

Active is: Anticipating what's ahead

The ECB is getting its tools ready

by Franck Dixmier | 06/09/2019   

Summary

In recent months, the ECB made it clear that it will use all necessary measures to preserve growth and increase inflation in the euro zone. Since then, the political and macroeconomic environment has deteriorated, so we expect the ECB to announce new monetary-stimulus measures at its next meeting.

Key takeaways

- We expect the ECB to announce concrete monetary-stimulus measures at its 12 September meeting, in line with the comments it made in July
- Among the likely announcements are a rate cut, a new multi-tier deposit facility for banks and enhanced forward guidance – but we don't expect the launch of a new asset purchase programme given the lack of consensus among ECB members
- Markets will likely be disappointed, which would give investors an opportunity to take advantage of tensions in interest rates and spreads

During its 25 July meeting, the European Central Bank (ECB) validated the approach President Mario Draghi outlined in Sintra, Portugal, a month earlier: the ECB stands ready to take all necessary measures to preserve growth and move closer to its inflation target of 2%. The ECB's teams were then given a mandate to examine all monetary-stimulus options, including restarting its bond-buying programme.

Since then, the political and economic environment has deteriorated:

- The euro zone – particularly Germany – is in a confirmed macroeconomic slowdown.
- Euro-zone inflation remains anaemic, with consumer price inflation (CPI) at 1% and core CPI at 0.9% in August.
- Political and geopolitical risks have escalated, with growing trade tensions between the United States and China and an increasingly tangible risk of a hard Brexit.
- Inflation expectations are again close to their lowest levels, with the 5-year/5-year forward swap at 1.20% on 4 September. This measurement of medium-term inflation expectations indicates that the markets are doubtful about the ECB's ability to push inflation higher.
- The US Federal Reserve lowered its rates in July.

As a result, we expect the ECB to announce more concrete monetary-stimulus measures on 12 September. These include a 10-basis-point drop in the deposit rate (a basis point is 1/100 of a percentage point); the introduction of a multi-tier deposit facility (which would tax banks' excess reserves above a threshold that is specific to each institution); and stronger forward guidance, with an explicit commitment that key rates will remain low for a long time.

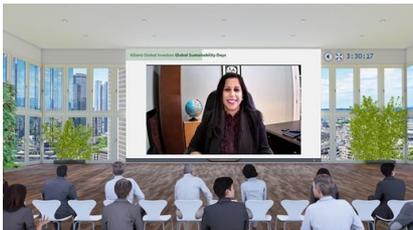
However, we think it is unlikely that the ECB will announce the relaunch of its bond-buying programme at this stage. Recent comments from central-bank members indicate that there is no consensus about whether a new round of quantitative easing (QE) is desirable, even if the option remains on the table. In

addition, the ECB probably wants to keep some room to manoeuvre to deal with a more pronounced deterioration in the economic and political environment – and to make a helpful tool available to its next president. Finally, the ECB may be seeking to regain some freedom from the markets, whose expectations are so high that they risk holding central banks hostage.

Given that the markets are anticipating a larger stimulus package – expecting an 80% probability of a 20-basis-point rate cut and news of the restart of QE – they might be disappointed. For investors, this may provide an opportunity to take advantage of possible rate and spread tension to buy on dips – in particular by reinforcing duration on sovereign bonds and increasing credit exposure.

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About the author



Franck Dixmier
Global Head of Fixed Income

Franck Dixmier is Global Head of Fixed Income and a member of the Investment Executive Committee at Allianz Global Investors.

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Facing growing geopolitical risks, Fed will likely cut rates

by [Franck Dixmier](#) | 11/09/2019





Summary

While domestic growth appears robust, international risks are rising – including worsening US-China trade tensions and the growing risk of a hard Brexit. As such, we think the Fed won't take any chances and expect the central bank to announce a 25bp rate cut at its next meeting.

Key takeaways

- We expect the Fed to cut the fed funds rate by 25 basis points at its 17-18 September Federal Open Market Committee meeting
- Faced with a still-robust economy and growing geopolitical concerns, Fed Chair Powell likely wants to avoid taking risk – preferring instead to keep monetary policy accommodative by lowering short-term rates
- We expect this will meet the market's expectations, and anticipate that long-term rates will stay firmly anchored at today's low levels

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