Changing Direction

Much of the market's attention over recent months has been centred on monetary policy and specifically on when some of the main central banks may start to reverse course. This follows their comprehensive provision of monetary stimulus over the last 18 months to help their respective economies deal with the economic fallout from the Covid-19 pandemic. These measures included rate cuts as well as enormous quantitative easing programmes.

The central bank's policy discussions have been set against a backdrop of a quicker than expected economic rebound. These deliberations though have been complicated by the fact that the spike higher in inflation looks likely to persist for longer than previously envisaged, while at the same time, the downside risks to the economic outlook have increased. However, over the coming days, we are likely to see some significant announcements on the central bank front.

First up, will be the US Federal Reserve on Wednesday evening. At its last meeting in September, Fed Chair Powell gave clear guidance that if the recovery in the economy continues broadly as expected then a decision on slowing its pace of monthly QE purchases would be forthcoming at this month's meeting.

While tapering is not in itself a tightening of policy, it does represent a step towards that policy stance. The subsequent release of the minutes from the September meeting showed that purchases could be initially scaled back by $15bn per month. Since that meeting, while incoming US macro data has tended to disappoint versus expectations, there has been no indication from speeches given by various Fed members, including Chair Powell, of any change to this timeline.

Therefore, with the Fed widely expected this week to announce the start of tapering, the focus will be on the meeting statement and press conference for any update to its view on the interest rate outlook. The most recent set of interest rate projections from the Fed, released in September, showed a continuation of the trend in the central bank turning more hawkish on rates, with half of its Committee now anticipating that rates may have to rise next year. The market is currently pricing in the possibility of official US rates starting to rise around the midpoint of 2022.

However, it may be the Bank of England meeting on Thursday that steals the central bank limelight this week. The mood on Threadneedle Street has turned decidedly more hawkish recently. This has been evident in a number of comments from Governor Bailey where he stated the Bank will "have to act" to curb rising inflation.

This has heightened market speculation that the BoE will hike rates before the end of the year. Indeed, futures contracts are pricing in the possibility of UK rates rising by around 40bps by year end and further rate increases are envisaged next year. The release of the November Monetary Policy Report will give a more detailed insight into the BoE's current thinking on the economic and inflation outlook for the UK economy.

In contrast, given last week's update from the latest ECB policy meeting, it seems likely that the ECB will lag behind both the BoE and Fed in terms of the timing of rate increases. Indeed, ECB President Lagarde stated on a number of occasions during the post meeting press conference that the current market expectation that official Eurozone rates could be hiked before the end of 2022 are inconsistent with the ECB's outlook.

Oliver Mangan
Chief Economist,
AIB

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