

Central Bank Roundup

October 1, 2019

September has been an interesting month to say the least: The U.S. and China traded more blows in their trade war; Boris Johnson's prorogation of British Parliament was deemed illegal by the UK Supreme Court; and of course the madness that hit the repo market felt all too-similar to 2007. But there were also major central bank actions which, despite grabbing fewer headlines than some of the aforementioned factors, had and will continue to have major implications on the markets going forward. Below, we discuss the major actions – or lack thereof – taken by three of the world's most important banks.

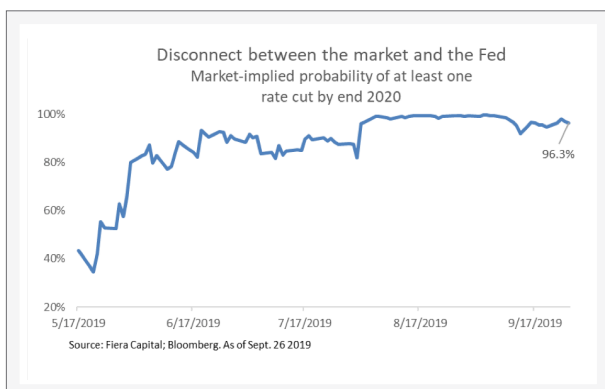
The Federal Reserve – Taking out some insurance

Much to no one's surprise, the Federal Reserve took out some additional "insurance" by lowering the Fed Funds rate for the second time this year at its September gathering. As justification for the rate cut, the Fed acknowledged the global headwinds that have plagued the marketplace – namely lingering anxieties on the U.S.-China trade front that have clouded the global economic backdrop and threatened to spillover to the domestic (i.e. American) economy. In the accompanying statement, the Fed struck a cautious balance – acknowledging the healthy state of the domestic economy and healthy labour conditions that have bolstered consumer spending – though did soften the blow somewhat by reiterating that inflation remains subdued, while also giving a nod to global headwinds that have weighed on both business investment/exports. In the end, officials maintained their

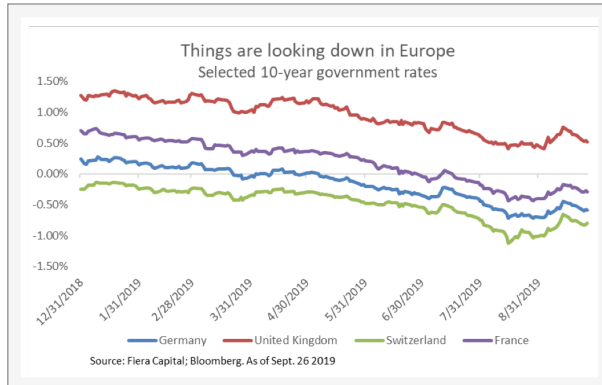
pledge to «act as appropriate» to sustain the expansion, though remained fairly noncommittal on future moves. Essentially, the Fed opted to maintain a flexible approach in order to monitor incoming data and trade developments before making another move; or, in other words, using a data-dependent approach. Interestingly, Fed members on average are not forecasting any further rate cuts through 2020 even as the markets continue to price in a 96% chance of at least one more rate cut over the same period (to be exact, a total of 2.5 rate cuts by end-2020), leaving investors vulnerable to disappointment should the Fed fail to succumb to the market's dovish bias.

European Central Bank – To QE infinity...and beyond

Similarly, the European Central Bank also ramped-up stimulus measures in response to an ailing and persistently stagnant European economy that has proven to be one of the main casualties of the trade war. As widely expected, the ECB followed through with a 10 basis point rate cut that sent the benchmark deposit rate further into negative territory. Perhaps more importantly, it also restarted its asset purchase program, promising €20 billion of net asset purchases per month, and even going a step further by pledging to keep the program going for as long as it takes for inflation to converge with the 2% target – or, in their words, "as long as necessary."



At the same time, with monetary policy clearly reaching its limits, President Draghi reinforced that monetary policy can't be the only game in town and urged governments to step-up with fiscal support. On that note, the German economy appears to be heading towards a technical recession with both survey and actual activity data pointing towards another quarter of negative growth in Q3 – which has ultimately bolstered calls for a fiscal package that would help to support the European economy more broadly.



The Bank of Canada – Steady as she Goes

Interestingly, in a speech the day after the announcement, Deputy Governor Lawrence Schembri said that “The Bank of Canada will continue to conduct monetary policy appropriate to our own circumstances. We will continue to ground our decisions in our policy framework, setting interest rates to achieve our inflation target, mindful of the implications for financial vulnerabilities.” In our view, the



BoC is signalling that economic fundamentals will have a greater weight on policy decisions than politics. For now, with unemployment just above historic lows, GDP growth having bounced back from some weakness early in 2019 and the bank's preferred gauge of core inflation hovering at target since April, the Bank is in steady-as-she-goes mode. Barring a severe deterioration in the global trade backdrop, we continue to believe that the Bank of Canada can remain sidelined even if/as the Fed and other global peers provide more stimulus.

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