Izabella Kaminska <izabella@the-blindspot.com>

The UK jumps on the disinflation bandwagon

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Morning Central Banker

By GEOFFREY SMITH

with BEN MUNSTER, CARLO BOFFA and JOHANNA TREECK

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SNEAK PEEK

— Relief for the Bank of England, as U.K. inflation falls to the lowest in a year

— **Decision day in emerging markets:** all eyes on Turkey after Erkan's cautious start

— Nigel Farage, Coutts, and the curious case of inclusivity-driven exclusion

Good morning,

Surely we can all declare victory now? Inflation is even coming down in the U.K. — and quickly enough for financial markets to junk their assumptions that the Bank of England would only stop hiking at 6 percent. The pound gave up a big chunk of its recent gains on Wednesday as expectations for the terminal rate were shaved to 5.75 percent.

True, the improvement in core inflation — especially for services — was less impressive. As such, while the consensus for the BoE's August meeting is now coalescing around a quarter-point hike, some analysts at least (such as Barclays) are sticking to their prediction for a half-point. The key difference, as some pointed out, is that the U.K.'s real activity data is now slowing and starting to surprise to the downside, having shown resilience through the first half of the year.

That ought to be enough to tip the hand of a Bank that has, until recently, consistently erred on the timid side during the current cycle.

Send tips to bmunster@politico.eu, jtreeck@politico.eu, gsmith@politico.eu, ikaminska@politico.eu. Tweet us, too: @Geoffreytsmith, @JohannaTreeck, @izakaminska, @cgboffa6

POLICY TICKER

ECB 3.75% ⇡ — BOE 5% ⇡ — FED 5.25% ⇡— SNB 1.75% ⇡— BOJ -0.10% ⇣— RBA 4.10% ⇡— PBOC 3.55%⇣— CBR 7.5% ⇣ — BOC 5% ⇡

DRIVING THE DAY

— People's Bank of China decides on Loan Prime Rate.

— Turkey seen hiking another 5 percent after cautious start by Erkan, 1 p.m.

— U.S. Philly Fed manufacturing index and weekly jobless claims, 2:30 p.m.

The People's Bank of China kept its Loan Prime Rate unchanged, as expected, after shaving it by 0.10 percent last time out.

The Central Bank of Turkey is under pressure to deliver another substantial rate hike after new Governor Hafize Gaye Erkan soft-pedaled at her first meeting. The lira has continued to fall since then and analysts expect her to hike the key one-week rate another 5 percent to 20 percent.

The Philadelphia Federal Reserve releases its monthly manufacturing survey, while weekly jobless claims are also due.

SPEAKERS' CORNER

SOFTLY, SOFTLY: The BoE can probably risk accelerating its balance sheet run-off, now that the first year of quantitative tightening has passed off relatively smoothly, Deputy Governor Dave Ramsden said on Wednesday.

Didn't touch the sides: While going out of his way repeatedly to stress that the Bank Rate, not QT, is the 'active tool' for tightening monetary conditions, Ramsden noted that this year's runoff (£80 billion, split £45 billion in active sales and £35 billion in maturing bonds) had probably not added more than 0.10 percent to the benchmark 10-year Gilt yield. He adding that the market had absorbed the sales without any increase in short-term volatility or drop in liquidity.

Maturities to increase next year: More bonds from the Bank's Asset Purchase Facility expire in the 12 months from November than in the current 12-month period (around £50 billion), so just keeping the amount of active annual sales at around £40 billion would result in a bigger overall run-off, he argued. And don't forget that the Bank has also almost completely run down its £20 billion corporate bond portfolio at the same time this year, which also suggests plenty of market capacity to absorb higher sales.

"Carefully considered increase": "Taken together, for me personally, these factors support a carefully considered increase in the pace of reduction in the stock of gilts in the twelve months ahead reflecting: the completion of the CBPS unwind; the reduced need for aiming off for learning; and evidence so far on marketing functioning," Ramsden summed up.

ECONOMIC INDICATORS

STUBBORN CORE: Eurozone inflation has a core strong enough to make any pilates instructor proud. Underlying inflation rose faster than first thought in June, with core inflation, which strips out volatile food and energy components and is seen as a bellwether for future inflation trends, accelerating to 5.5 percent, from 5.3 percent in May. An earlier estimate had put it at 5.3 percent. Eurostat also confirmed that headline inflation fell to 5.5 percent year-over-year in June, from 6.1 percent in May. Pantheon Macroeconomics economist Claus Vistesen said core inflation will likely stay elevated over the summer, easing to under 5 percent by August, but then falling rapidly through the rest of the year and hitting 3 percent by December.

PAY DISPUTES

ECB PAY BATTLE: European Central Bank trainees are receiving a lot of backing from their senior colleagues in their demand for higher pay. As POLITICO previously reported, the ECB is facing a revolt from its lowest-paid, as they are the only group excluded from pay rises despite inflation hitting double digits.

A petition to the Executive Board demanding higher pay, signed by 283 of the roughly 500 trainees currently working for the central bank, was opened to wider staff on Wednesday at noon. Some 336 staff members had taken the opportunity to back their junior colleagues with a signature by 8 pm.

Since December 2013, trainees' wages have risen by a measly 1.9 percent. By comparison, the ECB president's salary has risen 12.6 percent in that time, and current boss Christine Lagarde has seen her salary go up by 2.8 percent just since joining the bank in 2019.

FX MARKETS

KING DOLLAR: OK, so this time *has* been different. Usually, dollar strength equals pain for emerging markets. But the International Monetary Fund's annual external sector survey points out that 2021-2022 was anomalous, in as much as global commodity prices rose in parallel with the dollar. Normally, a higher dollar tends to depress commodity prices, as commodity importers can afford fewer barrels of oil/bags of coffee etc. The IMF's researchers estimate that a 10 percent rise in the dollar causes a 1.9 percent drop in real output within just two quarters in emerging markets and a 0.5 percent drop for advanced economies.

Specific supply shocks: But last year, the supply shocks specific to the energy and food markets ensured that prices stayed high, doubling the pain for the resource-poor and filling the treasuries of commodity exporters.

Euro valuation gaps: Interestingly, in its assessment of the eurozone's current account, the IMF found significant real exchange rate gaps among countries sharing the euro. The fund said that in 2022 the euro was undervalued in Germany by about 8 percent, while it was overvalued by about 10 percent in Finland and Italy.

Internal imbalances: As large disparities between policies at the national level linger, the IMF called for countries enjoying current account surpluses to "increase investment, whereas countries with weak external positions should undertake reforms to raise productivity." For the bloc as a whole, the IMF forecast a return to a current account surplus this year, after posting a deficit last year for the first time in a decade.

BANKING

FINANCIAL BREXCLUSION: The bizarre tale of Nigel Farage and his bankers, Coutts, took a dramatic turn, as the Brexit pioneer got his hands on an internal document that suggested very strongly that the bank-that-likes-to-say-'yah' had indeed dropped him as a client for having the wrong political opinions. "The Committee did not think that continuing to bank NF was compatible with Coutts given his publicly-stated views that were at odds with our position as an inclusive organisation," the document said. It went on to advocate "exiting" Farage as soon as he had paid off his mortgage, an action that took him below the bank's technical threshold for retail accounts.

Conspiracy, not cock-up: We admit that this came as something of a surprise to us, as we had initially — and quite naturally — defaulted to 'computer-driven cock-up' rather than 'woke establishment conspiracy' as the likeliest explanation for his abrupt debanking by the NatWest subsidiary.

Computer says: 'above my pay-grade': The document, run in cringeworthy detail by the Daily Mail, made clear that this was not the result of some overzealous coding of screening software for 'politically exposed persons', and certainly not the result of any top-down ordnance from the Financial Conduct Authority, but rather a subjective judgment by the bank's management, informed by the reporting of the more left-wing elements of the British media establishment. The bulk of the material it cited came from The Guardian, the Independent and the BBC.

Outsourced due diligence: These reports counted for more than the bank's own assessment of his dealings with them, which it described as 'professional', and for more than the bank's own anti-money laundering team's opinion that he was no longer a 'PEP' in any case.

Exclusive inclusivity: Farage reacted to his vindication with the grace and magnanimity that one has come to expect. But Coutts' action — in a world where access to a bank account is indispensable — meant that in this instance, at least, the great man's hyperbole appeared justified (it's worth pointing out that Coutts is not alone here — none of Britain's other banks want to touch Farage with a bargepole). So – just so that we're all on the same page: Coutts, which has built a centuries-old business on exclusivity (not banking to the vulgar), has now excluded one of its clients in the pursuit of 'inclusivity'. Everybody can understand that, right?

DIGITAL CURRENCIES

CRYPTO RETURNS, FOR THE UMPTEENTH TIME: The Digital Euro Association (DEA), an influential Brussels-based lobby group, has a novel argument in favor of "tokenized deposits," the much-discussed corollary to CBDCs. Tokenizing deposits would effectively put regular commercial bank deposits on "distributed ledgers" (cough, blockchains, cough) in order to make money "programmable" — that is, adorning it with fun enhancements like self-executing transactions and DeFi integration.

Won't anybody think of the fractional reserve? The encroachment of central bank-issued digital cash has set alarm bells ringing at commercial banks who wonder whether this flashy and exciting new technology could draw away their cherished deposits and undermine their credit-creation abilities — and that's why they're scrambling to roll out their own hyper-efficient, fun-enabled digital cash. Some are even mulling creating "synthetic CBDCs" and "stablecoins" — crypto-adjacent, one-to-one-backed fiat currency derivatives whose introduction would allow DeFi functionality etc., but also require a complete overhaul of the beloved fractional reserve model. Not ideal!

Fighting blockchain with blockchain: The DEA argued in a paper today that tokenized deposits could (that word just *won't* go away) be the solution. Unlike with synthetic CBDCs and stablecoins, such deposits would really just represent a secondary, virtual layer on top of a commercial bank's standard liabilities. Little would materially change — and deposits could be held against limited liquid assets and plowed into safe long-term investments, as per ancient tradition. “They are regular deposits with a new dress,” Conrad Kraft, one of the paper’s authors, enthused to Morning Central Banker.

Terms and conditions apply, extensively: For that reason, the DEA says, scant new legislation and regulation would have to be rolled out to mitigate against the potential risks — the same old rules apply. Although the DEA did concede that “the regulation of TDs may require some review of monetary policy measures and regulatory requirements, to ensure that there is no unwanted impact on the provision of credit or on financial stability. ” Which admittedly leaves a fair amount of scope for literally anything.

QUOTED

“Uncertainty remains certain. First, the geopolitical situation linked to the Russian invasion of Ukraine, and globally, still represents a downside risk to growth and an upside one to inflation through the end of 2023 and start of 2024. The rise in food prices could also be more persistent than expected. On the other hand, the fall in wholesale energy prices could have a more marked impact on overall prices for producers and consumers,” **Bank of France Governor François Villeroy de Galhau** said in an interview with the magazine Mutations.

“I feel comfortable saying today that there is a clear need for another hike in July, and that a hike should be one of the options for September. And therefore, I would not be surprised if we continue to hike in September. … Life seems to be full of black swans, especially in the last few years, but if the economy evolves as we currently foresee, I would say we will remain in restrictive territory for longer than a lot of market participants expect,” **Bank of Lithuania Governor Gediminas Šimkus** told Econostream in an interview.

WHAT WE’RE READING

— ECB to push banks for weekly liquidity data as scrutiny grows (Bloomberg)

— The macroeconomic effects of the tariff shield: an evaluation using the ThreeME model (Conseil d’Analyse Economic)

— Inflation set to fall further in July as new Ofgem price cap kicks in (NIESR)

WHAT’S ON

(Editor’s note: this is intended as a selective list, giving precedence to European events). All times CET.

Japan June exports, imports, 1:50 a.m.

China PBoC loan prime rate decision, 3:15 a.m.

German June PPI, 8 a.m.

ECB publishes May balance of payments data, 10 a.m.

Turkey monetary policy decisions, 1 p.m.

U.S. weekly jobless claims, 2:30 p.m.

U.S. Philadelphia Fed manufacturing survey, 2:30 p.m.

S. Africa Reserve Bank monetary policy decisions, 3 p.m.

U.S. June existing home sales, 4 p.m.

Eurozone July consumer confidence, 4 p.m.

BoE’s executive director for payments Cleland speaks, 7 p.m.

Federal Reserve publishes weekly balance sheet, 10:30 p.m.

HEADLINES

Here's a recap of yesterday's news, along with Pro articles and alerts from overnight.

Finally, UK inflation comes off the boil
Relief for the Bank of England ahead of its August meeting.
By Geoffrey Smith · Jul 19, 2023, 6:43 AM