# Financial markets

## Central banks ease their monetary policy again

*H1 2019 was marked by an easing of monetary policies on both sides of the Atlantic. The target range for the US Federal Reserve's effective interest rate has dropped by 75 basis points since July, standing at 1.5% to 1.75% in early November. The European Central Bank (ECB) has decided to lower the deposit facility rate to –0.5%, maintain its refinancing rate at 0% and relaunch the quantitative easing policy of buying assets on financial markets.*
*In addition, outstanding loans continue to increase throughout the Eurozone, despite persistent disparities: they are rising sharply in France and Germany but continue to decline in Italy and Spain.*
*In France, outstanding loans grow more than in the other major European partner countries, with lower interest rates for households, in particular.*
*The euro exchange rate forecasts are fixed at 1.11 dollars, 0.87 pound sterling and 120 yens. The real effective exchange rate for French exporters is expected to drop slightly in Q4 2019 and then stabilise over the forecasting period.*

### The US Federal Reserve (Fed) has reduced its base rates and is taking steps to offset the lack of liquidities on the interbank market

The Fed has reduced three times its main base rate by 25 basis points since the end of July. Its upper limit currently stands at 1.75% (*Graph 1*). At the press conference on 30 October, the Fed Chairman pointed out that in light of the good health of the US economy, the institution was not planning to lower its rates again in the coming months. The low levels of unemployment (3.6% in October) and inflation, which remains well below its 2% target (at 1.7% in September 2019), are the main arguments in support of this stable rate outlook.

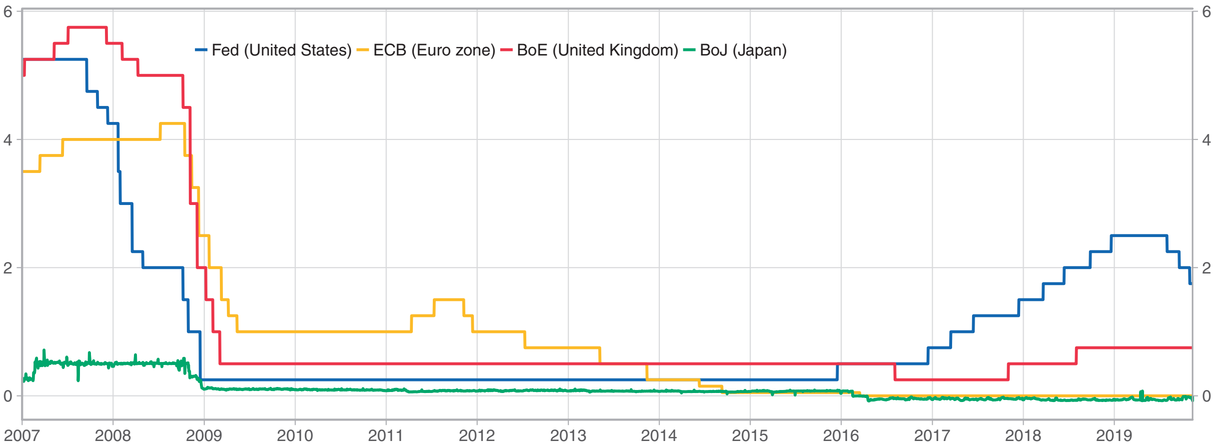
In addition, in mid-September, the US collateralized interbank market suffered a liquidity squeeze when the rate on this market soared from 2.4% to 10% within a few hours. The effective rate briefly exceeded its upper limit set by the Fed, which then intervened to provide the markets with the liquidity they were lacking. As a result, the Fed has resumed an asset-purchasing policy, which has increased the size of its balance sheet again. Since then, it is up this right to make massive short-term asset purchases because the market is still thought to be exposed to risks of occasional shortages.

### The ECB is striving to move closer to its inflation target by intervening directly on financial markets

On 12 September 2019, the ECB decided to reduce the deposit facility rate by 10 basis points to –0.5%, but without changing the other two rates. This measure is intended to further discourage banks from depending liquidity at the ECB.

In addition, on 1st November 2019, the ECB resumed its quantitative easing policy by buying €20 billion of assets per month on the financial markets. The size of the ECB's balance sheet is therefore expected to increase again in the future.

**1 - Base rates of the main central banks**
in %




*Source: Fed, ECB, BoJ, BoE*

The resumption of such a policy can be explained essentially by the fact that inflation (headline and core) remains below the 2% target level in the Eurozone. Indeed, inflation in the Eurozone stood at +1.0% in November and core inflation reached +1.5%.

## US and European sovereign yields have fallen once again since the beginning of the year

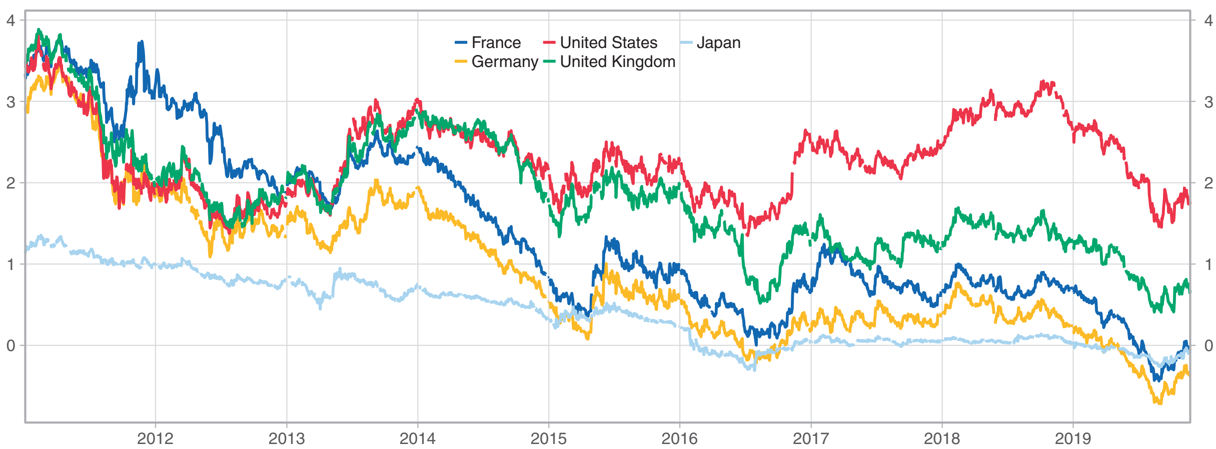
The decline in US and European sovereign yields, observed since January 2019, can be mainly explained by the implementation of a more accommodating monetary policy than expected in the United States (*Graph 2*).

At the same time, the Italian rate has fallen significantly, from an average of 2.5% in April to 1.4% today, which will alleviate the future debt burden weighting on the Italian budget. In addition, the Italian spread, defined as the gap between the Italian and the German 10-year bound yields, has also dropped to 170 basis points (*Graph 3*). This period of calm on the markets appears to be related to the Italian budget proposal in the autumn, in line with European budgetary rules.

## Prospects remain favourable for the credit markets

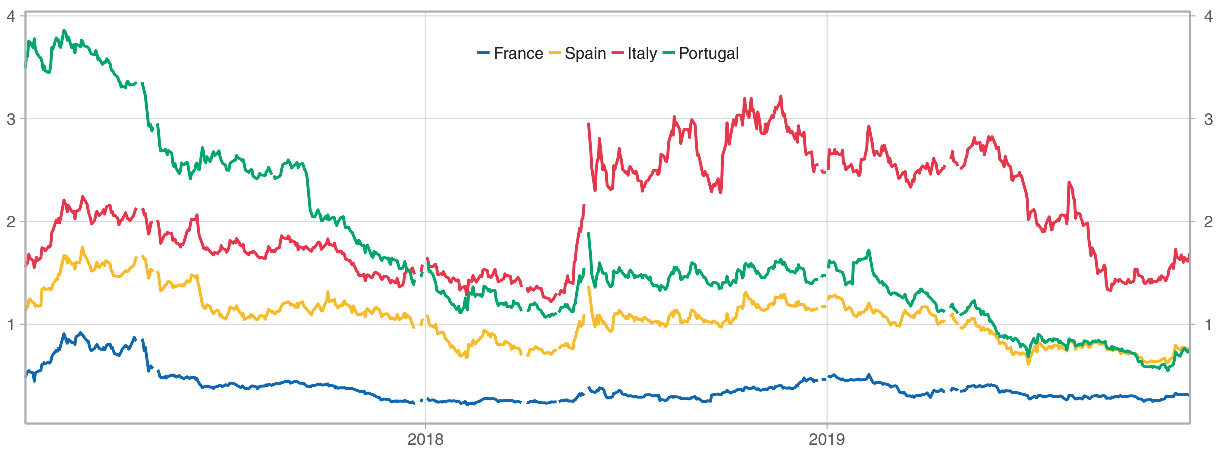
In October 2019, the growth rate of outstanding corporate loans year on year remained buoyant in France (+7.5%) and in Germany (+6.3%, *Graph 4*). Conversely, outstanding corporate loans have continued to fall in Spain (–0.9% in October) and Italy (–1.4%). These variations in outstanding loans are mainly due to the stabilisation of the average interest rate on corporate loans, standing at 1.2% in Germany, 1.4% in France, 1.3% in Italy and 1.7% in Spain. In light of this trend, European banks are anticipating stable credit supply and

**2 - Ten-year interest rates**
in %




*Source: DataInsight*

**3 - 10-year sovereign interest rate differential with the German rate**
in % points




*Source: DataInsight*

demand conditions in the Eurozone in Q4 2019, according to the Bank Lending Survey conducted by the ECB.

In addition, France once again stands out from its main European partners due to the buoyancy of its household credit (+6.3% year on year in October 2019, compared with +3.5% in the Eurozone) and a lower rate for new loans than in the rest of the Eurozone (1.2% in France against 1.4% in the Eurozone in October 2019).

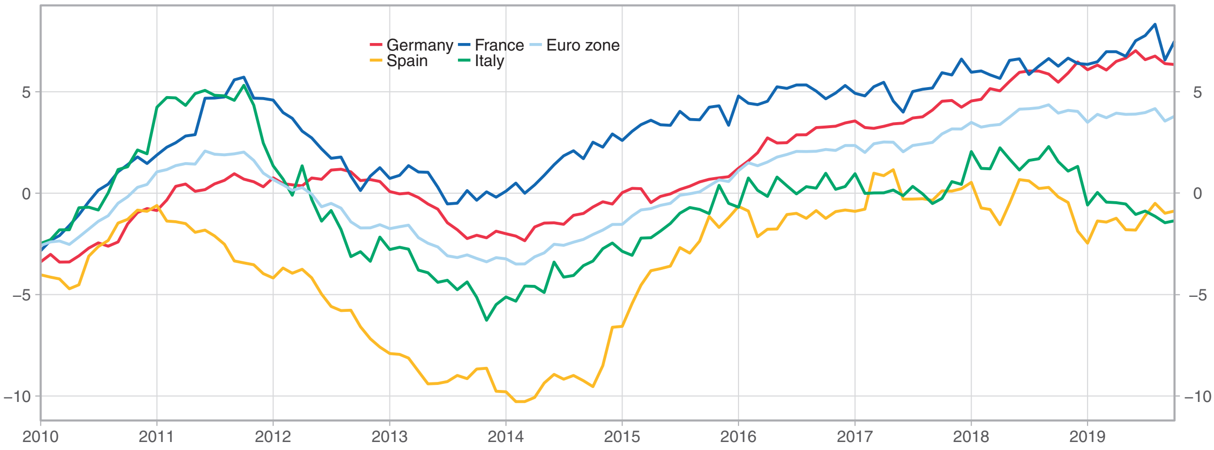
## Increasing stock market indices in all zones

Since the summer, stock market indices have been reacting to bullish factors, including announcements about monetary easing, and conversely, to uncertainties following the Sino-American trade war and Brexit (*Graph 5*).

As for the emerging economies, the Argentine index (Merval) fell back sharply in early August due to pre-election uncertainties, in particular, but has since returned to the level recorded in April. In addition, the sharp depreciation of the peso prompted the central bank to raise its base rates. The other emerging market stock indices have risen significantly since the beginning of the

**4 - Annual growth rate of outstanding business loans to companies in the euro area**

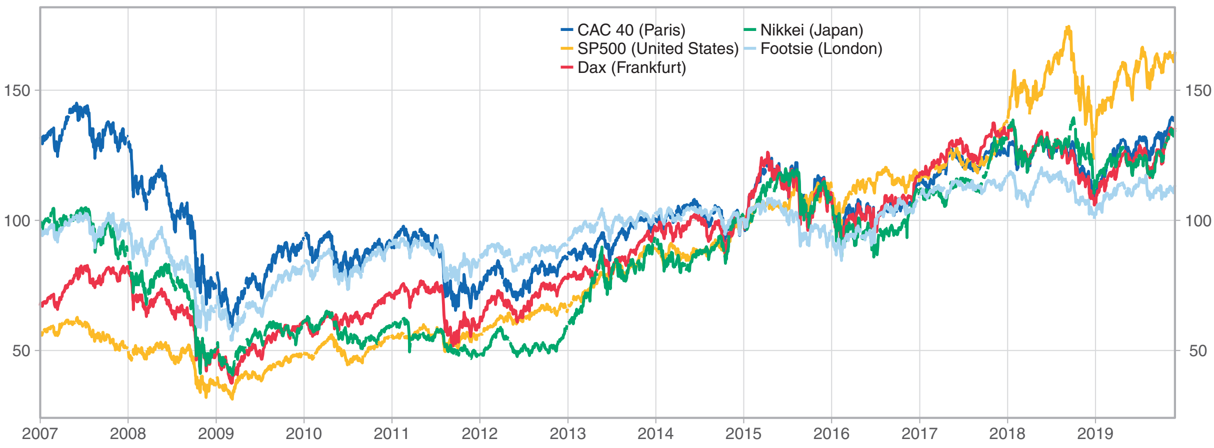
year-on-year changes in %




*Source: ECB*

**5 -Stock market indices of the developed countries**

base 100 at 01/01/2015




*Source: DataInsight*

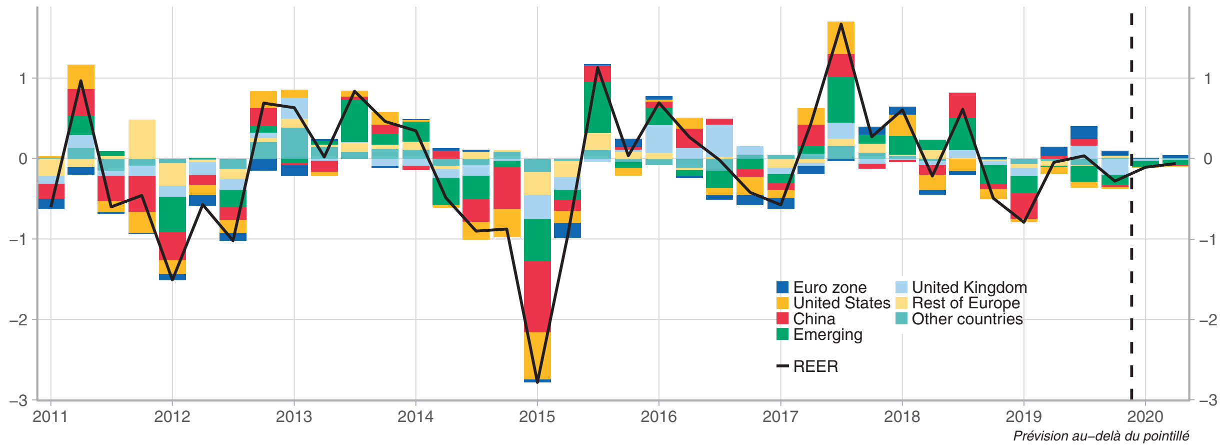
year, with the Chinese index gaining nearly 15%, the Brazilian 25% and the Russian 35%.

## The French real effective exchange rate (REER) stabilised in Q3 2019

After depreciating continuously against the dollar since the beginning of the year – probably due to weaker growth prospects in the euro zone than in the United States – the euro appreciated slightly again to $1.11 in October, which was the level used as the forecasting hypothesis. The pound sterling and the yen remain stable at £0.87 and 120 yens to one euro respectively. After a relatively sluggish Q3, the French real effective exchange rate is expected to depreciate slightly in Q4 (–0.3%) before stabilising again in H1 2020 (–0.1%) in line with the exchange rate hypothesis (*Graph 6*). Overall in 2019, the real effective exchange rate is likely to depreciate by –1.4%, compared with +0.3% in 2018, and with the growth overhang standing at –0.4% in H1 2020. ■

**6 - Real effective exchange rate (REER) in France and its main contributing components**

quarterly changes in percentage points and main contributions in percentage points




*Source : Banque de France, National statistical institutes, INSEE calculations*