

Financial markets

A cautious normalisation of American monetary policy

Monetary policies continue to diverge on either side of the Atlantic. On the American side, the Federal Reserve raised its base rate in June 2017 and is expected to do so again following the meeting of its Monetary Committee on 12 and 13 December 2017, reassured by the prospect of American inflation hitting the target of 2% and a buoyant labour market. The Federal Reserve also began reducing its balance sheet in October 2017 and will step up this process progressively over the next 12 months. On the European side, the ECB is extending its quantitative easing until at least September 2018, although it is halving its net security purchases, and has announced that interest rates are to be maintained at their current levels for an extended period “well beyond” the end of the asset purchase programme.

As a whole, the credit market in the Eurozone continues to improve. However, situations vary between European countries. Outstanding loans to the private non-financial sector, businesses and households are rising strongly in France and Germany, but remain stable in Spain. The situation in France is distinctly more dynamic than in its partner countries although the same interest rates apply. After easing credit terms in the last quarter, European banks are expecting to stabilise their terms. The proportion of non-performing loans is declining in all countries.

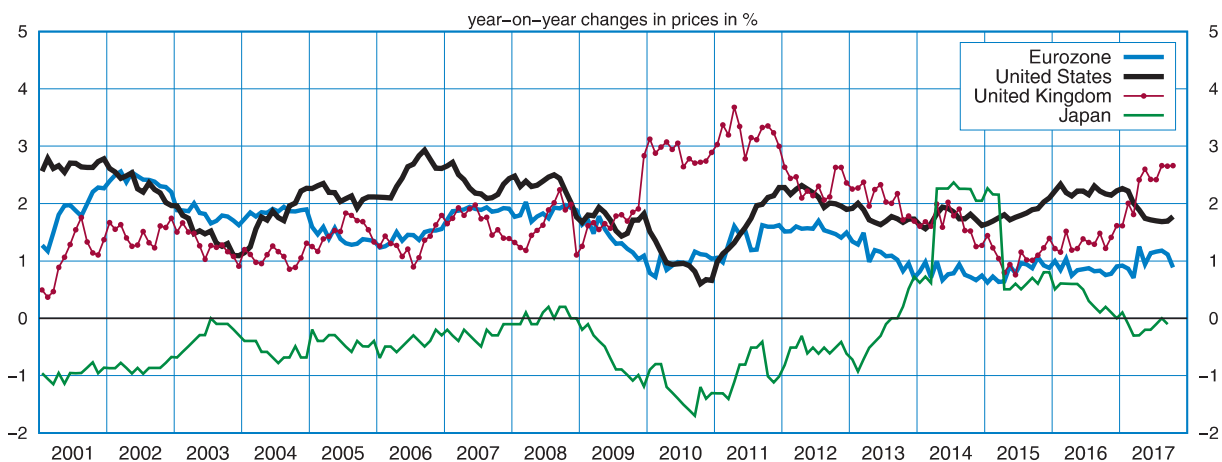
The Euro appreciated against other currencies from January 2017 until September 2017, when it topped \$1.20 due to an improvement in the economic outlook in the Eurozone. Since then, it has stabilised at around \$1.17. Consequently, the real effective exchange rate for French exporters appreciated strongly in Q3 2017. The Euro exchange rate has been set at \$1.17, £0.88 and 130 yen for forecasting purposes.

The Fed cautiously normalises its monetary policy

The Federal Reserve raised its base rate in December and is expected to do so again in 2017. It has also been reducing its balance sheet, amounting to \$4,500 billion, at a rate of \$10 billion per month since October 2017. The rate of this reduction will increase progressively until it reaches \$50 billion per month between now and the end of 2018. The Fed has been encouraged to pursue this policy by the drop in unemployment to 4.1% and dynamic inflation – both headline and core – nearing the target of 2% (Graph 1).

The appointment of Jerome Powell, who takes over from Janet Yellen as the new Chairman of the Federal Reserve, does not seem to indicate a dramatic change in short-term monetary policy.

1 - Core inflation in the world



Sources: Eurostat, BLS, JSB, ONS

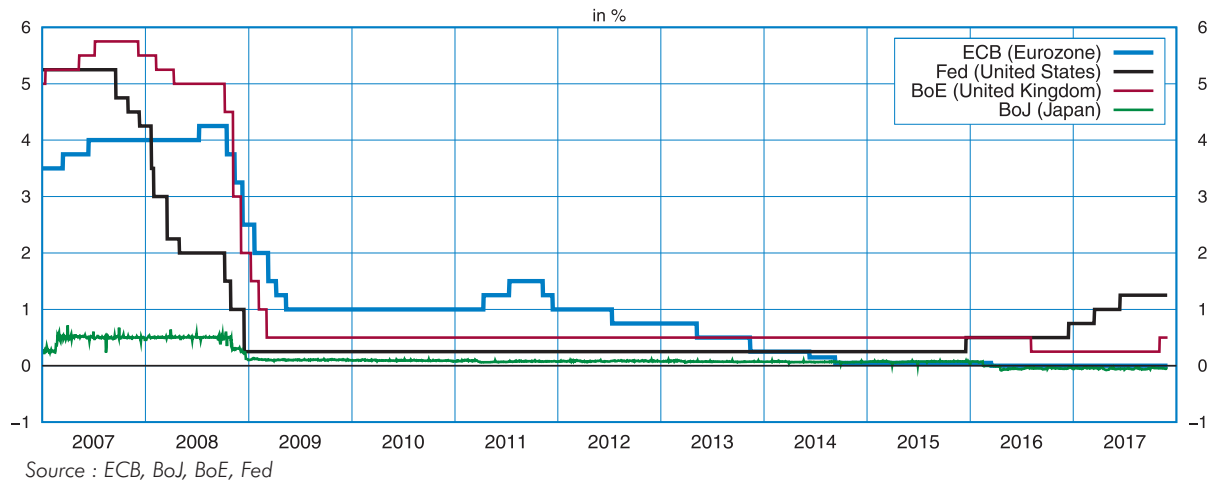
The ECB continues its accommodating monetary policy

In October, meanwhile, the European Central Bank confirmed that it is extending its accommodating policy. Indeed, core inflation remains close to 1% – below the target of 2%. Base rates are maintained at a historically low level: the deposit facility rate has been at –0.40% since March 2016. The Governor of the ECB, Mario Draghi, has announced that the three base rates would remain at their current levels for “an extended period (...) well beyond” the end of the security purchase programme. This programme will be maintained until at least September 2018, at a more moderate rate: €30 billion per month from January 2018, instead of €60 billion up to now.

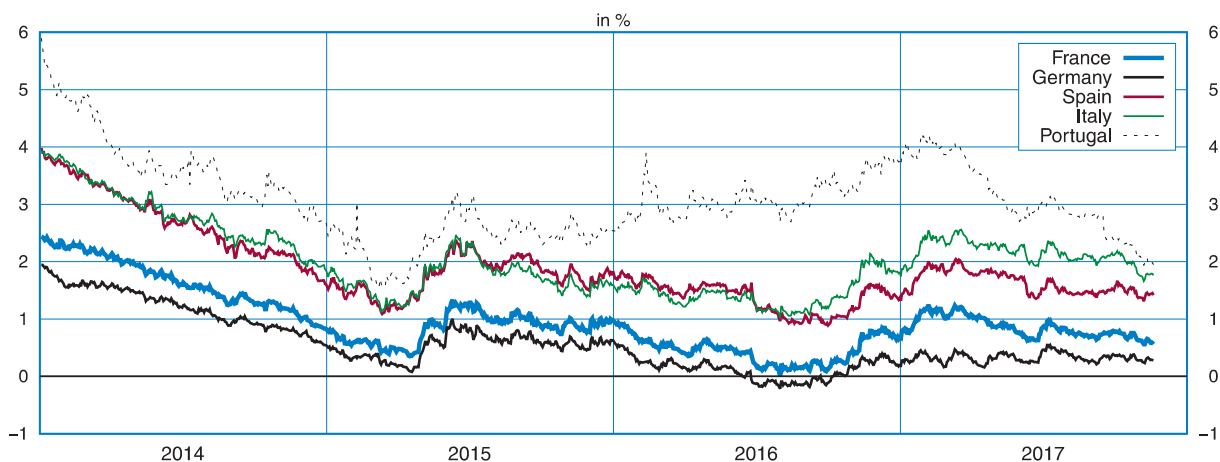
European sovereign yields remain stable

Sovereign yields of the advanced countries remain stable, and do not appear to be affected by uncertainties relating to the political crisis in Catalonia or the Italian elections (*Graph 3*). Spreads are decreasing slightly: the French-German spread fluctuated between 30 and 40 basis points, whereas the Italian-German spread now comes to approximately 140 basis points, against the 200 points recorded in Q1 2017.

2 - Base rates of the main central banks



3 - Ten-year European sovereign yields



International developments

Credit is very buoyant in the Eurozone, and especially in France

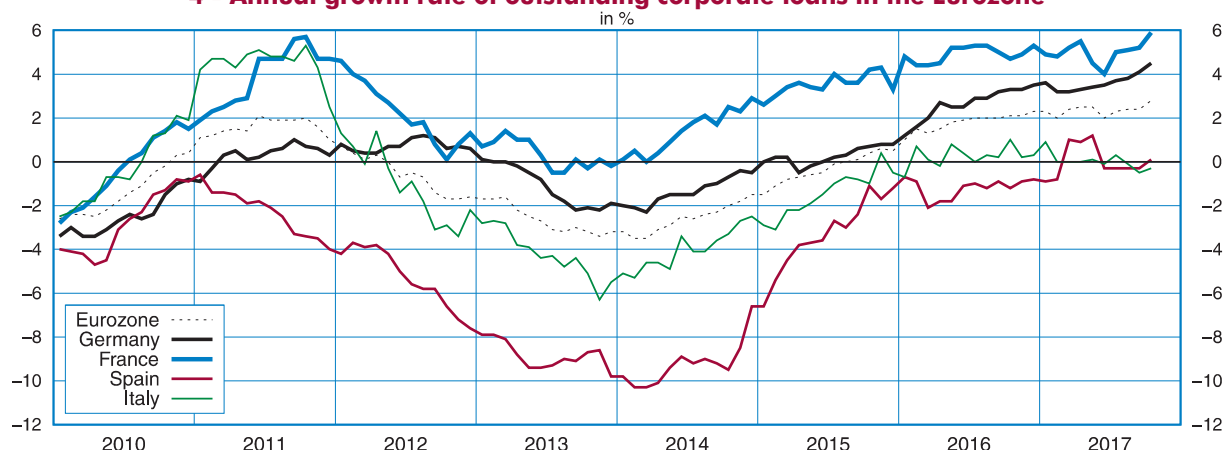
Credit terms continue to improve in the Eurozone as a whole, with disparities between countries. Outstanding loans to non-financial corporations in the Eurozone continue to increase strongly (Graph 4). In October 2017, their year-on-year growth rose to 5.9% in France (cf. *Special Analysis* p. 19) and 4.5% in Germany. However, outstanding corporate loans are stable in Spain (+0.1%) and are declining again in Italy (-0.3%). The interest rates for new loans to non-financial corporations are stabilising in these four countries: they are hovering around 1.5% in Germany, France and Italy and around 2% in Spain.

Regarding lending to households, France stands out from its main European partners with a lower interest rate and much more vigorous outstanding loans: the annual rise in these amounts outstanding reached 5.9% in October 2017 against +2.7% for the Eurozone as a whole. This trend does not seem to be adversely affected by the slight increase in the rates on new loans to households observed throughout the Eurozone.

Stock markets are returning to historically high levels

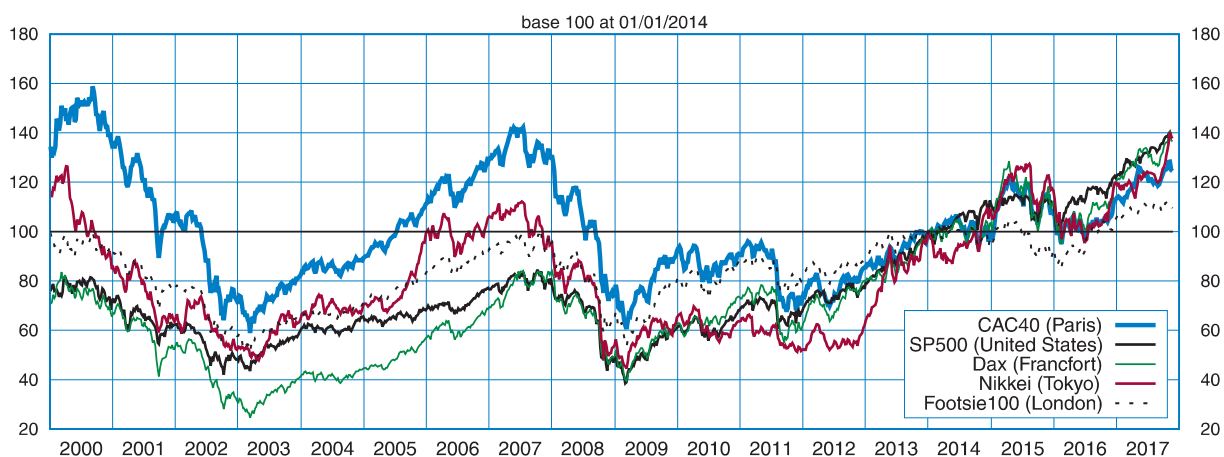
The low interest rates and the favourable economic outlook are pushing stock market indices to historically high levels (Graph 5). In Europe, prices

4 - Annual growth rate of outstanding corporate loans in the Eurozone



Source: European central bank

5 - Stock market indices of the advanced countries



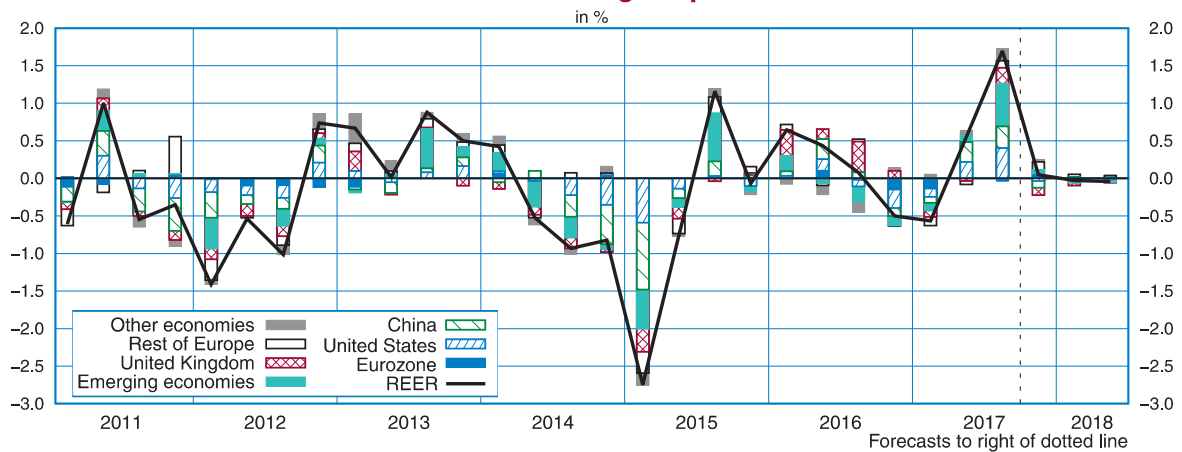
Source: DataInsight

are currently exceeding their peak of early 2008. In the United States, the S&P 500 is now at its highest level since its creation, driven by expectations of a more expansionary fiscal policy and against a backdrop of still-high profits for American enterprises.

The euro appreciated in the summer of 2017

During Q2 and Q3 2017, the euro appreciated significantly against the dollar and the other currencies, driven by favourable economic prospects and by uncertainty over the conduct of American economic policy, which is leading to a significant appreciation of the real effective exchange rate for French exporters (*Graph 6*). By convention, the exchange rate of the euro has been set at £0.88, 130 yen and \$1.17 through to the end of the forecasting period. ■

6 - Quarterly change in real effective exchange rate (REER) of France and its contributing components



Sources: Banque de France, National statistical institutes