in the economy. It is also weighing on the outlook for output and employment. An appreciating exchange rate would be expected to result in a slower pick-up in economic activity and inflation than currently forecast.")
- "In December, the RBA prefaced the appreciation warning with the observation that the 'Australian dollar remains within the range that it has been in over the past two years'. It seems fair to argue that this might suggest a slightly more relaxed stance towards the currency on the part of the RBA," according to Westpac.

RESERVE BANK OF NEW ZEALAND: Announcement of new Governor Adrian Orr removes some uncertainty premium

- Some of the uncertainty premium regarding the RBNZ Governor vacancy was unwound this week after the announcement that Adrian Orr would take the helm in March 2018. Orr has a solid CV, analysts point out; he was considered to be an 'internal' candidate given his vast experience at the RBNZ. He has also been the head of the NZ Super Fund.
- Analysts at TD Securities have no view yet as to whether he is a hawk or a dove. By March, however, TD Securities notes that we should be aware of what the RBNZ's new mandate is and whether or not there will be a Committee-style structure to voting on policy decisions, potentially with published votes and meeting minutes.

NORGES BANK: Rate path tightened

- Although the Norges Bank unanimously kept the repo rate unchanged at 50bps (as expected), it tightened the path, bringing forward its estimate of the next hike of 25bps by six months to Q1 2019, mainly due to a weaker assumption on the rate of the NOK.
- Morgan Stanley suggests that the rate path is conditional on two factors: "First, the exchange rate is projected to start appreciating from here on, but if it fails to do so this alone could bring the first rate hike even closer," and "second, the correction of the housing market is projected to be "soft" but risks are that in an adverse scenario the first rate hike gets pushed back."
- Combined with its new forecasts – where CPI and the CPI-ATE measures of inflation were raised over the central bank's forecast horizon – the central bank is striking a constructive tone, Morgan Stanley says.

RIKSBANK: Likely to maintain rates and guidance; will asset purchases be extended?

- The Riksbank is unlikely to rock the boat at its policy meeting on 20 December 2017 given the higher domestic inflation data and the weak SEK, and the consensus expects the repo rate to be unchanged at -50bps.
- "The Riksbank probably sees no reason for further stimulus, while a first rate hike is still a long way off." The CPIF measure of inflation has averaged 2% over the last year, and Nordea believes that higher energy prices as well as the unexpectedly weak SEK suggests the inflation will likely remain close to target through 2018, and the central bank's easing cycle could be near an end.
- There will be some attention on whether the central bank extends its asset purchases, with the current programme set to conclude at the end of 2017. "In connection with the two latest decisions to extend the purchase programme, Governor Ingves had to use his casting vote to push through the decision," Nordea says, "against the current economic backdrop he will probably not do that at the upcoming meeting." But with that said, Nordea expects the central bank will retain optionality to resume asset purchases if the SEK appreciates rapidly.
- Additionally, there will be focus on the Riksbank's rate path. The current guidance – which extends through to Q4 2020, at which time the repo rate is seen at 0.75% – will likely be maintained, with the first rate rise pencilled in for the middle of 2018. Nordea expects the decision will be unanimous.