
BANKING ON EUROPE

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Last week was central bank week in Europe, as both the European Central Bank (ECB) and the Bank of England (BOE) held policy meetings on the same day. The outcomes of these events did not necessarily break new ground, but the results did offer some guidance for the U.K. and [eurozone](#) bond markets going forward. More specifically, it appears the stage has been set on the [monetary policy](#) front for the remainder of this year and into 2019.

Let's start with the BOE. Following the [rate hike](#) of 25 [basis points \(bps\)](#) at the prior meeting in early August, no changes were implemented this time around. The BOE's asset purchase program remained constant as well. The lack of a follow-up [tightening](#) move was certainly no surprise, as the markets had been expecting this type of result.

What about going forward? For the near term, U.K. policy makers seemed to be slightly more optimistic, revising their third-quarter 2018 [GDP](#) growth estimate upward by 0.1 percentage points. However, looking beyond the here and now and into 2019, the BOE's assessment highlighted greater uncertainty around [Brexit](#), as well as the potential for increased risks coming from trade and the emerging markets (EM). Nevertheless, the current policy stance is still that there is need for ongoing tightening but that any future rate hikes should remain "limited and gradual."

Now for the ECB. Once again, no surprising outcomes here, as the previously announced timeline for continued [tapering](#) and ending new quantitative easing purchases remains in place. The ECB's intention to keep its [balance sheet](#) constant when new purchases end also remains in place and will be achieved by reinvesting any maturing/redeemed proceeds from its investments. In the post-meeting presser, ECB president Mario Draghi stated that policy makers have not yet discussed what this reinvestment strategy will look like. Interestingly, there had been conjecture the ECB would perform its own version of the Federal Reserve's (Fed's) Operation Twist, whereby maturing proceeds would be recycled into longer-dated maturities more than shorter-dated ones, but Draghi mentioned no such discussions have yet to take place. In other words, stay tuned.

Much like the BOE, the ECB acknowledged risks from "protectionism," i.e., trade, and specifically mentioned EM countries Turkey and Argentina. Fiscal policy issues were also highlighted, no doubt in a nod to Italy's ongoing budget saga. The ECB's [inflation](#) estimates were left largely unchanged, but its growth estimates were revised 0.1 percentage points lower for both this year and 2019.

Conclusion

So, where does this leave the U.K. and eurozone fixed income markets? Draghi reiterated the continued need for "significant stimulus" going forward to achieve the ECB's inflation goals, while the BOE seems to be on a slow trajectory for rate hikes, with their own asset purchase program remaining in place. In other words, neither central bank appears to foresee any urgent need to switch policy course any time in the near

future to a more hawkish stance. This point was underscored by the ECB's commitment to keeping rates unchanged at least through the summer of 2019. In such an investment landscape, a spike in yield in either the bund or gilt arenas does not seem likely. Meanwhile, on the other side of the Atlantic, the [Federal Reserve \(Fed\)](#) appears ready to continue leading the charge on the policy normalization front and is widely expected to raise rates on September 26 and then potentially again in December.

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DEFINITIONS

Eurozone (EZ): Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Basis point: 1/100th of 1 percent.

Tighten: a decline in the amount of compensation bond holders require to lend to risky borrowers. When spreads tighten, the market is implying that borrowers pose less risk to lenders.

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Brexit: an abbreviation of "British exit" that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

Tapering: A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

Balance sheet: refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new positions.

Inflation: Characterized by rising price levels.

Federal Reserve: The Federal Reserve System is the central banking system of the United States.