FINANCIAL MARKETS

IS MONETARY TIGHTENING OVER?

BLACKWELL GLOBAL

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THE BLACKWELL ADVANTAGE

BLACKWELL GLOBAL

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We believe that sound investment and trading decisions begin with a strong grounding in financial education. Our goal is to make this available to everyone - and this free eBook is part of that commitment.

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ARE WE ENTERING A NEW CYCLE?

FOREWORD

Global economic growth is slowing. International trade tensions and geopolitical events like Brexit have created uncertainty.

As a result, we've seen many of the world's central banks become more flexible in their approach to monetary policy.

The purpose of this eBook is simple. It analyses the monetary policy position of the world's major central banks.

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CEO, Blackwell Global Investments (UK) Limited

CENTRAL BANK PRIORITIES

WHY DO THESE PRIORITIES MATTER?

Before we look at the policy stance of each major central bank, it's important to understand why monetary policy matters.

Remember - a central bank's monetary policy affects the flow of capital within its economy. This flow of capital can affect the strength of its currency.

For example, higher interest rates act to reduce the flow of capital, which can strengthen a currency. Alternatively, lower interest rates act to increase the flow of capital, which can weaken a currency.

So if a trader understands the monetary policy stance of a central bank, they can determine the future price direction of its currency.

FEDERAL RESERVE

In recent years, the Federal Reserve has set the pace for monetary policy tightening. In response to a thriving US economy, the central bank has hiked the federal funds rate nine times since December 2015 (to a target range of 2.25% to 2.5%).

Last year, three further rate hikes were forecast for 2019. However, policymakers revised that forecast down to two rate hikes at the December 2018 meeting.

Fast-forward to March 2019 and there are suggestions that two rate hikes are unlikely. The Federal Reserve's chair, Jerome Powell, has said that future rate hikes will be data dependent.

So why has the Federal Reserve's monetary policy stance changed? Fundamentally, the US economy is strong - but a global slowdown, trade tensions and Brexit remain a concern. US inflation is also muted at 1.9% y/y, which means policymakers are happy to be patient with future rate hikes.

EUROPEAN CENTRAL BANK

Unlike the Federal Reserve, the European Central Bank (ECB) has not been in an aggressive tightening cycle. In fact, in an effort to stimulate economic growth, the ECB has implemented quantitative easing and negative interest rates.

However, the ECB's stimulus package (totalling 2.6 trillion euros) for the eurozone came to a halt in September 2018. This coincided with a downturn in economic growth of the bloc's largest economies, including Germany.

It's led some economists to conclude that the ECB will not hike its refinancing rate (0.0%) and deposit rate (-0.4%) in 2019, as previously thought.

In fact, given stalling economic growth within the eurozone, plus global pressures, some economists believe the ECB may introduce fresh stimulus in 2019.

BANK OF ENGLAND

Brexit - and the uncertainty it creates - is dominating the Bank Of England's (BOE) approach to monetary policy.

The eventual format of Brexit is currently unknown - but the default legal position come Friday 29th March is "No Deal". Mark Carney, governor of the BOE, has emphasised the economic risks of a "No Deal" scenario, citing falling levels of business investment in the UK and the risk of recession.

In February 2019, the UK central bank cut growth forecasts to 1.2% for 2019 - the lowest in a decade - because of Brexit and global pressures.

With this uncertainty, the BOE has cut its bank rate (0.75%) forecast to a single 0.25% increase within the next two years.

BANK OF CANADA

The Bank Of Canada's (BOC) benchmark interest rate currently stands at 1.75%. Up until October 2018, the Canadian central bank hiked rates on five separate occasions.

But falling oil prices and a slowing housing market, in addition to global headwinds, have dragged on the Canadian economy. It's forced policymakers to give themselves flexibility for the timing of the next rate hike.

Governor of the BOC, Stephen Poloz, has stated that the central bank still needs to increase borrowing rates, but the path to that remains unclear.

BANK OF JAPAN

The pressing concern for the Bank Of Japan (BOJ) is hitting its 2% inflation target. In January 2019, annual core inflation printed at 0.8%. This inflation goal has dictated the monetary policy of Japan's central bank in recent years.

Currently, the BOJ is in a cycle of quantitative easing, in which it purchases bonds in an attempt to push inflation towards 2%.

One board member of the BOJ, Goushi Kataoka, advocates increasing monetary stimulus to hit the bank's inflation target. This tactic, plus negative interest rates, are topics that are likely to dominate the central bank's agenda in the coming months.

RESERVE BANK OF AUSTRALIA

The next rate move for the Reserve Bank Of Australia (RBA) could be a cut. The central bank's official cash rate is currently 1.5%. However, a falling housing market, along with concerns about rising unemployment (particularly in the construction industry), could force the RBA into an easing cycle.

RESERVE BANK OF NEW ZEALAND

In February 2019, the Reserve Bank Of New Zealand (RBNZ) kept its official cash rate at 1.75%. The central bank said it expects to maintain this rate through 2019 and 2020, adding that its next rate move could be a hike or cut, depending on economic conditions.

SWISS NATIONAL BANK

The Swiss National Bank (SNB) has a benchmark interest rate of -0.75%. The rate is deliberately lower than the ECB's interest rate to ensure the Swiss franc does not appreciate. The expectation is that the SNB will maintain this rate for the foreseeable future, especially as poor economic growth grips the eurozone.


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