

Implications of US Monetary Policy Tightening Expectations for Euro Area Financial Markets

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For small steps, for big steps, for life

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1. Base Case – Gradual Fed Hikes

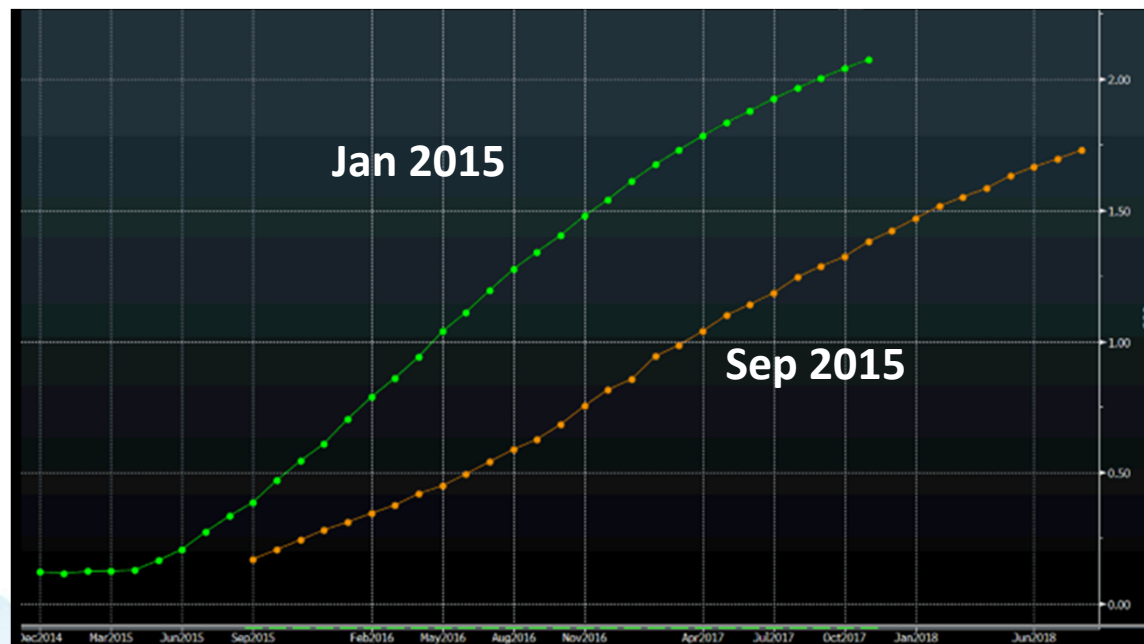
“...moving slowly...strikes me as a prudent approach to take”

Janet Yellen, July 2015

“With inflation low, we can probably remove accommodation at a gradual pace”

Stanley Fischer, Aug 2015

Chart: Fed Funds Path



- Anticipated terminal Fed rates little changed at c.2%
- The market has however re-priced the expected pace of rate hikes

1. Base Case – Marginal Impact on Euro Rates

Chart: Divergence in Rate Expectations



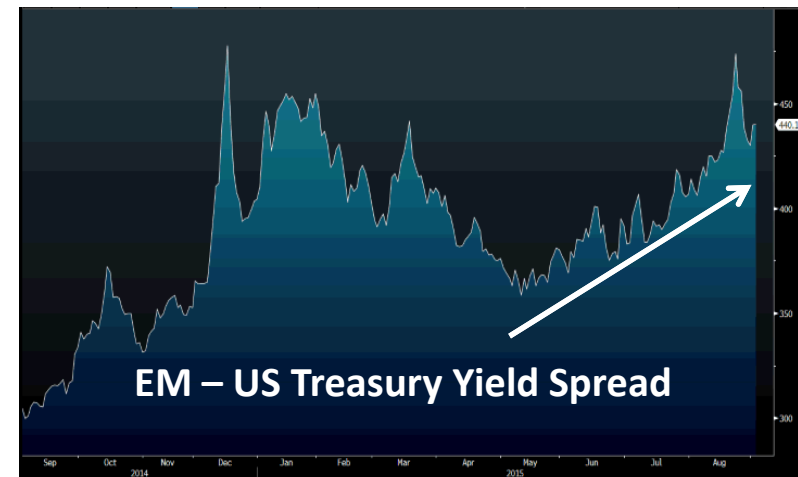
- To date expectations for Fed rate hikes have had limited impact on Euro Money Market rates
- ECB Policy Actions
 - Rate cuts
 - Fixed rate full allotment
 - TLTRO
 - ABS PP
 - Covered Bond PP 3
 - Public Sector PP
- Excess Euro liquidity continues to drive Euro Money Market rates

2. Potential Risk – Negative Market Reaction (EM)

Chart 1: EM Equity Market Sell Off



Chart 2: EM Bond Yields Rise



EM bond index – JP Morgan EMBI Global

Chart 3: EM FX Depreciation



EM FX – Merrill Lynch Global Emerging Markets FX spot

- Could a Fed hike lead to additional EM asset weakness?

“..current developments in emerging market economies have the potential to further affect global growth adversely”

Mario Draghi, Sep 2015

3. Potential Implications of Fed Hike – Europe

Chart 1: Weaker Equity Markets?



Chart 2: Sovereign Spread Widening?

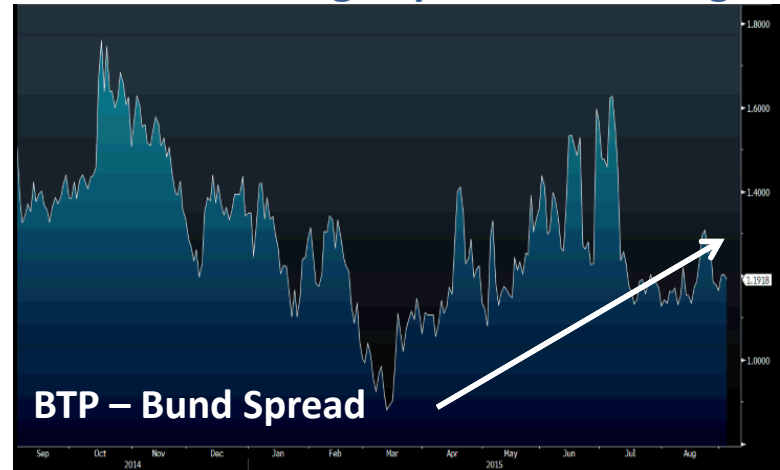
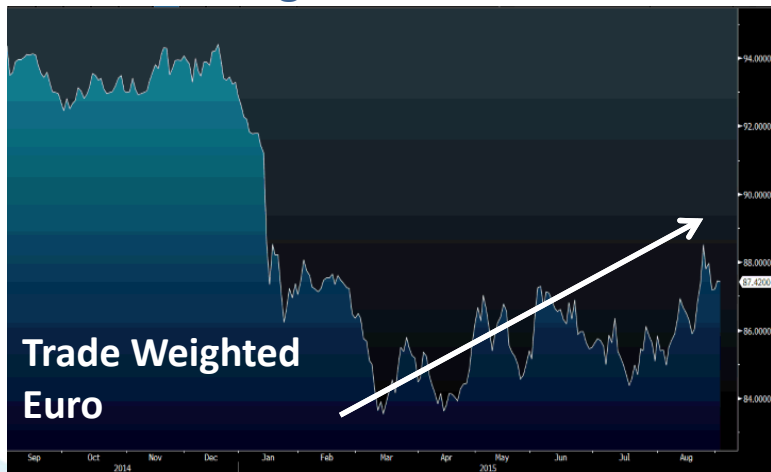


Chart 3: Stronger Euro?



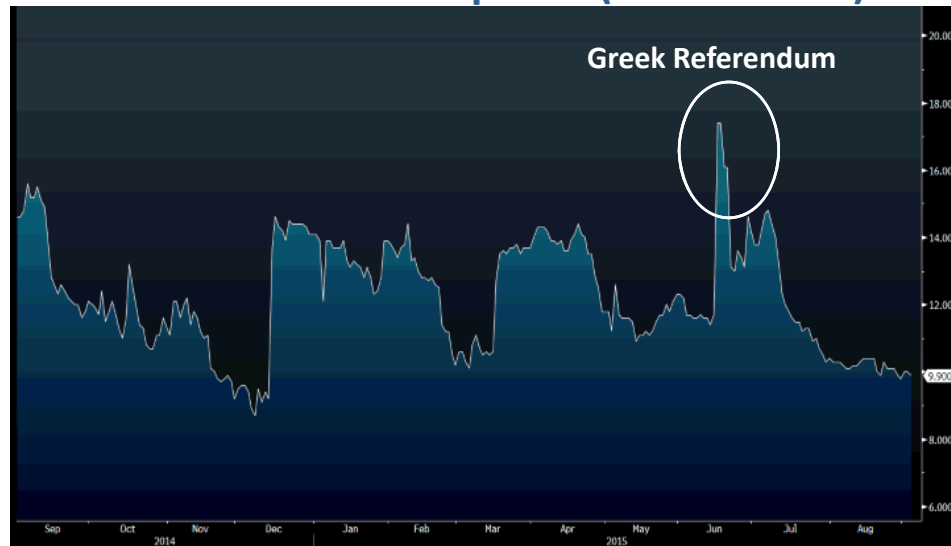
- Could tighter financial conditions impact global growth and investor confidence?
- Would there be an ECB response?

“...we are willing and able to act, if warranted, by using all the instruments available within our mandate”

Mario Draghi, Sep 2015

4. Conclusion

Chart: EURIBOR – OIS Spread (1st Contract)



- Recent market tensions have had little impact on Euro Money Markets

- Euro Money Markets have largely de-coupled from US rate movements
- Base Case: Gradual US rate rises pose little threat
- Risk Case: Recent EM weakness expands into broader crisis, potentially requiring further policy response
- Either Case: **Euro Money Markets continue to operate effectively**



Thank you

Appendix: US Monetary Policy Framework

Chart: US Fed Policy Rates + Market Expectations



Current Stance

- Fed Target Range 0 – 25bps
- RRP 5bps (\$300bn cap)
- IOER 25bps
- Fed Funds Effective c.14bps

Market Expectations

- Fed Target Range 25 – 50bps
- RRP 25bps (temp. unlimited)
- IOER 50bps
- Fed Funds Effective 33 – 40bps
- Timing?

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