Central Banks / Global Economy

Pause and end of cycle

El País (Spain)

Sonsoles Castillo

Over the recent weeks there has been a major shift in the tone of central banks. The common theme of communications from different jurisdictions is one of caution and prudence.

Among this chorus of voices, the change in the discourse of the United States Federal Reserve (Fed) is particularly surprising. In December, it increased interest rates and suggested up to three additional increases this year. It is now entering pause mode and stopping interest rate rises for an extended period of time. Moreover, it suggests that it may have come to the end of its cycle and appears to be ready to end the reduction of its balance sheet sooner and at higher levels than expected.

The European Central Bank (ECB) is heading in the same direction, albeit from a very different starting point. With a more predictable strategy, the ECB has been moderating its expectations and has reported a slowdown in monetary normalization. Its latest statements confirm that its accommodative policy will be extended over a longer period. In particular, extraordinary liquidity measures (TLTROs) will be extended and the hiking cycle of interest rates is likely to be delayed.

Other central banks in Southeast Asia are heading in the same direction. Japan, which has been characterized by its profuse use of quantitative easing, is in favor of adopting further measures, India has already cut interest rates and China may follow suit to complement its liquidity injection policy.

The synchronization of these messages reveals common themes: growth slowdown, absence of inflationary pressures and clear downside risks to the economic outlook, mainly linked to the possibility of a trade war breaking out between the USA and China or Europe. These are all factors that justify entering "risk management" mode. Of course, the abrupt market correction at the end of the year -and its impact on financial conditions- has also played a role.

In a complex environment, nobody is willing to take risks‒least of all the Fed, which has succeeded in creating some room for maneuver. As such, it is now pertinent to wait a while until the considerable uncertainties that threaten global growth‒such as trade negotiations and Brexit‒dissipate and a clearer horizon comes into view. If these "match points" are saved, the Fed may make an additional adjustment and monetary normalization may resume in Europe at the end of this year.

Once the end of Federal Reserve's hiking cycle is confirmed, the "new normal" of monetary policy will be evident: interest rates well below previous cycles and a much larger balance sheet than before the crisis. Ultimately, this will mean central banks having a greater role in the operation of financial markets.

DISCLAIMER

ENQUIRIES TO:
BBVA Research: Calle Azul, 4 Edificio La Vela, Floors 4 & 5 28050 Madrid, Spain
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 25
bbvaresearch@bbva.com www.bbvaresearch.com