Financial markets

Monetary policies normalisation are placed on hold

In the context of a slowdown in the global economy, the rhetoric of the main central banks has changed substantially in recent months. The US Federal Reserve (Fed) claims it is being "patient", plans to stop reducing its balance sheet in September 2019 and has declared its readiness to respond to the trade tensions. The European Central Bank (ECB) will be launching its Targeted Long-Term Refinancing Operations (TLTRO) programme in September 2019, whilst core inflation in the Eurozone remains below its target level. Neither the Fed nor the ECB envisage raising their rates before mid-2020.

Outstanding loans continue to increase throughout the Eurozone, despite persistent disparities. They are rising sharply in France and Germany but continue to decline in Italy and in Spain. In France, outstanding loans remain more dynamic than in the other major European partner countries, with lower interest rates for households, in particular.

The euro exchange rate forecast assumptions are fixed at 1.13 dollars, 0.88 pounds sterling and 125 yen. The real effective exchange rate for French exporters is expected to stabilise in Q2 2019 and then appreciate slightly in Q3.

The Fed has put the normalisation of its monetary policy on hold

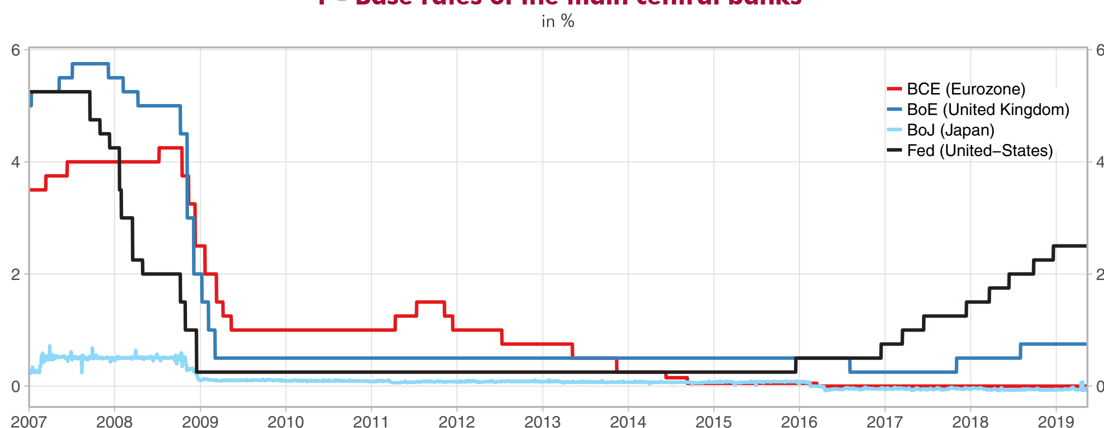
At the last three meetings of its monetary policy committee (FOMC), on 30 January, 20 March and 1st May, the Fed left its base interest rate unchanged at 2.5% (*Graph 1*), in accordance with its declaration to remain "patient" vis-à-vis the normalisation of its monetary policy, provided that inflation appears relatively stable. In early June, the Fed declared that it was considering reducing this rate in future, in response to the global trade tensions. No change in the rate is now anticipated in 2019, despite a slight drop in the unemployment rate in the United States, which is still below the usual estimates of the structural rate, and core inflation around 2%.

The Fed continued to reduce its balance sheet in Q2 2019, at the rate of around 1% per month. However, there are plans to end this reduction in September if, as anticipated, activity in the US economy slows down towards the end of the year.

The stabilisation of the US rate is generating flows of capital into certain emerging countries with the aim of obtaining higher returns. This is proving

1 - Base rates of the main central banks

in %



Source: Fed, ECB, BoJ, BoE

more beneficial to certain countries than others, particularly the most politically and economically stable nations. These incoming flows have led to the appreciation of certain currencies, including the Brazilian real at the end of March. Conversely, Argentina and Turkey – in the grip of economic difficulties – are deriving little or no benefit from the effects of this stabilisation of the US rate.

The ECB pursues its accommodating monetary policy

During the meeting of 6 June 2019, the ECB extended the deadline for the next rise in its base interest rates, which should not occur before mid-2020, at the earliest. Consequently, as during its meeting on 10 April, the ECB decided to refrain from modifying its rates.

The stoppage of the asset-purchase programme in January 2019 has contributed to the stability of the size of the ECB balance sheet in H1 2019. However, this balance sheet should start to increase in H2 with the launch of the new Targeted Long Term Refinancing Operations (TLTRO) programme. This policy can be explained essentially by the fact that inflation (headline and core) remains below the 2% target level in the Eurozone. In addition, the ECB, like the Fed, is still paying close attention to short-term changes in the economy before deciding on its future policy.

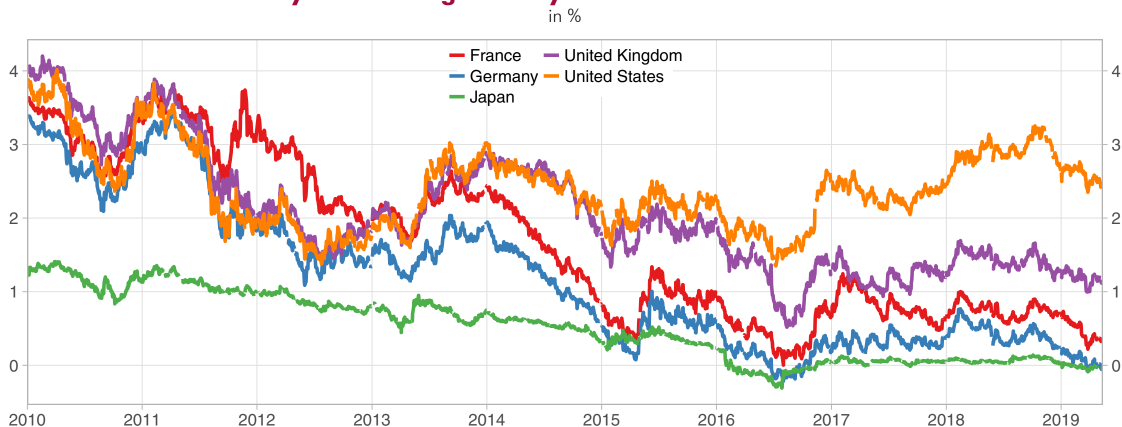
US and European sovereign yields fell in H1 2019

The decline in US and European sovereign yields, observed since mid-March, can be mainly explained by the implementation of a more accommodating monetary policy than expected in the United States (*Graph 2*), especially with the assumption of a possible future reduction in interest rates.

The Italian yield stabilised at around 2.6% on average in April and May, due to uncertainties over the sustainability of Italian public finance, in sharp contrast to the declining German and French yields (*Graph 3*). The probable implementation of the excessive public deficit procedure could trigger a new increase in the Italian spread.

2 - Ten-year sovereign bond yieds in the advanced countries

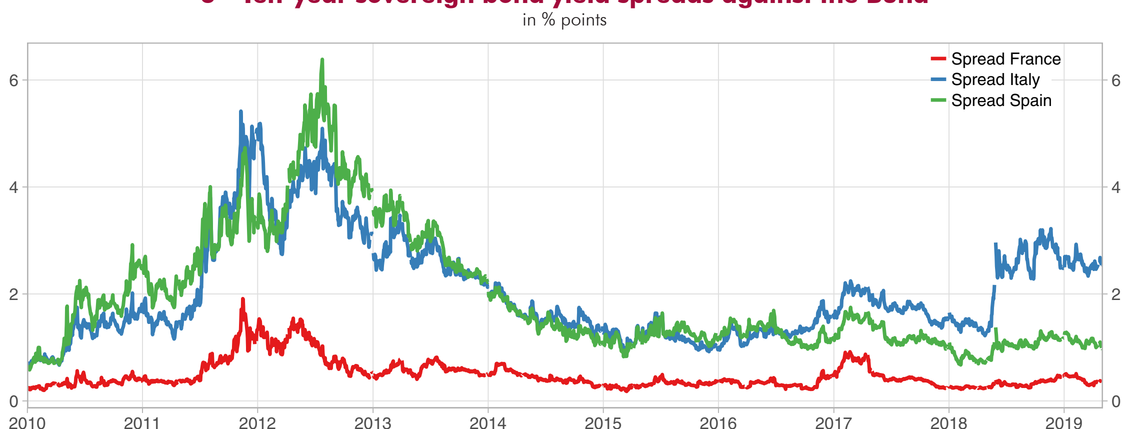
in %



Source: DataInsight

3 - Ten-year sovereign bond yield spreads against the Bund

in % points



N.B. The Bund is the German ten-year sovereign bond yield

Source: DataInsight

International developments

Prospects remain favourable for the credit markets, despite disparities

In April 2019, the growth rate of outstanding corporate loans year-on-year remained buoyant in France (+6.9%) and in Germany (+6.6%). Conversely, outstanding corporate loans have continued to fall in Spain (–1.3% in April, *Graph 4*). In Italy, outstanding loans have fallen again (–0.5%). In addition, while the average interest rate for corporate loans stabilised in March – at 1.3% in Germany and between 1.4% and 1.5% in France and Italy – the Spanish rate exceeded 1.8% (after 1.7% in February). For Q2 2019, the European banks anticipate a slight tightening of credit terms and a slackening of demand for credit in the Eurozone.

France once again stands out from its main European partners due to the buoyancy of its household credit and corporate lending (+5.9% year-on-year for households in April 2019, compared with +3.4% in the Eurozone) and a lower rate for new loans than in the rest of the Eurozone.

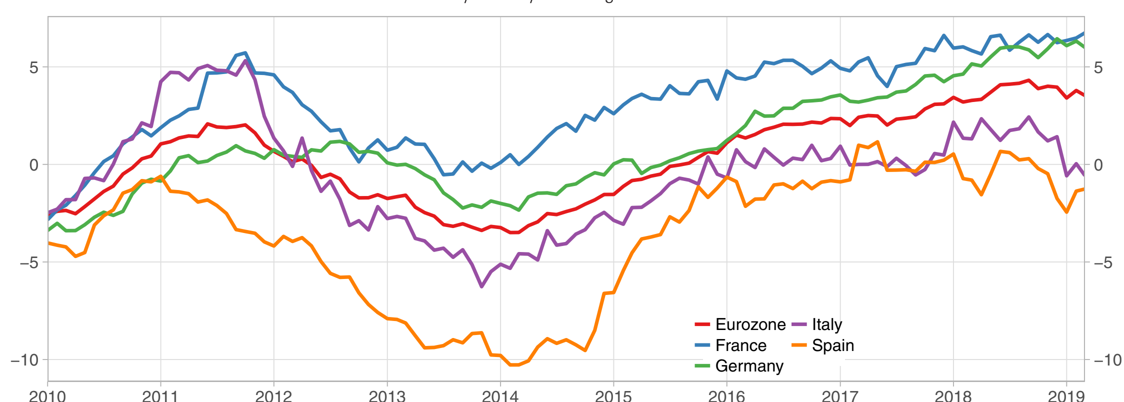
Stock markets returned to historically high levels in early spring

Stock market indices in the advanced countries bounced back between January and April 2019 (*Graph 5*). This rise stemmed from the Fed and the BCE adopting a more accommodating rhetoric than in the past and US activity being more vigorous than anticipated. However, this stock-market rebound has been interrupted by the resurgence of trade tensions between the United States and China since May 2019.

After the rise in the Brazilian index due to the optimism of investors and after the implementation of President Bolsonaro's first measures, the publication of unfavourable economic indicators and the slow pace of reforms have caused the index to edge down slightly. The Argentine index remains highly volatile and in sharp decline. Indeed, despite the release of IMF aid, Argentina remains in economic difficulty with high inflation and weak growth in the context of heightened political uncertainty in the run-up to the October elections.

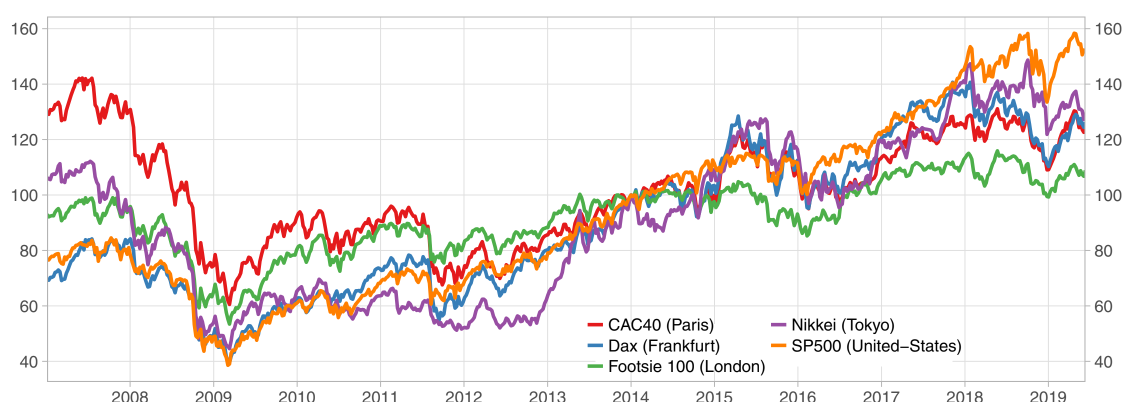
4 - Outstanding corporate loans in the Eurozone

year-on-year changes in %



Source: ECB, Banque de France

5 -Stock market indices of the advanced countries



Source: DataInsight

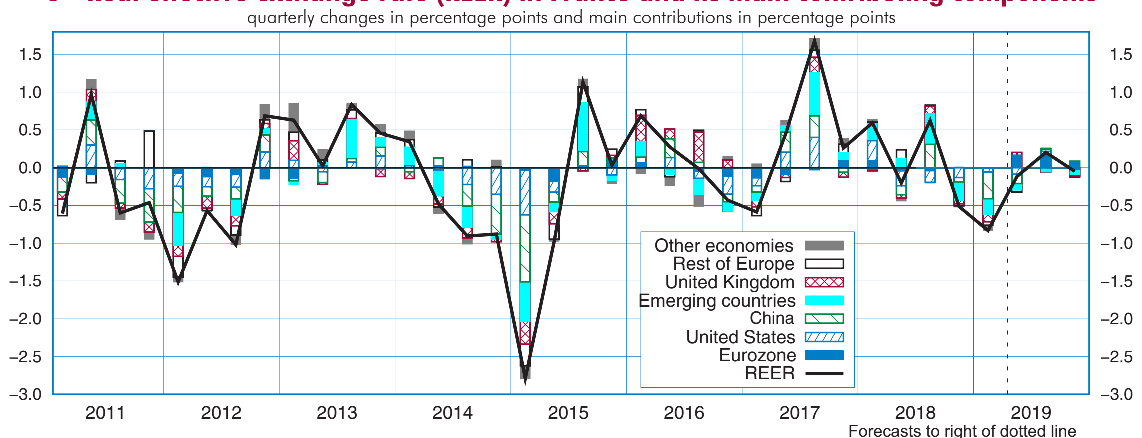
The French real effective exchange rate (REER) depreciated slightly in early 2019

At the end of February 2019, the euro/dollar exchange rate started a continuous decline before stabilising at around $1.12 to the euro. This is explained mainly by the BCE maintaining a very flexible monetary policy with the implementation of the new TLTRO programme, while the Fed continues to reduce its balance sheet. However, the uncertainties in Europe have faded a little in line with the European election results and the continuation of Brexit negotiations, while they are increasing in the United States due to the new trade tensions with China. In early June the euro/dollar exchange rate increased slightly at $1.13 to the euro, the assumption adopted here.The pound sterling and the yen are expected to remain stable at £0.88 and 125 yen to one euro respectively.

The French real effective exchange rate (REER) depreciated in Q4 2018 (–0.5%) and in Q1 2019 (–0.8%). It is expected to stabilise in Q2 2019, and to appreciate slightly in Q3 2019, before stabilising again in Q4 due to inflation gaps (*Graph 6*). ■

6 - Real effective exchange rate (REER) in France and its main contributing components

quarterly changes in percentage points and main contributions in percentage points



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