



## ***Tightening the tap, but no rate hikes***

Much of the market's focus over the summer has been on when the US Federal Reserve will make an announcement about beginning to taper or scale back asset purchases under its QE programme. We are certainly getting closer to an announcement, but it looks as if the ECB will beat the Fed to the draw at its upcoming Governing Council meeting on Thursday.

A number of ECB Board members have signaled over the past week that given the improvement in economic and financing conditions in the Eurozone, a reduction in the pace of asset purchases may be announced at the meeting. In this regard, new economic projections for the meeting are likely to see upgrades to the ECB's inflation and growth forecasts.

The tapering is expected to take effect in the fourth quarter, but it should be modest. The pace of purchases will possibly be scaled back from €80bn to €60bn per month, the same amount as in the first quarter of the year. At the press conference, President Lagarde will likely continue to strike a dovish tone, noting that the rowing back of purchases should be seen as a tweak to what is still very accommodative monetary policy.

It can be expected that the ECB will emphasise that financing conditions remain very favourable, reflecting still large scale purchases, continuing substantial liquidity support measures and negative interest rates. Assuming the economic recovery proves sustained, a further reduction in purchases, possibly to €40bn per month, could be announced in December, with more tapering announcements likely in 2022.

The ECB is likely to be moving in sync with some other major central banks, as the Bank of England is due to conclude the latest batch of bond purchases under its QE programme around the end of the year, while the Fed is widely expected to start tapering over the winter. As such, the near-term impact on currency markets should be limited, with the main forex pairs remaining within the well-defined trading ranges that have been in place for some time.

The signals on tapering from the ECB have helped the euro recover some ground lost over the summer, but overall, currency movements have been quite limited in recent months. Similarly, Eurozone bond yields have moved upwards again in the past week, reversing some of the fall seen in the summer. However, there is no sign of the core bond markets moving out of their relatively narrow trading ranges of the past couple of years.

A key reason is that, even though the tapering of asset purchases may be about to begin, there is no sign that rate hikes will follow anytime soon, certainly in the Eurozone. ECB rates are not expected to start to be raised until 2024, while in the US, Fed hikes are not seen until early 2023.



In the last cycle, concerns around the tapering of asset purchases by the Fed gave rise to the so called 'taper tantrum' in 2013, when bond yields soared. This was due to fears that reduced Fed asset purchases could cause a collapse in the US bond market, as well as some concerns that rate hikes might also follow. Neither happened.

Markets would appear to have learnt their lesson, while central banks have improved their policy guidance. Tapering can be easily absorbed by markets, which have an abundance of liquidity. The bigger question is when will rates start to rise, and that still seems quite a long way off.

Oliver Mangan  
Chief Economist,  
AIB

\*\*\*\*\*

R:mrk-com/Mlt View/Mkt View2021/.doc

AIB Customer Treasury Services  
DUBLIN / CORK  
aib.ie/fxcentre

Customer Treasury Services NI  
BELFAST  
aibni.co.uk/fxcentre

Customer Treasury Services GB  
LONDON  
aibgb.co.uk/fxcentre

Customer Treasury Services US  
NEW YORK  
aib.ie/fxcentre

This publication is for information purposes and is not an invitation to deal. The information is believed to be reliable but is not guaranteed. Any expressions of opinions are subject to change without notice. This publication is not to be reproduced in whole or in part without prior permission. In the Republic of Ireland it is distributed by Allied Irish Banks, p.l.c. In the UK it is distributed by Allied Irish Banks, plc and Allied Irish Banks (GB). In Northern Ireland it is distributed by First Trust Bank. In the United States of America it is distributed by Allied Irish Banks, plc. Allied Irish Banks, p.l.c. is regulated by the Central Bank of Ireland. Allied Irish Bank (GB) and First Trust Bank are trademarks used under licence by AIB Group (UK) p.l.c. (a wholly owned subsidiary of Allied Irish Banks, p.l.c.), incorporated in Northern Ireland. Registered Office 92 Ann Street, Belfast BT1 3HH. Registered Number NI 018800. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. In the United States of America, Allied Irish Banks, p.l.c., New York Branch, is a branch licensed by the New York State Department of Financial Services. Deposits and other investment products are not FDIC insured, they are not guaranteed by any bank and they may lose value. Please note that telephone calls may be recorded in line with market practice.