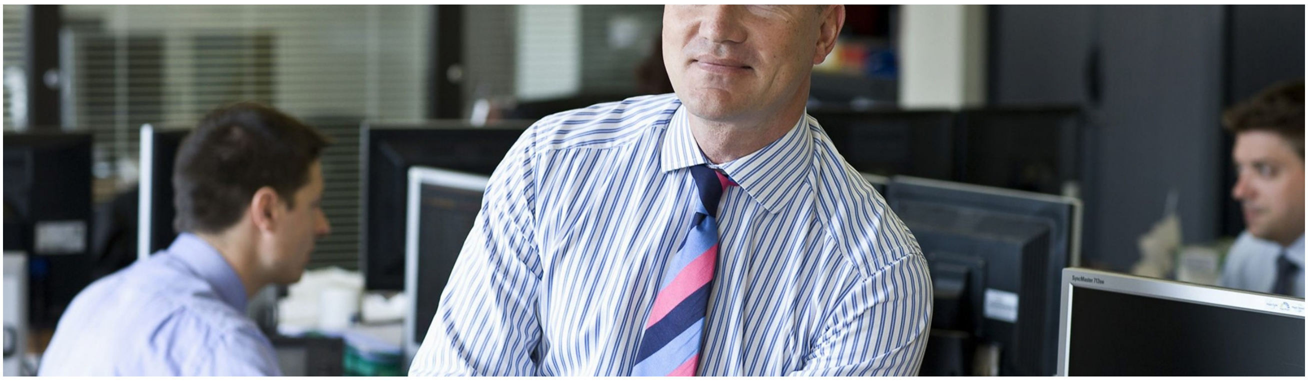
ECB likely to stay the course, despite uncertainties

by Franck Dixmier | 10/12/2018



Summary

As the European Central Bank continues the very gradual normalisation of its monetary policy, we expect it will soon announce the wrap-up of its bond-buying programme. But this won't signal the end of its accommodation: the central bank has multiple tools at its disposal to carry out its duties.

Key takeaways

- Despite disappointing numbers about euro-zone growth and inflation, we believe the ECB will stay the course and announce its final bond-buying wind-down at its 13 December meeting
- Even as its asset-purchase programme ends, the central bank will still be accommodative: it can be flexible with its reinvestment policy, the timing of rate hikes and the availability of long-term loans for euro-zone banks
- The continuation of the ECB's accommodative policy will likely be good news for investors, some of whom fear premature monetary tightening

There is little doubt that the European Central Bank will announce the wrap-up of its asset-purchase programme at its next meeting on 13 December, but recently announced data make the timing of this meeting awkward. The euro-zone growth rate has slowed, reaching only 0.2% in the third quarter, according to Bloomberg – the worst performance in four years. Inflation has also grown weaker: overall inflation was 2% in November against 2.2% in October, and core inflation was 1% against 1.1%.

Despite these disappointing numbers, we believe the ECB will stay the course for its final bond-buying wind-down. ECB President Mario Draghi suggested as much in his recent comments to the European Parliament, as did the minutes of the ECB's last meeting in October. The central bank likely views the recent data slowdown as the result of temporary headwinds rather than a permanent shift. In addition, the euro-zone's peak growth in 2017 makes the latest data appear worse in comparison.

Even though we do not expect a surprise announcement on 13 December, it will still be interesting to take note of the ECB's updated economic forecasts – which will incorporate 2021 for the first time. We expect the central bank's projected growth rate to be revised down only slightly despite the recent drop in oil prices, since cheaper oil should re-inject purchasing power and consequently boost core inflation.

This is all supportive of the ECB's very gradual normalisation of monetary policy, in our view. It would be wrong to think that the end of the central bank's asset-purchase programme will signal the end of its accommodation. The ECB is clearly in control and has important policy tools at its disposal to carry out its duties. Three tools in particular will be key in 2019:

- **The terms of the ECB's reinvestment policy.** While EUR 212 billion in maturing debt is expected to be reinvested in 2019, many unknowns remain. To date, the ECB has not indicated the reinvestment horizon, nor the duration of the new bonds purchased, nor the allocation of the purchases between public and private debt.

- **The timing of the first interest-rate hike**. While earlier ECB guidance may have prompted the markets to anticipate a rate hike in the autumn of next year, the latest expectations are for the first rate increase to occur in the spring of 2020.

- **The ability to offer new long-term loans to meet banks' needs.** The ECB would use this tool if a liquidity squeeze hit the markets, particularly given that many banks are due to repay existing cheap loans known as targeted longer-term refinancing operations (TLTROs).

We don't expect the ECB to give much detail, if any, on these three points at its next meeting. This is to ensure it maintains the ability to react to changes in the economy.

However, the continuation of the ECB's accommodative policy will likely be good news for investors, some of whom fear premature monetary tightening. The next meeting should also not change the perspective of euro-zone bond markets, which are currently more influenced by strong risk aversion than by fundamentals.

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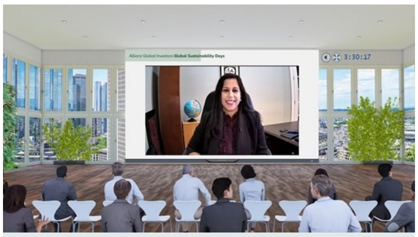

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Fed is set to hold steady, which could surprise markets

by Franck Dixmier | 17/12/2018

Summary

A host of US economic issues – from trade tensions to a flattened yield curve – has drastically reduced expectations of rate hikes after the FOMC's December meeting. Yet the Fed sees a healthy US economy and may announce it is forging ahead, which could catch investors off guard and trigger volatility.

Key takeaways

- Ahead of the FOMC's December meeting, fed funds rate forecasts moved sharply lower – showing a 70% probability of an increase in December, virtually no expectation of a hike in 2019 and a rate decrease in 2020
- Yet we believe signs of a strong US economy mean the Fed will likely confirm its monetary-tightening strategy at its 18-19 December meeting
- Still, the Fed has consistently demonstrated that it is not on autopilot and will make decisions based on the latest macroeconomic developments; that could mean more unpredictability and more market volatility

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