# Another form of independence for central banks

## 13 May 2024

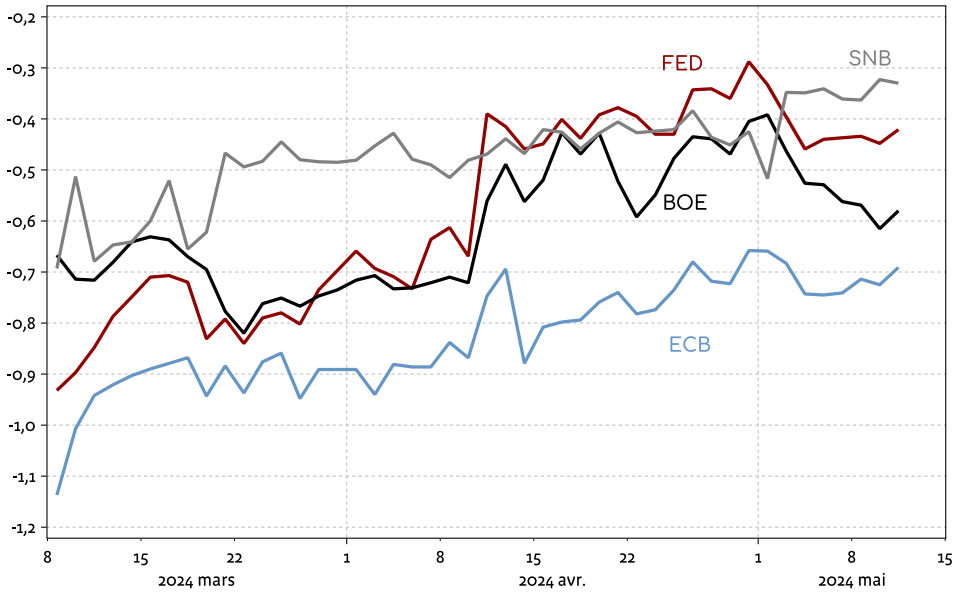
Dear Clients and Partners,

Europe's main central banks have either started to cut rates or implied that they will do so this summer. Meanwhile, the US Federal Reserve (the Fed) has shelved any impulse that it may have had to relax monetary policy. What does this divergence mean for our globalised financial markets where the dollar reigns supreme?

Following in the footsteps of the SNB (Swiss National Bank), which cut its key rates by 25 bp to 1.5% on 21 March, Sweden's Riksbank cut its rates by 25 bp to 3.75% on 8 May. That same week, the BoE (Bank of England) left its rates unchanged at 5.25%, but two of its nine MPC (Monetary Policy Committee) members had voted in favour of a 25-bp cut. Everything seems to point to an imminent BoE rate cut this summer, which could arrive as early as its meeting on 20 June. The ECB is also widely expected to lower rates at its Governing Council meeting on 6 June. By contrast, at its meeting on 1 May, the Fed made the prospect of a reduction in its key rates seem more remote than before (cf. chart 1).

Expected trajectory of short-term rates between now and December 2024

Evolution anticipée des taux courts d'ici décembre 2024

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For investors in globalised financial markets where the dollar reigns supreme, all eyes are on the Fed. In the literature on the global financial cycle – popularised by the work of French Economist Hélène Rey – this phenomenon has been the focus of much scrutiny. The global financial cycle accounts for 25% of the changes in asset prices (equity, credit etc.). The Fed is at the heart of this cycle; it is the source of "waves" that spread to the global markets. In fact, these effects seem so pronounced that some even question the ability of other central banks to control their domestic monetary conditions regardless of whether they have floating exchange rates. After all, if US monetary policy determines the financial conditions of each country, what, then, is the role of an independent central bank? It may be independent of its own government, but it is not independent of the decisions of the Fed.

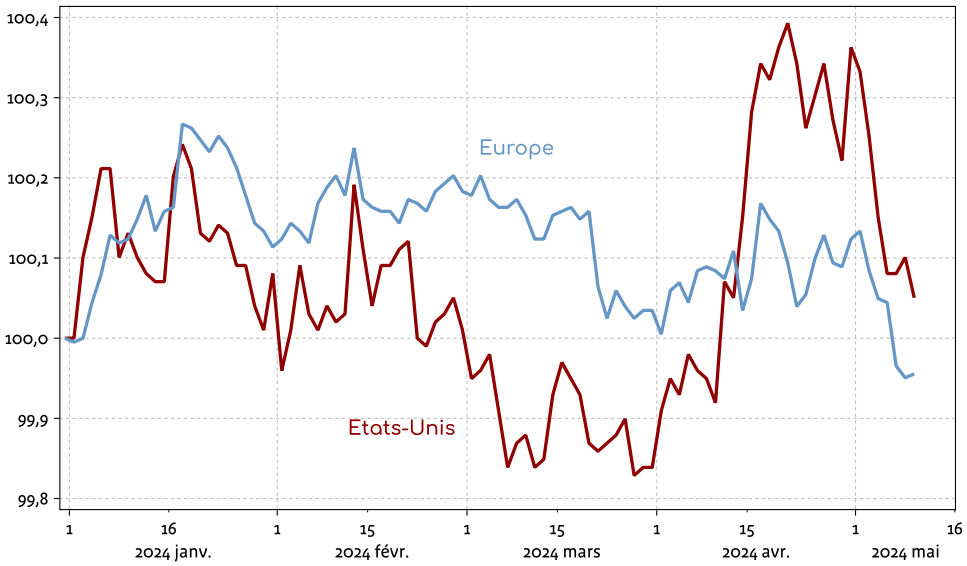
However, a careful analysis of recent events suggests that this reading requires qualification. For there nevertheless seems to be sufficient room for manoeuvre for European and US financial conditions to decouple. Indeed, this is what we have seen since April (cf. chart 2).

**The decoupling of European and US financial conditions**

The Goldman Sachs Financial Conditions Index

**Découplage des conditions financières européennes et américaines**

Indicateur des conditions financières de Goldman Sachs

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- *Europe / United States*

In times of stress, however, when investors' risk aversion skyrockets, the global cycle takes over again and there is, in reality, only one global financial market.

For now, the monetary tensions coming from the US are partly offset by the rhetoric and actions of Europe's central banks. This decoupling of financial conditions has been possible because it is taking place in a macroeconomic context of stable growth and moderate inflation. Over the coming weeks, macroeconomic publications will need to be inspected to check that they corroborate this scenario.

Our exposure rates are as follows:

- **Dorval Convictions:** The equity exposure rate is 65%.

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