Financial markets

Monetary policies against economic slowdown

At their latest respective monetary policy meetings, both the European Central Bank (ECB) and the Federal Reserve (Fed) recognised that there were areas of uncertainty that determined their future policies. As a result, the Fed stabilised its rates on 30 January 2019 after the increase decided upon in December 2018, and announced that it was being "patient" over the pace of any future increase in its base interest rates. Meanwhile, the ECB put an end to any increase in the size of its balance sheet by halting its asset purchase programme, as planned, in January 2019. However, in the Eurozone, a rise in base interest rates is unlikely to happen before the end of 2019 due to the economic slowdown and core inflation being below its target level.

The increase in outstanding loans continues despite ongoing disparities within the Eurozone, disparities that are strengthened by the downturn in credit in Spain and Italy. In Q1 2019, the European banks anticipate a slowdown in credit, especially to companies, both in terms of supply and demand.

The stock market indices of the advanced countries experienced a rebound after the major downturn in the last quarter of 2018. The emerging market indices also picked up, despite economic problems in Argentina and Turkey.

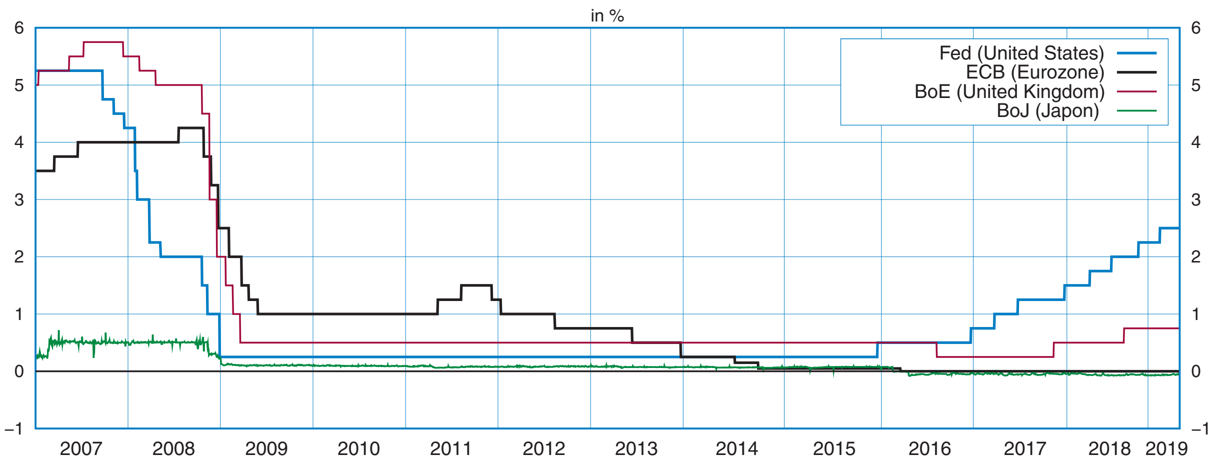
The euro has stabilised around $1.14 since November 2018 after depreciating a little. The pound is holding up at around £0.88 to €1. For forecasting purposes, the euro exchange rate has been set at $1.14, £0.88 and 125 yen. The real effective exchange rate for French exporters is expected to depreciate slightly in Q1 2019 and then should stabilise in Q2.

The Federal Reserve continues to normalise its monetary policy but is showing patience

In 2018, the Federal Reserve (Fed) raised its base rate four times in succession, by 25 basis points each time, the most recent being at the monetary policy meeting of the Federal Open Market Committee (FOMC) on 18 and 19 December (*Graph 1*). On 30 January, it was decided to keep the rate at 2.5%. Uncertainties surrounding US growth have led the Fed to announce that it intends to be patient over the frequency of increases that are to come. The central bank lets markets anticipate a single rise in 2019, in Q4.

Meanwhile, the Fed is continuing to reduce its balance sheet, at an average rate of $30 billion per month. The reasoning behind this policy is a core inflation of over 2% and an unemployment rate that is close to, although lower than, the usual estimates for the structural rate.

1 - Base rates of the main central banks



Sources: Fed, BCE, BoJ, BoE

This tightening of monetary policy continues to have an adverse effect on the emerging economies. The depreciation of the Argentine peso against the dollar forced the Argentine central bank to intervene in order to stabilise the exchange rate. The Turkish central bank for its part is not in a position to continue to raise its base rate given the country's current recession.

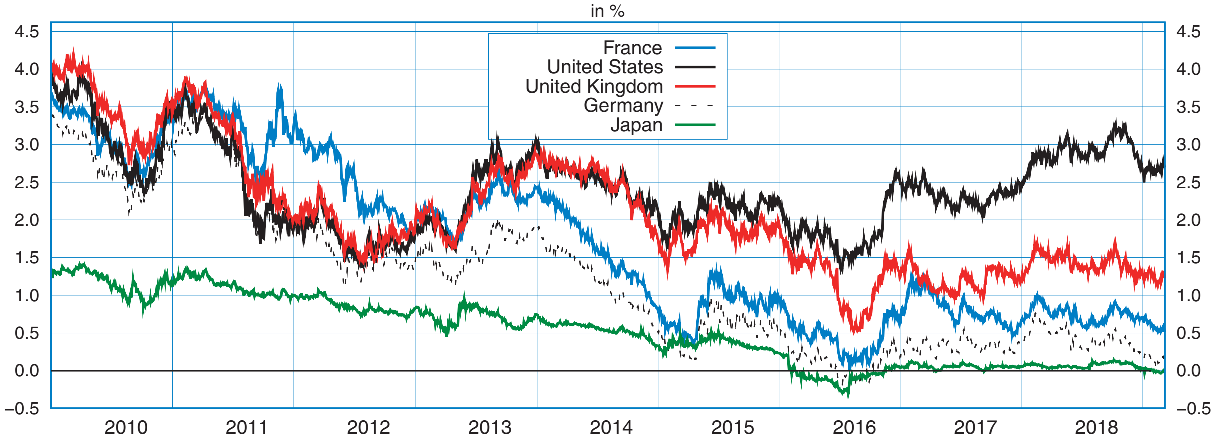
The ECB continues with its accommodating monetary policy

At its last two meetings on 24 January 2019 and 6 March 2019, the ECB left its base interest rates unchanged and suggested that it hoped to keep them at this level until at least the end of 2019. It also decided on a new targeted long-term refinancing operation from September 2019. However, the end of the asset purchase programme has been effective since 1st January 2019. Amounts resulting from the repayment of maturing assets are reinvested in new public and private assets in order to stabilise the size of the ECB balance sheet. The ECB's monetary policy is basically the result of headline inflation, standing at 1.4% in January 2019, and core inflation of 1.1%, which is still below the 2% Eurozone target. The ECB, like the Fed, is therefore paying close attention to short-term changes in the economy before deciding on its future policy.

US and UK sovereign yields experienced a slight rebound at the start of 2019.

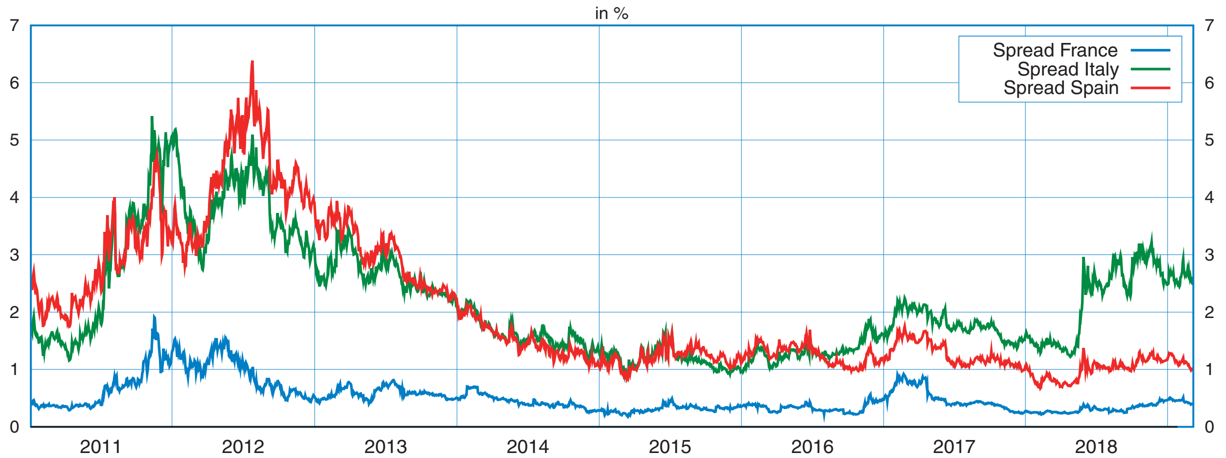
US and UK sovereign yields bounced back slightly in January 2019 as a result of an anticipated rise in inflation, combined with a slight rebound in the price of oil and a lesser risk aversion on the part of investors (*Graph 2*). The Italian 10-year yield has stabilised at a relatively high level due to the increase in government debt and a poor growth outlook (*Graph 3*).

2 - Ten-year sovereign yields in the advanced countries



Sources: DataInsight

3 - Sreads in relation to the Bund



Source: DataInsight

The outlook remains favourable for the credit markets, despite disparities

In January 2019, the growth rate of outstanding loans year-on-year remains buoyant in France (+6.2%) and in Germany (+6.1%). However, outstanding loans to companies are down in Spain (–2.4% in January, Graph 4) and in Italy (–0.5%) compared with the previous year. In addition, in January the average interest rate for corporate loans remains stable in Germany at around 1.3%, and in France and Italy at between 1.4 and 1.5%, while in Spain it is stabilising at 1.7%. In Q1 2019, the European banks anticipate a slight tightening of credit terms and a slowdown in the demand for credit in the Eurozone.

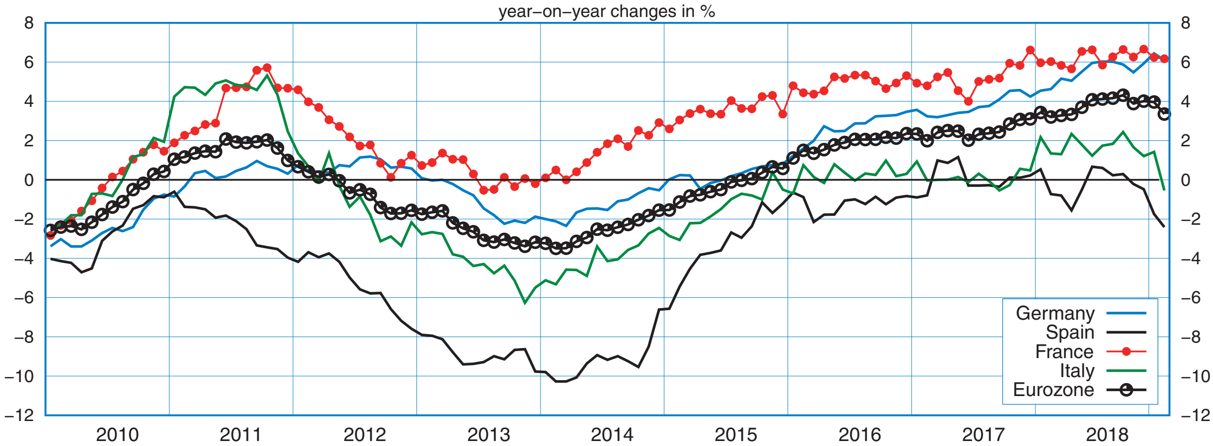
France still stands out from its main European partners by the buoyancy of its household credit and corporate lending (+5.4% year-on-year for households in December 2018, compared with +3.2% in the Eurozone) and a lower rate for new loans than in the rest of the Eurozone.

Stock market indices are rallying a little at the start of the year

Stock market indices in the advanced and emerging countries are experiencing a rebound at the start of 2019 (Graph 5), thanks mainly to an easing of trade relations between China and the United States, a more expansionist Chinese fiscal policy and the Fed's patience over the increase in rates. The ECB's still-accommodating monetary policy and the favourable outlook in the automotive and technological sectors are supporting the European indices.

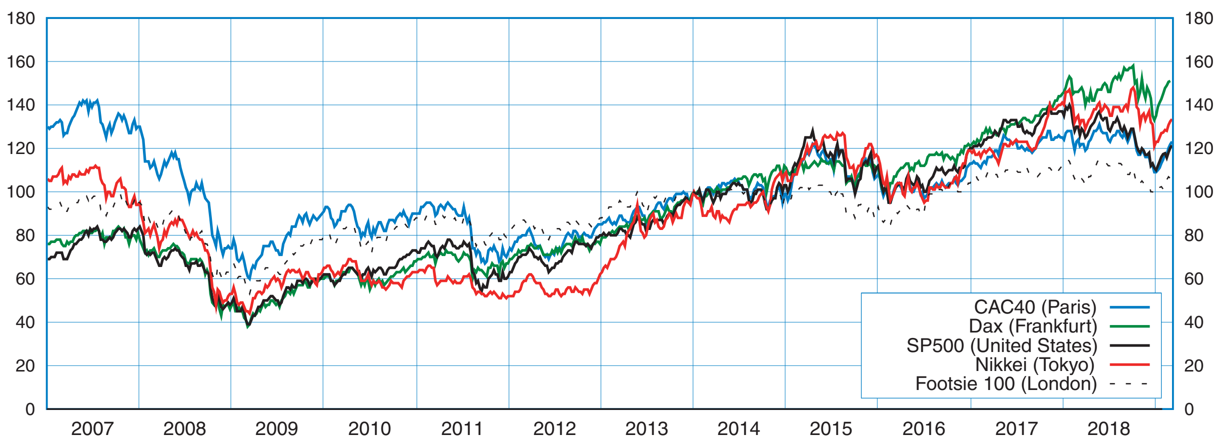
The landscape is more contrasted for stock market indices in the emerging countries, but most of them are also rising at the start of 2019. Investor optimism, revived by the election of President Bolsonaro in Brazil, is driving up the Morgan Stanley Capital International Emerging Market (MSCI EM) stock market index, which measures market performance in the 24 emerging countries.

4 - Outstanding loans to companies in the European area



Source: BCE, Banque de France

5 - Stock market indices of the advanced countries



Source: DataInsight

International developments

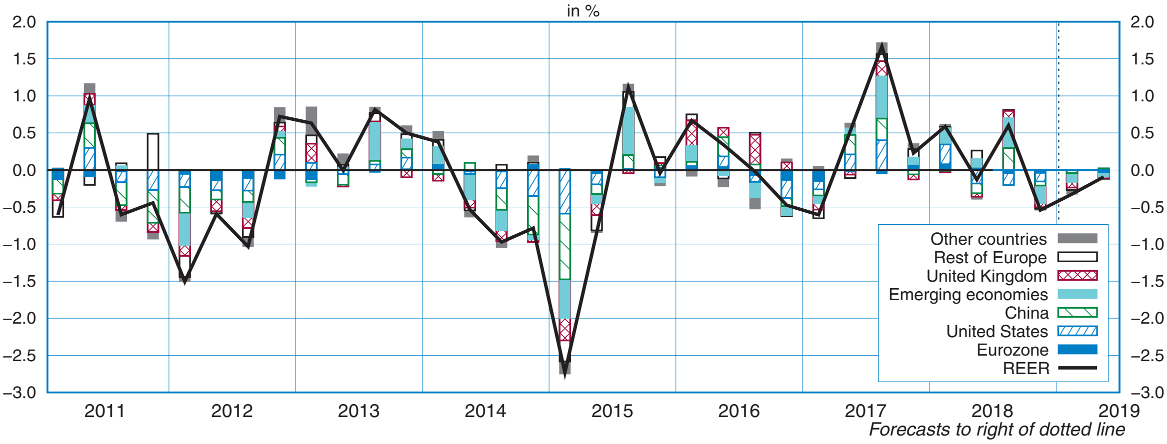
The rise in the Argentine Index since the end of 2018 was associated mainly with an attractive policy in favour of foreign capital. The subsequent fall occuring since mid-Frebruary is due to poor results in the banking and energy sectors.

The euro has stabilised against the dollar since Q4 2018

The euro has been stable at $1.14 since Q4 2018 in a context of uncertainty over the growth rate differential between the United States and the Eurozone. The pound and the yen are stable at £0.88 and 125 yen respectively for one euro. The euro exchange rate is set at 0.88 GBP, 125 JPY and 1.14 USD over the forecasting period.

The French real effective exchange rate (REER) depreciated in Q4 2018 (–0.5%). This depreciation looks set to continue into Q1 2019 (–0.4%) before stabilising in Q2 (–0.1%), as a result of a slightly weaker inflation in France than in the rest of the Eurozone (*Graph 6*). ■

6 - Quarterly change in real effective exchange rate (REER) of France and its contributing components



Sources: Banque de France, National statistical institutes, INSEE calculations