

Steady Rates By ECB, BoE & RBA

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BoE Policy Meeting (Wed-Thurs): Rate Decision @1100gmt

BoE ends its 2-day MPC meeting today. The interest rate decision is finely balanced, with markets pricing in around 40% chance of a rate hike. Likewise, 52/58 respondents in the latest Bloomberg survey expect the BoE to leave rates unchanged at 5.25% today. Over past week, the GBP/USD had risen as high as 1.9778 on the prospect of an April rate hike. However, **we maintain our view for steady rates in April, but follow up with a 25bps increase in benchmark rates to 5.5% in May.**

The inflation outlook plays a central role in the BoE's decision. CPI rose to 2.8% in Feb, persisting above the 2% inflation target, while the retail price index (RPI) also hit a 16-yr high of 4.6% vs 4.2% in Jan. Likewise, core RPI ex mortgage payments edged up to 3.7% vs 3.5% previously. Housing inflation continued to remain high, with Nationwide housing index rising 9.3% in March, albeit softer than the 10.2% pace in Feb. Despite higher mortgage rates capping demand, tight housing supply is likely to keep house prices supported. At the same time, average earnings (ex bonuses) rose 3.5% in Jan compared to 2006 peak of 4% in Jul. The softer wage inflation comes in a month when some new pay awards became effective. Inflation expectations appears moving sideways, suggesting there is little danger of runaway wage inflation in the months ahead.

Weighing up the balance of risks to inflation, we believe that with wages (one of the key indicators BoE monitors closely for inflation) still remaining contained, the BoE would have some room to keep rates unchanged at 5.25% at the meeting this week. Nonetheless, with inflation risks still persisting, the BoE is likely to maintain a tightening bias, and follow up with a 25bps increase to 5.5% in May.

ECB Policy Meeting (12 Apr Thurs): Rate Decision @1145gmt, Press conference @1230gmt

ECB holds policy meeting next week, with the CB widely expected to leave rates unchanged at 3.75%. Players are likely to scrutinize ECB Pres Trichet's press conference (post meeting). We expect the Gov to reiterate key phrases such as interest rates are at "moderate" levels, and monetary conditions, "accommodative". The phrase "the council will monitor very closely all developments so that risks to price stability over the medium term do not materialize" should also be included. Indeed, the above phrases should set the stage for the ECB to deliver more rate increases further down the road.

Indeed, ECB rhetoric over past month has been consistently hawkish. ECB Pres Trichet recently highlighted the eurozone was expanding at a pace above potential, and there is no time for price complacency. He added that the CB would do what is necessary to ensure price stability, though he warned of no precommitment on future moves. ECB Liebscher also viewed that price risks have not diminished in recent months, and that the growth outlook was currently better compared to 6mths ago. Ample liquidity remained a concern. Indeed, recent data showed both M3 measure of money supply and loans to private sector persisting around 10% growth rates, reflecting accommodative conditions posing upside risks to inflation.

The ECB is not likely to deliver any surprises next week, and should keep rates unchanged at 3.75%. However, ECB rhetoric is likely to pave the way for the CB to lift rates to 4% by June. Ahead, we believe the broad-based economic expansion, coupled with persistent risks of 2nd round effects on wages should allow the ECB to lift rates to a peak of 4.25% by Sept.

RBA: Maintained Steady Hand

In line with our expectations, the RBA left rates unchanged at 6.25% on Wed. However, with some players positioned for a rate hike, the AUD/USD fell to 0.8077 during Asian trading Wed. However, with carry trades coming back into play, AUD/USD rebounded to 0.8195 during Ldn/NY trading and presently lingering around 0.8183.

From here, we continue to stick to our view for **RBA to lift rates by 25bps to 6.5% in June**. However, our call would be subject to review following two sets of key data - March labour data (12th Apr) and Q1 CPI (24th Apr). Upward pressure on wages and higher inflation increases risks of RBA taking a more pre-emptive step of raising rates in May.

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