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2019: a difficult year, ending on a hopeful note

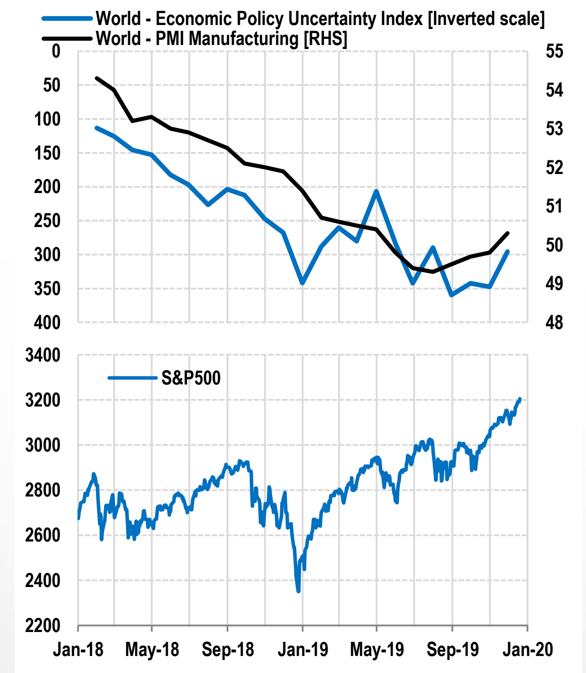
■ 2019 has been dominated by uncertainty, in particular about trade tensions and hard Brexit risk, as well as mounting concern about the slowdown of the global economy. This has led to additional policy easing by the ECB whereas the Federal Reserve has reversed course by cutting the federal funds rate on several occasions ■ This has further reduced the remaining policy leeway of central banks, a subject that will be analysed in the context of the strategic reviews by the Fed and the ECB. It has also led to increased calls for fiscal stimulus ■ Equity markets have delivered surprisingly strong returns with investors preferring to look at the role of lower interest rates, rather than at the weakening of the profits outlook ■ The year ended on a hopeful note with the improvement of certain business surveys.

How should one characterise 2019? Stressful, frustrating, difficult, reassuring, amazing, interesting, hopeful? Probably all of the above. Man-made uncertainty (mounting trade tensions, Brexit discussions with a fluctuating likelihood of a no-deal departure from the EU) caused stress ("when will this end?") and frustration (because of its impact on growth). But there was also endogenous uncertainty, which is inherent to the development of the business cycle (with corporate investment slowing down after having grown significantly) or a structural rebalancing of an economy, like is the case in China.

The reaction from the major central banks was reassuring. The ECB stepped up its accommodation, whereas the Federal Reserve reversed course by cutting rates on three occasions. It has demonstrated that inflation-targeting central banks are risk averse: they can't afford a big slowdown, otherwise it would jeopardise the odds of reaching their objective. Financial markets have understood this monetary put option all too well and the performance of equities has been genuinely amazing. Against a background of slowing global growth, a dimmed profits outlook and pervasive uncertainty, they have climbed the proverbial wall of worries. With interest rates stuck at a very low level, it implies, going forward, a high degree of sensitivity to the growth outlook.

Another reassuring development has been the acknowledgment that monetary policy has virtually reached the end of the road. It is reassuring because it forces a re-think of how to fight economic downturns. Mario Draghi made a rallying cry on the occasion of the September meeting of the ECB Governing Council for fiscal policy to step in so as to boost growth and enhance the effectiveness of monetary policy in reaching its target.

UNCERTAINTY, MANUFACTURING PMI AND STOCK MARKET



Source: Datastream, Markit, EPU, BNP Paribas

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Eco WEEK

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The bank for a changing world

The Federal Reserve's strategic review of the objectives, tools and communication of its monetary policy has to be seen in the same light. The results are eagerly awaited in the first semester of next year and will fuel speculation about the outcome of a similar exercise at the ECB, where, quoting Christine Lagarde, "no stone will be left unturned". This review will take place against a background of increased concern about the unintended consequences of a prolonged period of negative interest rates. In this respect, the Swedish central bank took the interesting decision this week of hiking its policy rate and bringing it back to zero, despite a slowing economy, on the grounds that negative interest rates may end up having net negative effects.

One area of particular debate in the Eurosystem will be the role of the central bank in the context of the climate change challenge. ECB President Lagarde said during her confirmation hearing, that she was ready to make aggressive strides toward environmental objectives. In the ECB's governing council, opinions are divided as many fear that the ECB might enter a political minefield. Concerns about the environment have increased in 2019, as CO2 emissions are still rising and the earth is still on a high emission path. The increased frequency of natural disasters (heatwaves and flooding in Europe, wild fires in the Brazil Amazon region, California and Australia) may be a warning of the things to come. Environmental considerations are increasingly taken into account in policy decisions. Recently, the EU has taken some major initiatives such as the adoption of a taxonomy for sustainable activities (which is essential for formulating climate policy to avoid green washing) and the announcement by the European Commission of the Green Deal to make the EU carbon neutral by 2050. These initiatives were most welcome considering the important setbacks in 2019. The COP25 was a failure as countries could not agree on rules for an international carbon market and President Trump confirmed that the United States will formally pull out of the Paris agreement on 4 November 2020, one day after the upcoming US presidential election. It makes next year's COP26 from 9-19 November in Glasgow crucially important. This reminds us that many developments of 2019 will influence the turn of events in 2020. Central bank policy rates are stuck at a (very) low level, uncertainty may have declined a bit but trade tensions and hard Brexit concerns haven't disappeared. However, recent survey data provided some hope that in 2020 growth could actually surprise to the upside. It is what we wish to all of our readers.

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