Lessons from the Fed

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An orderly, gradual and well communicated withdrawal - this is the message we hear most as regards the process of normalising monetary policies. And it is also one of the conclusions we draw from the ECB's latest press conference held last Thursday in Frankfurt.

Without doubt, the improvement in the economic panorama in the major developed economies is laying the groundwork for a withdrawal of monetary stimulus measures. From the United States, the Federal Reserve (Fed) is leading the process of withdrawal, firstly by very gradually reducing the asset purchasing programme and secondly by raising interest rates after a considerable time (nearly a year). With the unemployment rate at 4.7% and inflation close to target, the Fed has already raised its key interest rates for the third time in a row, to 1%, and envisages two more hikes in the remainder of the year. Comparing this process with earlier rate-raising cycles makes it abundantly clear that this is a very gradual withdrawal.

However the Fed still has to tackle another challenge in its exit strategy: managing the timing and pace of its balance sheet reduction, the balance sheet having quadrupled on average as a result of the large-scale purchases of public and private sector assets. The debate on the reduction of the balance sheet is already on the table, although it will probably not be implemented until next year, and here too, caution is the watchword. As regards "how" to exit, the sequence of normalisation measures is very important, and the Fed's sequence (first ending the bond purchasing programme, then raising interest rates and shrinking the balance sheet) is considered the "guide" for other central banks.

In the euro zone, the ECB is signalling that it will follow the same sequence. As regards "when" to exit, the ECB considers that it is still too soon to start withdrawing stimuli. Signs that inflation will converge steadily with the target are still insufficient, so care must be taken not to place too much strain on financial conditions. That said, if the economic recovery holds course and inflation (particularly core inflation) moves close to the target, sooner or later this debate will be with us. It is very important for the central bank to pay the closest attention to its policy of communication on this point. Here too we can learn something from the Fed, specifically from the unexpected impact of the premature announcement of the end of the bond purchasing programme in the spring of 2013 (the famous "taper tantrum" episode).