Focus

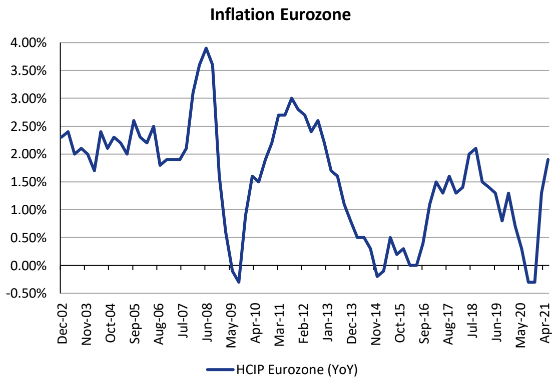
The European Central Bank (ECB) increased its inflation target in July to around 2.0%, but also left room for a higher inflation if necessary. The new target would be a significant change from the previous inflation target of 'below, but close to, 2% over the medium term'. The ECB's change of course has resulted in criticism on the central bank's independence. What will change with this decision of the ECB? And how unexpected has the decision been?

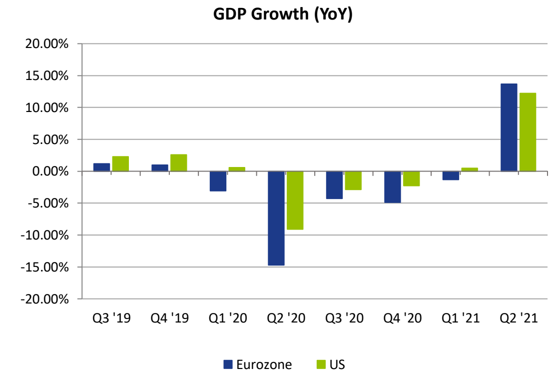
The ECB last revised its inflation target in 2003. Where previously an inflation of 'below 2.0%' was targeted, in 2003 the ECB decided to pursue a rate of 'below, but close to 2.0%'. ECB President Christine Lagarde argued that this target was too vague and 'sometimes gave the impression that a ceiling was being imposed on inflation, leading to lower inflation expectations'. The new strategy allows the ECB to keep interest rates very low for a longer period, as inflation is now permitted to temporarily exceed 2.0%. The new decision marks a significant shift in the central bank's tactics. With this new policy as a guideline, the central bank will have to take fewer actions if the economy resurges when the pandemic is over. The previous strategy was to act when inflation was threatening to go beyond 2.0%. In practice, this meant that the ECB increased the policy interest rate.

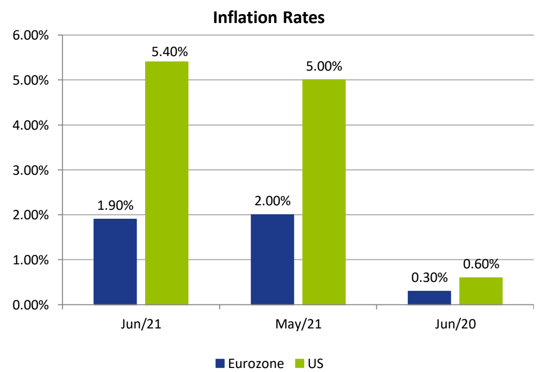
An important aspect in the current debate on ECB policy is the method of calculating inflation which does not include house prices. The low policy interest rate is seen as one of the drivers of the sharp increase in housing prices. Therefore, the ECB has asked Eurostat to increase the weighting of costs for home owners in the index, however this will take years to implement. In the meantime, the ECB will make its own assessment of these price developments, but Lagarde has already indicated that she does not expect this to lead to a significantly higher index.

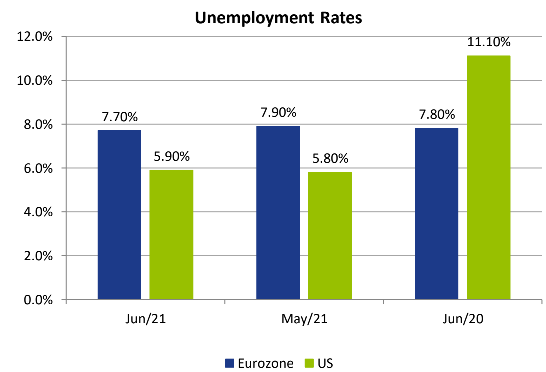
Despite the decision being part of the ECB's biggest monetary policy reform in the last two decades, the news did not come out of the blue. The policy change was already standard practice and was actually merely formalised with the new strategy. For example, ECB policymakers left the policy rate unchanged in May while inflation in the 19 eurozone countries increased from 1.6% in June to 2.0% in July, exceeding the ECB's old target. In addition, the fact that the entire Governing Council agreed unanimously on the new strategy shows that there were no controversial changes to the current policy.

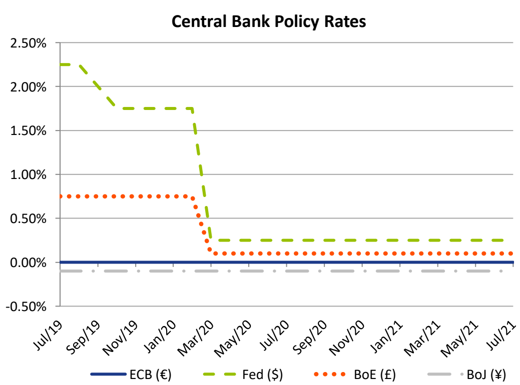
At the policy meeting on 22 July, the ECB said it would keep interest rates at low levels for as long as necessary to bring inflation up to the 2.0% target. This was the first meeting of the governing council after the announcement of the new inflation target two weeks earlier. Lagarde added that she would not want to create the impression that interest rates would now remain lower for a longer period of time than under the previous target. Critics argue that with its new policy, the ECB is effectively redistributing money between countries in the eurozone, thereby overstepping its mandate for price stability. By keeping interest rates low for a longer period of time, the real value of debt decreases, which is especially beneficial for countries with relatively high debts. At the same time, this is at the expense of purchasing power in the countries with relatively less debt. Time will tell whether it is a wise choice of the ECB to adjust the interest rate target with the corresponding policy shift.











Country Ratings	S&P	Moody's	Fitch
Netherlands	AAA	Aaa	AAA
Germany	AAA	Aaa	AAA
France	AA	Aa2	AA
United Kingdom	AA	Aa3	AA-
Russia	BBB-	Baa3	BBB
United States	AA+	Aaa	AAA
Japan	A+	A1	A
China	A+	A1	A+
Australia	AAA	Aaa	AAA

ZANDERS
TREASURY ▪ RISK ▪ FINANCE

Review & preview

Both the European Central Bank (ECB) and the Federal Reserve (Fed) have indicated in their interest rate decisions of last month that they will leave their interest rates unchanged and at low levels. The ECB has indicated that it will keep interest rates at low levels for as long as it takes for inflation to reach the 2.0% target. The Fed will also maintain a federal funds rate of 0.00%-0.25%. According to the Fed, the economy has made progress since the conditions for the rate cut were announced in December. For example, 'substantial progress' should be made towards the objectives of price stability and maximum employment.

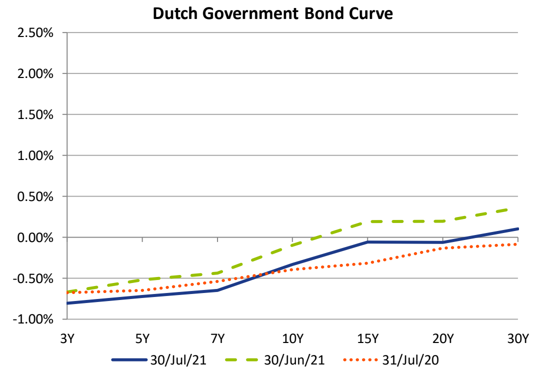
Existing owner-occupied houses in the Netherlands became more expensive in June 2021. Based on figures published on 22 July 2021 from Statistics Netherlands and the Land Registry. In June, houses were 14.6% more expensive than one year earlier, the largest price increase since December 2000. The price increase in the Netherlands has accelerated in the last six months

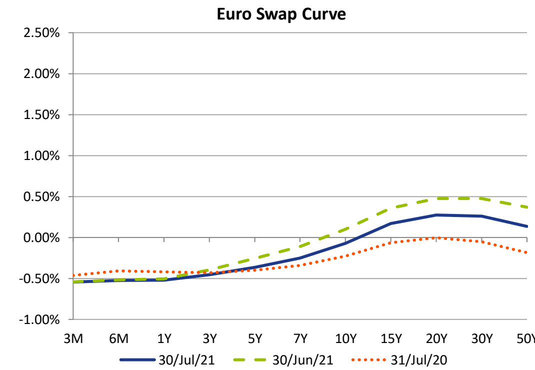
In early July, the State Council called for the use of monetary instruments, such as reductions in bank reserve requirements, to lower financing costs for companies. The Chinese central bank was quick to respond, announcing a 50 basis point reduction in these reserve requirements (by 15 July 2021). The easing of these liquidity rules should provide some breathing space in the face of rising interest rates, partly due to rising cost inflation. In addition, China's exports were higher than expected in June 2021. Exports increased by 32.2% year-on-year. Imports also increased by 36.7% in June 2021. This brought the trade surplus to USD 51.5 billion in May, compared to an expected surplus of USD 45.5 billion.

Based on the economic developments and forecasts of the Dutch central bank, inflation will remain at 1.5% in 2022 and increase to 1.8% in 2023. In 2021 government finances will still be strongly influenced by the pandemic. In 2022 and 2023, when the pandemic is estimated to be under control, the deficit will decrease to roughly 0.5% of GDP in 2022.

Agenda

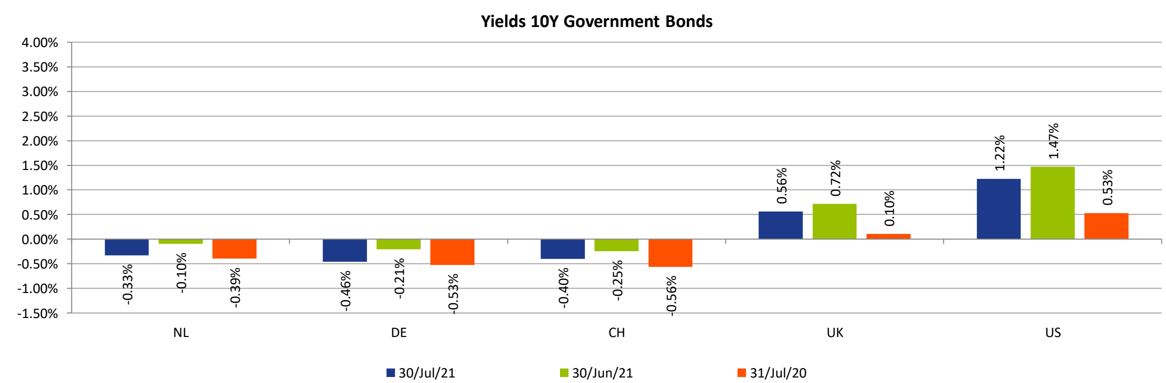
5 August	Inflation figures Netherlands
5 August	Interest rate decision Bank of England (BoE)
6 August	Unemployment figures United States
11 August	Inflation figures United States
19 August	Unemployment figures Netherlands
31 August	Inflation figures EU





Bank Ratings	S&P	Moody's	Fitch
Rabobank	A+	Aa2	A+
ING Bank	A+	Aa3	AA-
ABN AMRO	A	A1	A
BNG Bank	AAA	Aaa	AAA
NWB Bank	AAA	Aaa	n.a.
Deutsche Bank	BBB+	A3	BBB
BNP Paribas	A+	Aa3	AA-
Barclays Bank	A	A1	A+
Credit Suisse Int.	A+	A1	A

Currencies	30/Jul/21	30/Jun/21	31/Jul/20
EUR/USD	1.187	1.186	1.178
EUR/GBP	0.854	0.857	0.900
EUR/CHF	1.075	1.097	1.076
EUR/JPY	130.225	131.755	124.750
EUR/DKK	7.439	7.436	7.448
EUR/SEK	10.198	10.140	10.339
EUR/CAD	1.481	1.470	1.580
EUR/AUD	1.616	1.581	1.649
EUR/CNY	7.669	7.657	8.215



ZANDERS
TREASURY ▪ RISK ▪ FINANCE