

▲ ▲ ▲

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <http://www.djreprints.com>.

<https://www.wsj.com/articles/why-monetary-policy-isnt-the-only-game-in-town-anymore-1503318970>

HEARD ON THE STREET

Why Monetary Policy Isn't the Only Game in Town Anymore

The cumulative weight and persistence of central bankers' efforts may finally be paying off

Federal Reserve Chairwoman Janet Yellen and European Central Bank President Mario Draghi. The big question is whether economies that are gaining resilience still need so much central bank support. PHOTO: KAZUHIRO NOGI/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Richard Barley

Aug. 21, 2017 8:36 a.m. ET

The Jackson Hole gathering of central bankers of recent years has been an opportunity for policy makers to pledge extraordinary support for economies, in particular via quantitative easing. But this year looks different. As Janet Yellen and Mario Draghi prepare for this week's event, persistence looks like it is paying off.

The big question is whether economies that are gaining resilience still need such large amounts of central bank support, and whether monetary stimulus is pushing risky markets up too far. That is balanced against inflation, which is still proving softer than policy makers would like in both the U.S. and the eurozone, but may be providing false comfort to markets.

Recent communications from both the Federal Reserve and the European Central Bank hint at this. In the U.S., the Fed minutes last week noted continued easy financial

conditions despite the gradual rise in rates that the Federal Open Market Committee

Easy Street

Chicago Fed National Financial Conditions Index



Note: Positive values show financial conditions tighter than average, negative values looser than average

Source: Federal Reserve Bank of Chicago

THE WALL STREET JOURNAL

has put in train. One argument is that if other factors in markets are offsetting the Fed's actions, then tighter monetary policy might be warranted: the central bank has more room for maneuver.

In Europe, meanwhile, the account of the ECB's July meeting included a reference to the idea that a

broader and more self-sustaining recovery is less dependent on monetary policy—a new strand of thought in Frankfurt this year.

These issues run through both financial markets and the economy. In effect, a stronger growth and inflation picture compared with previous years means that still-loose monetary policy may be providing more stimulus and getting more traction: central bankers are getting a bigger bang for their buck.

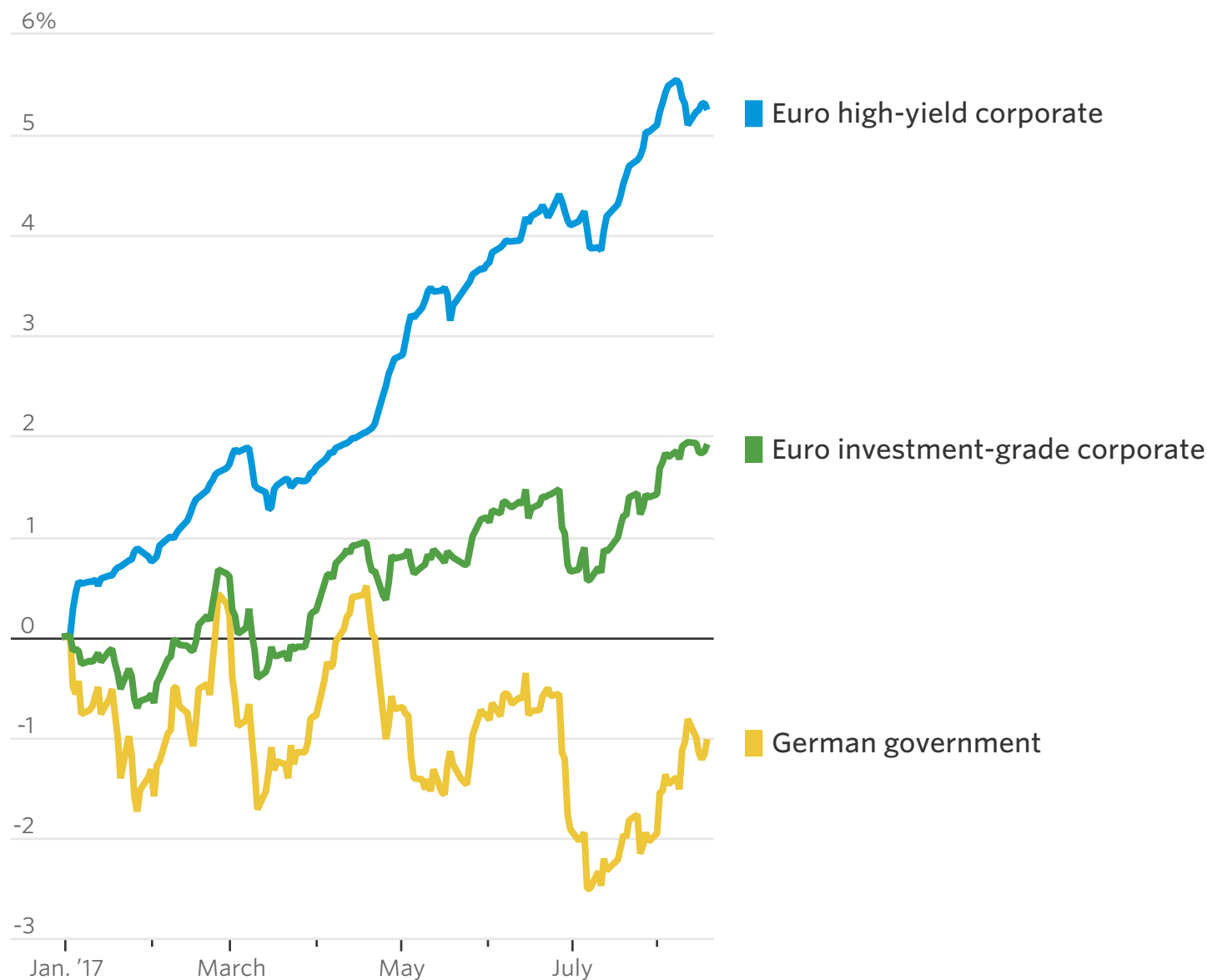
Europe is the test case. The ECB's policy settings are still at emergency levels, with a negative deposit rate and bond purchases running at €60 billion (\$70.5 billion) a month. But slack is being used up, with unemployment falling. Eurozone capacity utilization has picked up to a level not seen since before the global financial crisis, and the

European Commission's business survey has shown an uptick in companies citing equipment and labor as factors limiting production.

Meanwhile, negative rates may be growing more effective in spurring risk-taking. That is because for as long as interest rates were falling, investors could generate strong returns from risk-free assets such as government bonds. But that process likely came to an end last year. Total returns on German bunds this year are negative; returns on investment-grade and high-yield corporate bonds are positive, however. The stick of negative rates is being coupled with the carrot of a brighter outlook. That gives investors

Yield Hunt

Total returns on Bank of America Merrill Lynch bond indexes



Source: FactSet

THE WALL STREET JOURNAL

more reason to take risk, not less—although risky assets are already expensive.

True, still-sluggish inflation will deter central banks from acting too aggressively. But the policy debate isn't about stamping on the brakes: it is about easing on the accelerator. This year's Jackson Hole event comes

against a backdrop of continued central-bank largess, but markets need to think about policy makers doing less, and soon.

Write to Richard Barley at richard.barley@wsj.com

Business Building

Capacity utilization in the eurozone



Source: FactSet

THE WALL STREET JOURNAL