EDITORIAL

CENTRAL BANKS: SAME OBJECTIVE, DIFFERENT DATA, DIFFERENT POLICIES

It was a rare coincidence that last week, four major central banks – the Federal Reserve, the ECB, the Bank of England and the Bank of Japan – held their monetary policy meeting. Considering that they all target 2% inflation, their decisions shed light on the role of differences in terms of approach as well as in the economic environment and outlook. However, they share a preparedness to react when circumstances require. Given the mounting concern about the Omicron variant, more than ever, monetary policy is data-dependent.

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In the US, the Federal Open Market Committee decided to speed up the reduction in its asset purchases *"in light of the strengthening labor market and elevated inflation pressures."*[2] This accelerated tapering was widely expected, following recent statements of Jerome Powell and other FOMC members. Their assessment is *"aggregate demand remains very strong, buoyed by fiscal and monetary policy support and the healthy financial positions of households and businesses."* More important as a hawkish signal is the upward revision of the median projection of the FOMC members for the federal funds rate to 0.9% at the end of next year (0.3% in the projections of last September) and 1.6% in 2023 (1.0% previously).[3] Moreover, J. Powell stated during the press conference that, should inflation remain high, the policy rate could be increased before achieving maximum employment.[4] With net asset purchases scheduled to end mid-March next year, it seems that the first rate hike will come soon thereafter and the Fed chair gave a clear hint in that respect. In the previous cycle, there was quite a long separation between the end of QE and the first rate hike but he does not think that is at all likely in this cycle.

The ECB's decision to stop its net asset purchases in March 2022 under the Pandemic Emergency Purchase Programme was widely expected but the temporary and limited increase of the 'traditional' Asset Purchase Programme suggests that the governing council is expecting that in the medium run, inflation will evolve in such a way that a further normalisation of monetary policy will become possible[5].

1. Bank of England, Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 15 December 2021.
2. Federal Reserve, Transcript of Chair Powell's press conference, 15 December 2021.
3. The FOMC also expects a faster decline in the unemployment rate and a slower decline in inflation.
4. The FOMC has set two conditions for a rate hike: inflation above target for a sufficiently long time and employment having reached its maximum level. This second condition could be dropped based on the balanced approach provision, whereby the distance from the goal and the speed at which it is being approached need to be taken into account.
5. 'Further normalisation' would consist of tapering the APP, to be followed by an increase of the deposit rate.

CORE INFLATION, Y/Y %

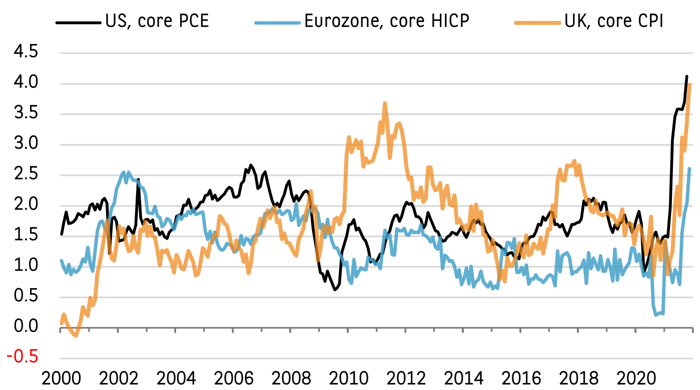

CHART 1

SOURCE: BEA, EUROSTAT, ONS, BNP PARIBAS

The Federal Reserve, the ECB, the Bank of England and the Bank of Japan have one thing in common, which is a preparedness to react when circumstances require. Christine Lagarde put it very nicely during her press conference: "we are driven by data".

Finally, the Bank of Japan announced its version of tapering. Purchases of commercial paper and corporate bonds will, from April 2022 onward, return to the pre-Covid-19 pace. However, the 'Special Program to Support Financing in Response to the Novel Coronavirus (COVID-19)' will be extended in part by six months until the end of September 2022, to support the financing of mainly small and medium-sized firms.[6] However, there is no prospect of any change in its interest rate policy.

Although the four central banks have the same inflation target of 2%[7], the differences in terms of their latest decisions may, at first glance, be puzzling. To some degree, they reflect differences in the importance given to the Omicron-related uncertainty. The Bank of England acknowledges that it might weigh on growth but it is more focusing on inflation, where the Omicron impact is not clear. The Federal Reserve seems to give less weight to the new variant, which reflects its conviction that the economy is strong and hence should be resilient. The ECB insists that *"the balance between the inflationary or deflationary impact that omicron will have is still totally uncertain"*, which explains its preference to *"keep flexibility and optionality in order to respond to change of circumstances"*[8]. Moreover, the different countries are at different stages of the cycle, in terms of inflation, the unemployment rate, etc. The four central banks have one thing in common however, which is a preparedness to react when circumstances require. Christine Lagarde put it very nicely during her press conference: *"we are driven by data"*.

William De Vijlder

US: MANUFACTURING PMI PRICE PRESSURES

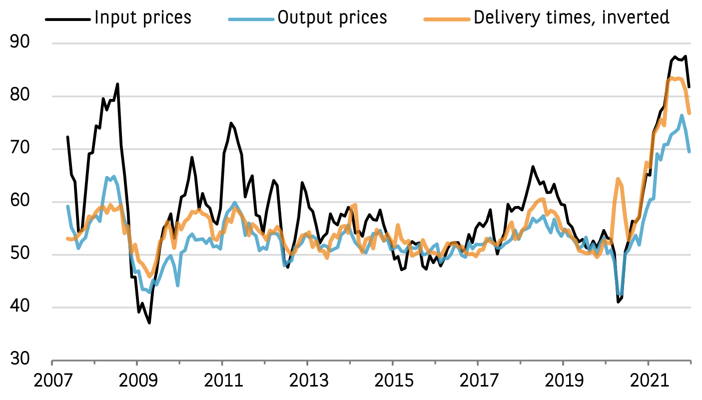

CHART 2 SOURCE: IHS MARKIT, BNP PARIBAS

EUROZONE: MANUFACTURING PMI PRICE PRESSURES

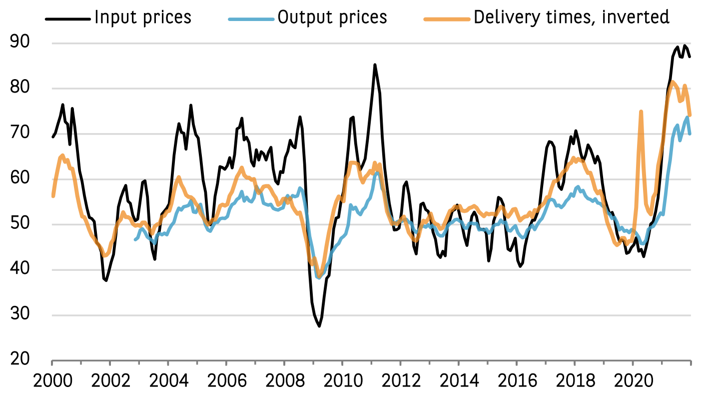

CHART 3 SOURCE: IHS MARKIT, BNP PARIBAS

UK: MANUFACTURING PMI PRICE PRESSURES

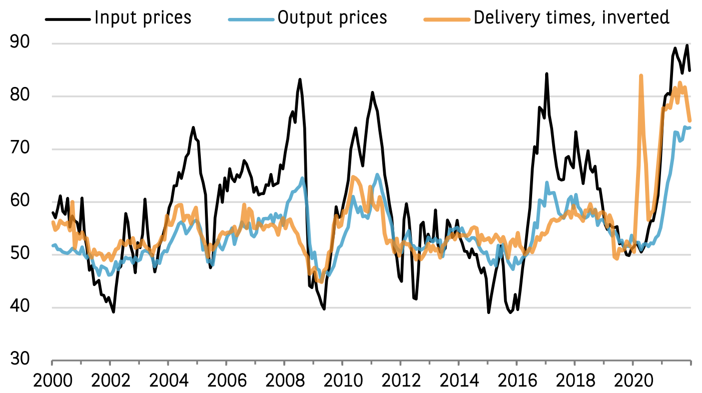

CHART 4 SOURCE: IHS MARKIT, BNP PARIBAS

6. Bank of Japan, Statement on monetary policy, 17 December 2021.
7. For the Federal Reserve, this target is part of the flexible average inflation targeting approach.
8. ECB, Monetary policy statement and press conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, 16 December 2021