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Capital Management

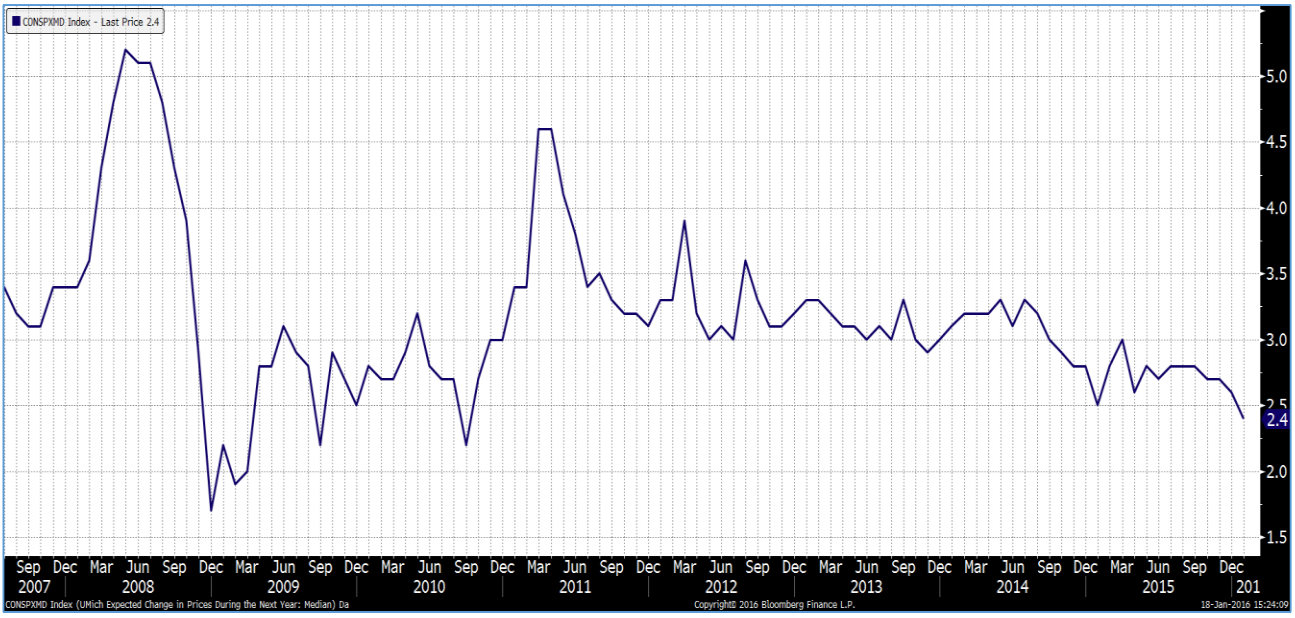
Central Banks Likely to Attempt to Reassure Markets over the next two weeks

Major central banks and market participants have not been on the same page in recent weeks. ECB and Bank of Japan policy adjustments in December were not well received and this month Fed vice Chairman Stanley Fischer's comment that expectations for four increases in fed funds in 2016 were 'in the ballpark' is clearly at odds with market participants view of the world. In addition, heavy handed policy actions by the Chinese authorities have resulted in a loss of confidence in their capacity to manage affairs and hurt sentiment globally.

One evident divergence in emphasis is around the consequences of the collapse in commodity prices, particularly energy. Policymakers, particularly in the US, have placed greater emphasis on the transitory effect on inflation and medium term growth benefits of weaker energy prices. Janet Yellen has often referred to it as a 'net positive'. Markets are more focussed on the carnage today in the oil, gas and mining sectors and the savage about turn in the terms of trade for commodity exporting economies. Talk of 'four rate increases' in that context is not what investors want to hear. Janet Yellen may be ultimately correct but in the meantime the energy price sell off and its effect on sentiment and financial conditions is creating its own reality.

The ECB's governing council meets this week, followed next week by the FOMC and Bank of Japan. We expect the central banks to attempt to reassure markets emphasising heightened growth risks and dis-inflationary pressures. Markets need central bank reassurance right now or the trends evident to date in 2016 will continue.

University of Michigan 1 Year Inflation Expectations



Source: Bloomberg

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