The central banks make moves

With all the attention at the start of the year focused on how the Fed and the ECB will go about implementing the shift in monetary policy, and with the feeling that the rate cuts could begin at different times on each side of the Atlantic, in recent weeks there have been certain developments that could shed some light on the agitated world of monetary policy.

Firstly, the Swiss National Bank (SNB) has joined the ranks of several monetary authorities in both emerging countries (Brazil, Chile, Malaysia and Hong Kong) and European countries (Poland, Hungary and the Czech Republic) by making a surprise announcement of a 25-bp cut in its official interest rate, placing it at 1.50%, now that inflation has reached the target (1.2% in February) and appears to be stable. In addition, with this reduction, Switzerland's central bank has managed to momentarily break the trend of the appreciation of its currency – an important step for an economy that continues to show significant weakness and which has a degree of openness exceeding 100% of GDP. Therefore, as we await the decisions of the two major central banks, the process of the normalisation of global monetary policy has already begun and it could lead to a reduction of around 100 bps in interest rates over the next 12 months.

In this early stage of the monetary easing process there has been a move against the current, as the Bank of Japan (BoJ) has raised its reference rate from –0.1% up to the 0%-0.1% range (the first rate rise since 2007), in addition to announcing the end of other unconventional measures, such as its yield curve control policy and its purchases of ETFs. This decision is only a first step towards the normalisation of its monetary policy, as the tightening of financial conditions has been minimal and the purchases of public debt will continue. Going forward, the key will be to keep a close eye on what happens to Japanese investors' public debt holdings abroad (more than a trillion dollars in US debt alone), given the effects that a repatriation movement could have on the American or European interest rate curves. The BoJ's decision, in addition to the promising recent pattern in inflation, also reflects the authorities' unease with the undervaluation of the yen (of between 25% and 30% relative to the major currencies), and this could lead to foreign exchange interventions if the situation is not reversed in the short term.

With this decision, the anomaly of the phase of negative interest rates can be considered closed. Indeed, it was during this phase that other central banks were introducing unconventional measures precisely to combat the risk of «Japanisation», which is characterised by: a significant reduction in potential growth, a fall in the natural interest rate to levels close to zero, a continued decline in prices and a loss of effectiveness of traditional monetary policy tools. The reality is that it is too early to declare that the Japanese economy has definitively left behind a behaviour which reflects structural factors that are difficult to reverse in the short term (demographics, etc.). By the same token, central banks throughout the world will continue to have in their «toolbox» the unconventional tools which they have had to design and use in the last decade. In this context, the ECB has announced an update to its tools and procedures for implementing its monetary policy strategy. Under the new operational framework, the depo rate will formally become the main reference rate, liquidity will be determined by the demand of the financial system, a structural portfolio of bonds will be maintained, there are no changes to the cash ratio and, from September, the spread between the refinancing rate and the depo rate will be reduced to 15 bps. With all this, together with newly created tools (TPI), the ECB will have the means to respond flexibly to the challenge of the dual objective (monetary and financial stability) in the turbulent waters which monetary policy will continue to navigate in the medium term.

For now, this year the challenge will lie in how best to manage the path towards more neutral monetary policy territory, limiting significant exchange rate imbalances if the timing differences that are anticipated in the adjustment process on each side of the Atlantic are confirmed. In the case of the dollar/euro exchange rate, the current levels are not far off the equilibrium exchange rate, which will offer a certain margin for the discrepancy. All this will need to be carried out with one eye on geopolitical risk and its potential effects on energy prices – the factor that could truly alter the roadmap. And, unfortunately, in this sphere the latest news is not positive, as indicated by the behaviour of the oil price and that of some traditional safe-haven assets, such as gold.

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