How are Central Banks thinking?

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The European Central Bank (ECB)

The ECB changed its tone on 'easing bias' in monetary stance yesterday fueling expectations that it will normalize monetary policy during the course of the year. Mario Draghi has signaled that the Bank was on track to end its € 2.55 trillion bond purchase programme this autumn. This has been interpreted by the market as a triumph for German-led hawks that have not supported the stance so far and could mark a major turning point in the euro zone's monetary regime.

The main rate has been held at 0.00% and deposit facility at -0.4%. The QE programme is to end September. However, the program will continue at the pace of 30 billion euros per month.

The ECB had hitherto taken the view that it would be willing to increase the level of bond purchases it makes in both duration and size, in case the economic outlook deteriorates. However, it has removed such a statement from its communication this time indicating that the stimulus could come to an end in the near future.

The solid economic recovery in the region supported the decision to remove the so-called easing bias. The ECB now expects GDP growth to be 2.4% in 2018 and 1.9% and 1.7% in 2019 and 2020 respectively.

As inflation forecast has been lowered from 1.5 to 1.4% for 2018, the indication is that the ECB may not be increasing the interest rate any time soon. The market was hoping that the deposit rate of minus 40 basis points would be lifted during the year, which still looks unlikely if this forecast works out.

Also the ECB would be monitoring the exchange rate with regard to the possible implications for the inflation outlook. A stronger euro could have an impact on European exports and affect prices in the region. As a result, the Bank could be forced to change its monetary policy.

Bank of Japan

On the other side, Bank of Japan voted 8-1 to maintain its target for 10-year Japanese government bond yields at around zero and its short-term deposit rate at minus 0.1%, extending its holding pattern on its current policy settings to a year and a half. In a way this is a vindication of the massive stimulus program which is helping drive inflation toward its elusive target.

The Bank also stuck with its pledge to buy government bonds at an annual rate of 80 trillion yen ($750 billion). The actual pace of purchases has fallen below ¥55 trillion in the most recent 12-month period.

The Federal Reserve view

In the USA it has been observed that businesses are reporting persistent labor market tightness with accelerating wage gains in many regions. This does make for a strong case for further interest rate increases. Hence, this assessment by the Fed appeared to indicate a slight strengthening of the labor market since it last issued its Beige Book report in mid-January.

More specifically it has said that - across the country, contacts observed persistent labor market tightness and brisk demand for qualified workers. The Fed also noted that four of its 12 districts witnessed 'marked increase' in steel prices partly due to a decline in foreign competition.

Overall, U.S. economic activity expanded at a 'modest to moderate' pace. Market players expect the Fed to raise interest rates later this month. Fed policymakers projected three rate increases for 2018 at a December policy meeting. As a corollary it is argued in recent weeks that rates need to rise gradually to keep tightness in the labor market from eventually fueling high inflation.

Bank of England

In Britain interest rates are still expected to rise in May following a series of hawkish signals from Bank of England. The hesitation so far is due to the fact that Britain's economy has moved from leading to lagging most of the other industrialized economies. The current bank rate is 0.50% but is expected to increase to 0.75% in May and up to 1.25% by the yearend.

RBI

Back home in India the RBI would continue to look closely at developments on the CPI inflation number when taking a decision on interest rates.

The main concerns today are on both the demand and supply sides. On the demand side, higher fiscal deficit is the main issue while on the supply side the proposed higher MSP of farm products, oil prices and house rent allowance are potential threats to the inflation number. While the CPI inflation number will not cross 6% in the next few months, moderation towards the 4% mark also looks unlikely.

Given also that liquidity will continue to be tight in the market which will reflect in bond yields, rates would tend to be increased and a 25 bps hike in repo rate is expected during 2018. This appears to have been buffered in by the market. A clearer picture on inflation will emerge once the monsoon progress is known.

Recap of central bank rates in selected countries

Country	Rate	Country	Rate
Turkey	8.0	Philippines	3.0
Mexico	7.5	South Korea	1.5
Russia	7.5	Thailand	1.5
Brazil	6.75	United States	1.5
South Africa	6.75	United Kingdom	0.5
India	6.0	Euro Area	0
Indonesia	4.25	Japan	-0.1
Malaysia	3.25	Switzerland	-0.75

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