

Research

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Central banks are no longer relevant

- **Today's ECB meeting will be another boring hold.** And that speaks volumes of central banks losing their relevance in a world where geopolitics, mercantilism, and realpolitik rule the roost. We see it in the US, where the Trump administration wants to have an 'independent' central bank do its bidding. President Trump's economic advisor and trade policy architect Stephen Miran being nominated to the Fed Board of Governors is a case in point.
- **Miran will likely be catapulted to the Board just in time before next week's FOMC meeting.** His term, unless extended, will be unusually short: until year-end. His sole purpose is to push for a string of rate cuts. At the same time, candidates for Fed Chair are auditioning live on TV, punting for jumbo rate cuts in hopes of winning the favor of the ever so mercurial Trump.
- **The irony is that rate cuts are justified, given the cumulative weakening of the US labor market.** While US real rates have eased, monetary policy is still tight, with the overnight rate the highest point on the yield curve except for the 30y Treasury yield. Without easing, the wheels will come off of the US labor market for sure, and we'll end up in a recession. Underlying inflation, which is currently running at two and a half to three percent, could easily fall below target. That would not be just a failure of monetary policy, but it could very well truly spell the end of the Fed's independence. Imagine Trump's wrath when inflation is below target and unemployment is rising.
- **At the same time, cutting rates further with inflation stuck above target (core inflation is just below three percent) is equally problematic.** At best, the Fed can hope and pray that inflation slowly glides towards target as it gradually takes its foot off the brake pedal. More likely than not, it will stay above target.
- **In such an environment, with the Fed's mandates of price stability and maximum employment in conflict, and with its independence eroding, cutting rates is the archetypical case of damn if you do, damn if you don't.** I really wouldn't want to be in Chairman Powell's shoes right now.
- **That's just the Fed's existential crisis.** This is about the ECB, right? The ECB doesn't have to deal with messy politics. There are no headlines about politicians calling on the ECB to cut rates or to buy bonds or cap yields. There's only an utterly toothless EU Parliament and an EU Commission that is by definition sympathetic. More importantly, leading politicians in the member states strangely avoid even talking about the ECB. Almost as if there is an omerta on not opening Pandora's box.
- **Critics of the ECB will argue that the central bank has long lost to fiscal dominance.** Under the TPI, or Transmission Protection Instrument, the ECB can

basically buy sovereign debt on the fly. Yes, member states must pay lip service to debt sustainability and fiscal rules. But EU fiscal rules have been watered down – and inevitably so as they had been breached so often. They can be suspended when convenient. I am thinking about a crisis with Russia, a known unknown. The Polish incident on Wednesday was just the beginning of a new Russian pressure campaign that invoked a predictably feeble and impotent Western response. If we move up the escalation ladder, will the ECB stand aside if, for example, France is under attack in the bond market? Perhaps it better not stand aside.

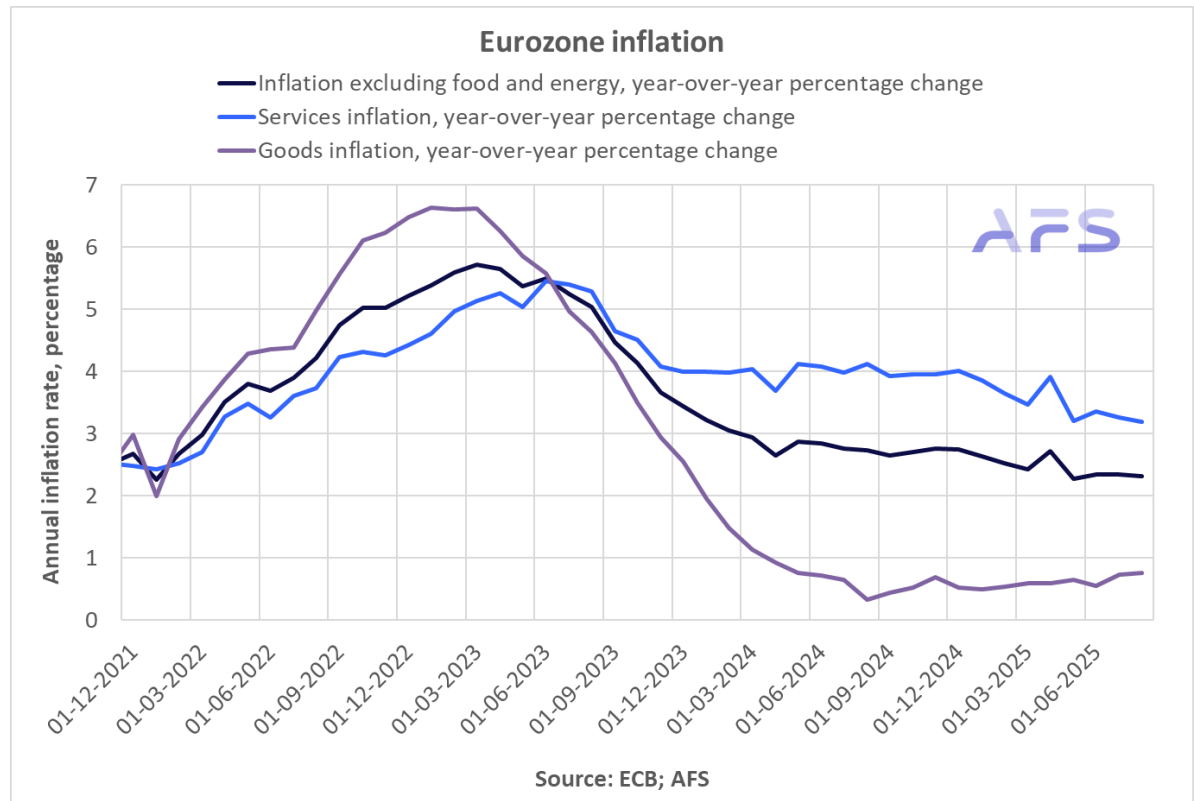
- **This world is oh so different compared to my formative years: the early 2010s.** This was the time when the ECB President wrote letters to the leaders of governments demanding austerity measures and supply side policies (selling state monopolies, breaking unions and cutting and gutting labor market protections) in exchange for bond buying and lending to liquidity-starved banks. I remember the Eurozone crisis and its main characters: Finance Ministers and central bankers (where are they now?). For much of the decade, we were hanging to every word coming out of former ECB President Draghi's mouth. That was captured oh so well by the graffiti on the ECB's premise, when the ivory tower was still under construction:



- **I want to conclude with a few words on today's meeting, which is not important at all as you may have noticed.** The ECB will hold rates for a second consecutive meeting. And President Lagarde's message will be tilted hawkish again, with a very high bar for another cut despite lousy growth and headline inflation at target. As a matter of fact, during the last press conference Lagarde revealed her preference for a hike as the next step. I would call that day-dreaming at this stage, but still. The thinking of the majority on the Governing Council is that rising government spending on defense and infrastructure in 2026 and beyond will boost growth and thus prevent inflation from falling below target. Doves on the Council are still holding out for the possibility of another cut, but their attempts to push the ECB in a dovish direction have been

remarkably impotent. Still, doves' resistance to the hawkish narrative has kept the forward curve inverted. But the majority on the Governing Council has no appetite for a cut: not today, not next month, and not in December.

- **The ECB, like the Fed, has problems with the data in the sense that they pull in the opposite direction.** You see, the ECB might be harping on about how it got inflation at target without triggering a recession. I would counter by pointing out two things. We might have avoided a recession, but trend real GDP growth is now less than a percent – a very, very lousy rate of growth. Furthermore, the dirty secret is that core inflation is bottoming out above two percent. Goods inflation has picked up, offsetting further easing in services inflation:



- **Granted, we're trending at 2.3 percent – certainly not a terrible number – but I think it's premature for the ECB to be victorious about having defeated inflation. We're at target when we're at target.**

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