Liquidity letter

n°47 I 2nd February 2022

Only the FED is slowing down

Central Banks Week

European Central Bank raises rates by 50bps

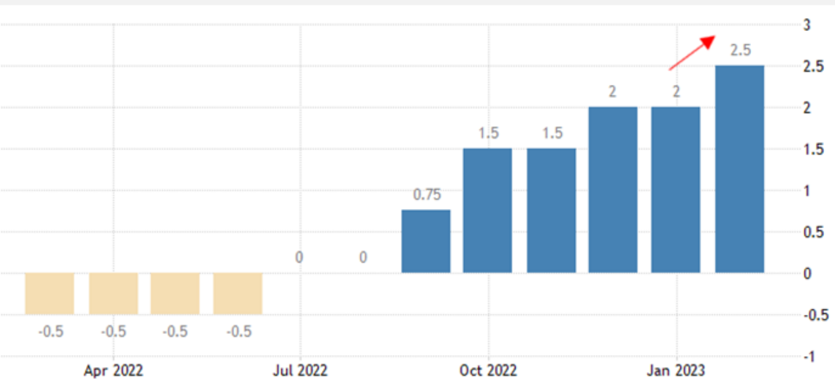
- **ECB** The Governing Council decided to raise the ECB's three key interest rates by 50bps and plans to continue to raise them substantially at a steady pace and to keep them at sufficiently restrictive levels to ensure an early return of inflation to its 2% medium-term objective.
- **50+50** Given the underlying inflationary pressures, the ECB intends to raise interest rates by a further 50bp at the next policy meeting in March and will then assess the future path of its monetary policy.
- **APP** The APP portfolio will be reduced by an average of €15 billion per month from the beginning of March until the end of June 2023, and the pace of these reductions will be adjusted over time
- **Key interest rates** The interest rates on the **main refinancing operations**, the **marginal lending facility** and the **deposit facility** will be increased to **3.00%, 3.25%** and **2.50%** respectively as from 8 February.

Number of the week

8,5%

This is the level of inflation in the Eurozone at the end of January, down from 9.2% last month

Evolution of the ECB deposit facility rate



Following the decision on Thursday 2 February, the ECB raised its rates to their **highest level since 2008**. The **deposit facility rate** will rise to **2.5%** for the first time in 14 years. In total, since July 2022, the ECB has raised rates by **300bp** and plans to raise them again on 16 March by a further 50bp.

Other ECB decisions

The ECB intends to continue reinvesting, in full, the principal repayments of maturing securities acquired under the **APP** at least until the end of February 2023.

15 billion per month on average until the end of June 2023, after which the pace will be adjusted over time.

With regard to the pandemic emergency purchase programme (**PEPP**), the Governing Council intends to reinvest the principal repayments of maturing securities acquired under the programme at least until the end of 2024, while retaining the possibility of adjusting all its instruments, in order to ensure that inflation returns to its medium-term target of 2%.

FED: Interest rates at their highest since 2007, but the pace is slowing

The FED decided on Wednesday to raise interest rates for the seventh consecutive time, this time by only **25 bp**, positioning them in the range of **4.5%** to **4.75%,** slowing the pace of tightening after six larger hikes.

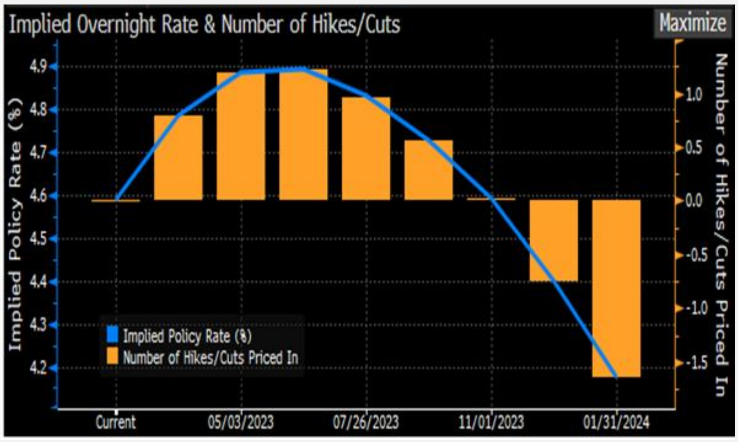
According to the FED, these increases will be appropriate to achieve a sufficiently tight monetary policy stance to bring inflation down to 2% over time. Inflation has fallen slightly, according to the central bank, but remains high.

Jerome Powell said the Fed still has "work to do" and that now is not the time to take a break because it is premature to claim victory over inflation. Central bankers had indicated in December a **final rate** of **5.1%,** but markets are now betting on **4.9%.** Powell said the slower pace of tightening will allow a better understanding of the impact of monetary policy on the economy to better define the next rate hikes and how long they should be kept at high levels.

> *You know, the work is not entirely done... so I think it would be premature... very premature to claim victory*
>
> *Jerome Powell, Chairman Federal Reserve*

FED rate hike expectations: markets target 4.9% max

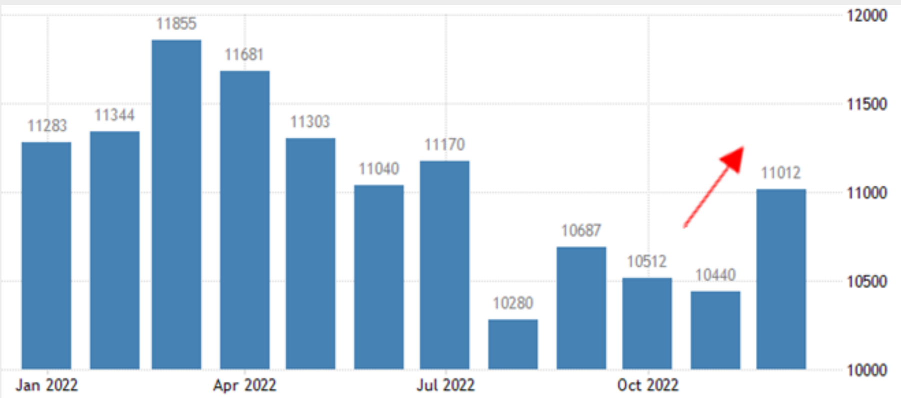
By keeping the commitment to future rate hikes, the FED has pushed back investors' expectations that the current cycle will end soon, despite the steady moderation in inflation over the past few months.
The press release states that future rate hikes would be in 25bp steps and would take into account the economic impact of the measures taken so far.
The institution hopes to be able to continue to bring inflation down to 2% without triggering a deep recession or causing a significant rise in unemployment, which currently stands at 3.5%.



Source Bloomberg

Markets were **uncertain** after the statement was released, but viewed the press conference as rather dovish. The policy-sensitive 2-year yield fell 13bps in the half hour Powell spoke.

Faced with the wide gap between market rate expectations and Fed guidance, Jerome Powell surprisingly displayed a calm, almost blasé attitude. Indeed, the futures markets are expecting rates to fall by around 50bps by the end of 2023, which would leave the policy rate at 4.4%, an outlook that did not budge after the meeting.



Source : US Bureau of Labor Statistics

On the statistical side, job creation in the US increased more than expected in December according to the latest Jolts survey published on Wednesday: 11 million after 10.4 million in November.

This was an unexpected increase considering that market expectations were for a drop to 9.5 million.

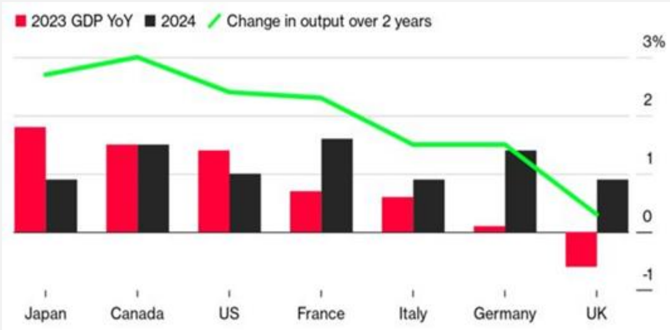
IMF: UK recession expected in 2023

According to the **International Monetary Fund**, the global economy is holding up well despite the difficult times, with the **economic outlook** actually less dark than it was a few months ago. Global GDP is expected to rise to 2.9% (from 3.4% last year) this year and then increase to 3.1% in 2024.

The forecast for 2023 is 0.2% higher than estimated in the autumn, but lower than the historical average (2000-19) of 3.8%. This change is also due to China's new, less restrictive pandemic policies.

"*All the signs are that we are seeing a rapid reopening of the economy, starting with China's, which will have an impact on supply: once the Chinese economy is fully reopened, we will have fewer supply chain disruptions than we had in 2022, with blockages and lock-ups, so we will have an expansion of production on that side*," said Pierre-Olivier Gourinchas, chief economist at the IMF.

UK: the sick man of the developed world



The IMF forecast this week that Britain would be the only G7 country to see its economy contract this year. Its gloomy outlook was published, coincidentally, on the third anniversary of the UK's exit from the EU.

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US | Consumer confidence - Conference Board - down

Agenda

3 February I Consumer Price Index publication for Eurozone

3 February I US unemployment rate publication

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