ECB'S BUSINESS ANALYST ON THE EURO, NEGATIVE RATES AND THE INVERTED YIELD CURVE

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Last week on the "Behind the Markets" podcast, Professor Jeremy Siegel from The Wharton School at the University of Pennsylvania and I had the pleasure of speaking with Dr. Diego Rodriguez-Palenzuela, who heads the European Central Bank's (ECB) business analysis division.

Given the recent yield curve inversion, Rodriguez-Palenzuela is keeping a closer eye on the U.S. but believes that the natural or equilibrium rate of interest is low on a global scale and the U.S. is not the only country affected by low natural rates.

Although Europe has negative short-term rates, it doesn't possess a negative term structure, and European economic growth is still significantly lower than that of the U.S. Part of the reason for low growth in Europe is due to external factors such as the low growth in emerging markets and protectionist trade policies.

The yield curve inversion may not be a sign to get overly bearish, and Rodriguez-Palenzuela says the ECB is still confident in the European recovery taking place.

Unlike past guests who see more adverse impacts of a negative interest rate environment, Rodriguez-Palenzuela acknowledged setbacks but noted the upsides of negative rates, including governments that can finance themselves very cheaply—not just safe havens such as Germany but also Spain.

Professor Siegel added that central banks aren't directly responsible for low interest rates, but market forces are. Rodriguez-Palenzuela believes demographics and the global savings glut is also contributing to low rates in addition to the slow global growth.

Rodriguez-Palenzuela finds the relationship between the ECB and EU to be a harbinger for maintaining European unity, despite the initial difficulties that countries faced when joining the EU.

Although Rodriguez-Palenzuela said it is hard to examine counterfactuals of how unity would have *developed without the euro*, what is happening with the United Kingdom trying to leave the European Union is perhaps an indicator that more countries might have left the EU earlier if they had not joined the euro currency union.

Looking ahead, there are still many things the ECB is working to improve upon. Rodriguez-Palenzuela highlighted the fragmented markets and the need to instill unity and integration and allow companies to scale.

Furthermore, he said he is focusing much of his research on inequality gaps caused by technology and the role for monetary policy and collateral when human capital and technology is becoming increasingly important.

Kevin Flanagan, WisdomTree's Head of Fixed Income Strategy, reacted to the discussion with Professor Siegel and noted in many ways that the markets have cut rates for the Federal Reserve (Fed) with a drop in borrowing rates. He also noted the yield curve was barely inverted when comparing it with the 80 and 40 basis point inversions that preceded the last two U.S. recessions. Although a yield curve inversion has been strong indicator of economic deceleration in the past, it shouldn't be seen as a sure sign.

In the last segment of the podcast, Jillian Fornito highlighted her time with the Global Interdependence Center (GIC), an organization that hosts conferences across the world to facilitate dialogue among academics, bank heads and investors to help expand global banking and economic perspectives. WisdomTree is a global sponsor of the GIC, and we have enjoyed talking to many of the speakers from its events on our podcast. We hope to see you at some of the GIC's upcoming events.

Please listen to the full conversation below.

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DEFINITIONS

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

Short-term rates : the rate of interest on a debt instrument maturing in two years or less.

Bear market : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

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.

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

Basis point : 1/100th of 1 percent.