

Global Markets Research

Research Alert

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Central Banks Preview

- Fed to refrain from policy act as the new Administration implements Covid-19 related stimulus
- ECB and BOJ to maintain policy stance amid ongoing reviews
- BNM could tweak to a more cautious tone

Summary

With the coronavirus pandemic still (literally) plaguing the globe and domestic economic recovery fragile, global central banks are largely expected to maintain their dovish policy stance this week and next.

Slow job market revival dims odds of QE tapering by the Fed (26-27 Jan)

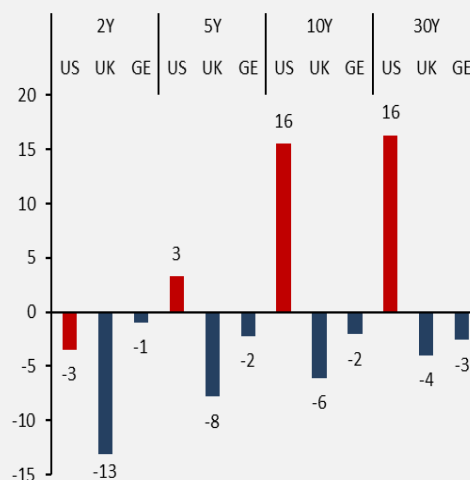
Recent surge in bond yields in tandem with renewed inflation expectations have spurred talks that the Federal Reserve might taper its bond buying program and even start raising rates soon. Chair Jerome Powell brushed off these speculations and assured markets that ample signals and guidance would be given (should there be any such plan) to avoid repeating the 2013 Taper Tantrum.

The Fed is expected to maintain its current monthly purchases at \$120b (\$80b treasuries, \$40b MBS) while keeping Fed funds rate at 0-0.25% at the same time. With vaccination rate still falling sharply behind the daily new coronavirus cases of above-200k, the Fed is weighing the reality that this is an out-of-control pandemic (the negative factor) and the potential mitigating measures/policies by the Biden's Administration's Covid plan (the positive factor). The impact of restrictions has also begun to show up in recent labour market and consumer-related data. Underlying inflation also remained modest. December's FOMC minutes also showed that officials are largely in agreement on the current policy approach, although some Fed's officials had openly discussed tapering (on the ground of strong recovery).

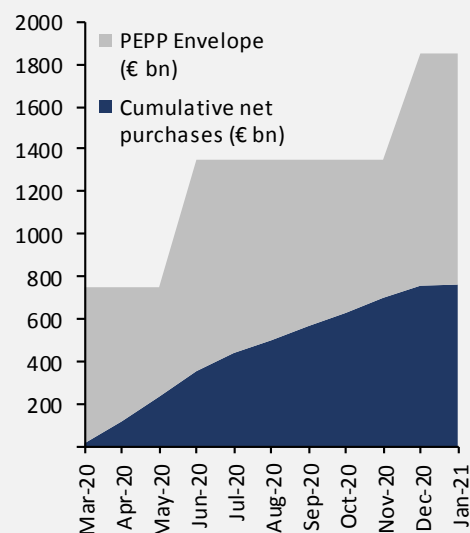
ECB to keep narratives (21 Jan)

The ECB is expected to maintain its monetary policy after having enhanced its targeted measures just last month that includes increasing the Pandemic Emergency Purchases Program (PEPP) Envelope by €500b to €1,850b as well as extending the period of purchases to at least end-March 2022. There is unlikely to be any adjustment to the Deposit Facility Rate (now at -0.5%) as policy makers judged the impact of PEPP more favourably according to latest minutes. ECB's has also thus far avoided using up its €1,850b envelope (net purchases stood at €762.5b as at 8 Jan); President Lagarde also repeatedly said that it is not necessary to fully utilise the program.

US long term yields shot up in recent weeks



Source: Bloomberg; based on last traded government bond yields on 1 Dec'20- 15 Jan'21



Source: ECB

Risks to the euro area's outlook remain on the downside given that vaccination drive had only just begun in late December (a few weeks behind the UK). Most of the biggest European economies remained in lockdowns/partial lockdowns or maintain some forms of strict rules to operate business. There is also increasing likelihood to impose even stricter measures across the continent (Germany's death rate surpassed that of the US) as the new UK strain made its way across the English Channel. The ECB has also crafted its latest outlook on the assumption of lockdowns through 1Q21.

It may continue to flag concerns regarding the stronger euro although recent sell down has reversed some gains. The increase in long EUR positioning may suggest a resilient EUR ahead despite the momentary resurgence in USD. The focus is more on the ECB's ongoing strategy review due to end in mid-2021 and there could be some recalibration of monetary policy goals before its expiry.

No change in BOJ's policy ahead of policy review (21 Jan)

The BOJ is expected to keep its monetary policy lever unchanged this week, standing pat ahead of a key policy review due March. In its December meeting, it has extended by six months a series of targeted measures to ease corporate funding. The review is set to fine-tune its market operations under yield curve control and asset purchases. We may see more tweaking in the area of its ETF purchases; the BOJ is the largest owner of Japan's domestic stocks, and was often criticised for propping up the countries' equity prices.

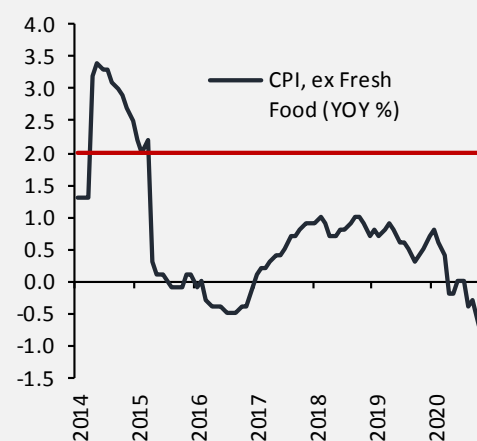
With inflation remained persistently below 1%, there were calls for the BOJ to abandon the 2.0% inflation target in recent years or introduce a more attainable inflation range target. This would represent a huge shift from its current policy and we judge such possibility to be low comes March. For now, as Japan suffers its worst Covid wave (new cases at north of 7000 on certain days) with lockdowns extended to more prefectures and dampened hope for the Summer Olympics (23 July), the BOJ is likely to continue delivering its dovish policy stance.

Expect BNM to pause despite increased downside growth risk (20 Jan)

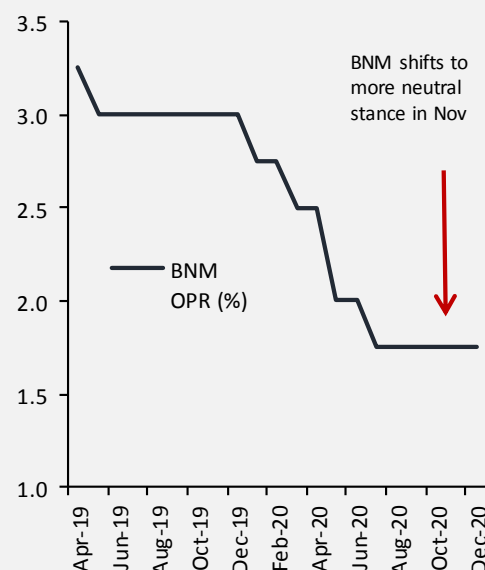
On the home front, we maintain view that BNM would keep OPR unchanged at 1.75%, despite some renewed expectations for a rate cut in view of the government's decision to impose a second Movement Control Order (MCO) in states hard-hit by Covid-19. The third wave that begun in October has seen new cases multiplying phenomenally to the point that daily infection surpassed 4,000 last week. There are mounting concerns over public healthcare system's capacity to cope with surging number of patients.

The economic impact of the second MCO is expected to be smaller as five essential sectors are still allowed to operate. Overall restrictions also appeared to be more relaxed compared to the first MCO in March when there was a nationwide lockdown. We estimate that every two weeks of MCO in the current localities could shave 2021 GDP growth by up to 0.5ppt. The main loser remains the retail sector especially small businesses that fall under the non-essential category. With interstate travel ban likely to be in place until after the upcoming Chinese New Year's celebration, consumers are also expected to scale back on festivity-related spending. While we do not expect any rate adjustment from BNM, it is possible that the MPC would adjust its neutral policy

Japan's core CPI inflation stubborn at sub 1%, way below BOJ's 2% target



Source: Bloomberg



Source: Bloomberg

tone to incorporate more dovishness and acknowledge the renewed economic concerns. The prompt response by the Government in introducing another stimulus package – PERMAI amounting to RM15bn (circa 1.0% of GDP) should also alleviate the pressure on BNM to cut this week.

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