

## The Week Ahead: US PCE data and the ECB's Sintra meeting in focus

### ► **UK: BoE delivered a hawkish surprise, hiking rates by 50 bps**

The BoE re-accelerated the pace of its tightening cycle, raising the Bank Rate by 50 bps to 5.0% at its 22 June policy meeting with a 7-2 majority. The two dissenting members voted to keep interest rates steady. This decision was against our and consensus expectations for a 25 bps hike at the beginning of the week; however, expectations of a 50 bps increase rose following the stronger-than-expected May inflation print. The BoE stressed that the "significant scale of recent upside surprises in wage growth and service inflation" underpinned its decision to deliver a 50 bps rate hike. The MPC kept its forward guidance unchanged from the previous meeting (May), reiterating its data-dependent approach and willingness to hike rates further "if there is evidence of more persistent pressure". However, the BoE stressed that the 50 bps increase in the policy rate would not be the new pace of future hikes, noting that the decision applied "only to this particular meeting". We see the BoE stepping back down to 25 bps rate hikes at the August and September policy meetings. Following the latest inflation data, we have now added an additional 25 bps hike for the November meeting, taking the terminal rate to 5.75%. We now see the need for further tightening given the strong underlying price pressures and increasing risks of inflation becoming more entrenched. Markets have revised terminal rate expectations significantly upwards to c.6.0% from 5.75% prior to the CPI release.

### ► **UK: Headline inflation unchanged in May; core CPI strengthens**

Headline and core inflation printed to the upside, with the headline unchanged at 8.7% y-o-y in May (consensus: 8.4%) as slowing energy and food inflation was offset by an acceleration in services CPI. Energy inflation decelerated to 8.4% y-o-y in May (April: 10.8%) and we expect a further moderation in 2H2023 with the reduction in Ofgem's price cap for household energy bills (effective from 1 July). Food prices moderated to 18.3% (April: 19.0%) on some easing of supply-chain pressures. However, core inflation accelerated unexpectedly to a 31-year high of 7.1% y-o-y (April: 6.8%; consensus: 6.8%) as both goods and service prices rose. Overall, the core data points to broad-based and persistent inflationary pressures. Service inflation increased to 7.4% y-o-y (April: 6.9%) due to wage growth and strong domestic demand for tourism and recreation. We see service inflation remaining elevated in the near term on the back of strong unit labour cost growth and the summer holiday season boosting package holiday prices. We see increasing risks of stagflation against the backdrop of higher interest rates and elevated inflation, with ongoing tightness in the labour market.

### ► **US: Powell maintains a tightening bias**

Fed Chair Jerome Powell reiterated a hawkish message in his testimony to the US Senate and House last week, suggesting that 50 bps of further rate hikes remains a "good guess" of the future policy outcome. He stressed the need to focus on reducing inflation and bringing it back to the target level. However, Powell highlighted that the FOMC was close to reaching a sufficient level of

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policy restriction, and justified the June pause, indicating the need for slower interest rate adjustments going forward. Powell noted that there was limited evidence of stress in the banking sector leading to tighter credit conditions but promised to continue monitoring the situation closely. The need for further rate hikes was also echoed by other Federal Reserve officials, including Michael Bowman, Christopher Waller and Thomas Barkin, in their speeches last week. The market continues to price just one more full 25 bps rate hike by the Fed this year, with a 69.0% probability of it occurring in July. We previously added a 25 bps rate hike at the July FOMC meeting to our forecast and now see scope for a further increase of the same magnitude in September. For more details, please see our note – **Economic Research Weekly: Global Data Watch 12-16 June 2023**, published on 12 June 2023. Next week's May PCE data will remain a critical input for the decision. Consensus expects a sharp slowdown in headline PCE (3.8% y-o-y; April: 4.4%), while core PCE is expected to remain unchanged at 4.7% y-o-y. Separately, Treasury Secretary Janet Yellen stated that she sees a lower probability of recession in the US, though a decline in consumer spending may be the price to pay for reducing inflation.

► **Turkey: CBRT begins a gradual pivot to monetary tightening**

The CBRT delivered a 650 bps rate hike, taking the one-week policy rate to 15.0% in the first policy decision under the new Governor Hafize Gaye Erkan. This was markedly lower than market expectations (1150 bps) and signals a preference for a “gradual” approach to monetary tightening. The financial stability concerns and potential for significant losses on the large bond holding of banks perhaps played a part in influencing the central bank's gradualist approach. The MPC statement stressed that monetary tightening will continue, albeit in a ‘gradual’ manner, until the inflation outlook has improved significantly. We now see the policy rate reaching 24.0% in 2023, which should help reduce inflation, alongside the higher base that is already evident in the decelerating annual inflation rate. Last week's lower-than-expected rate hike weighed on the TRY, which has depreciated by c.7.8% against the USD since the policy announcement. The CBRT statement pledged to ‘simplify’ the macro-prudential framework in the coming period. We expect the CBRT to ease the FX deposit conversion rate and security maintenance requirements introduced earlier. In addition to interest rate hikes, these regulatory reforms are critical to boost market confidence, in our view.

► **China: LPR cuts to be followed by fiscal support measures**

The PBoC cut its Loan Prime Rate (LPR) by 10 bps for both the 1-year and 5-year tenures. This follows a similar magnitude of interest rate easing in both the Medium-Term Lending Facility (MLF) and seven-day repo rate undertaken earlier in the month. While some market participants had expected a deeper cut in the 5-year LPR, the 10 bps cut signals a cautious approach by officials. The interest rate reduction should offer some impetus to credit growth in the economy, which remains weak. The monetary easing is likely to be followed by targeted fiscal support measures, expected to be rolled out in the coming weeks. The government has already announced an extension of tax breaks for electric vehicles until 2027. Proposed measures include tax incentives for high-end manufacturing, subsidised mortgage costs, increased lending, and incentives to boost the consumption of large consumer durable goods. If the underwhelming run in macroeconomic data persists, more aggressive fiscal stimulus measures are expected, perhaps following the end-July Politburo meeting. On the monetary side, support could include further interest rate reductions, coupled with cuts in the Reserve Requirement Ratio (RRR) in 4Q.

► **Week ahead: Sintra meeting and Euro area CPI are key**

Key global monetary authorities will gather at the ECB's annual forum on central banking in Sintra this week (26-28 June). Fed Chair Jerome Powell, ECB President Christian Lagarde, BoE Governor Andrew Bailey and the BoJ's Kazuo Ueda's discussion (28 June) will be keenly watched for clues on the future direction of policy. In the Eurozone, energy-related base effects and ongoing food disinflation are expected to lower headline CPI in June to 5.6% y-o-y (May: 6.1%). However, core CPI is envisaged to rise to 5.5% y-o-y (May: 5.3%) due to the summer-related tourism and low base from last year as Germany introduced subsidies to reduce public transport costs. Eurozone unemployment is forecast to remain steady at an all-time low of 6.5% in May. As noted earlier, the US PCE report for May will also be a critical data release this week.

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