Focus

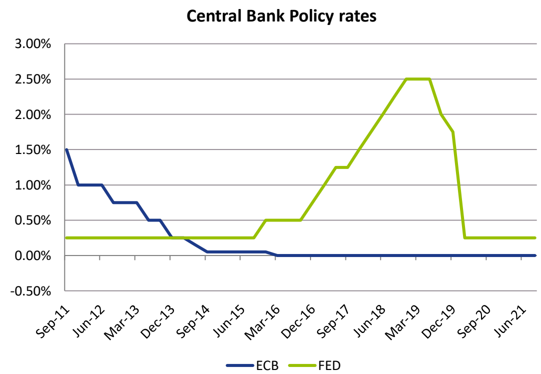
At a policy meeting this summer, the ECB announced that it would keep interest rates at a low level for as long as necessary to bring inflation to the 2.0% target. In addition, Federal Reserve Chairman Jerome Powell indicated at the end of August that although the central bank's buyback program may be phased out sometime in the near future, it should not be expected that the Fed will increase the policy rate anytime soon. With these announcements, interest rates appear to remain remarkably low as in previous years. However, what will actually happen with the economy when policy rates are increased again?

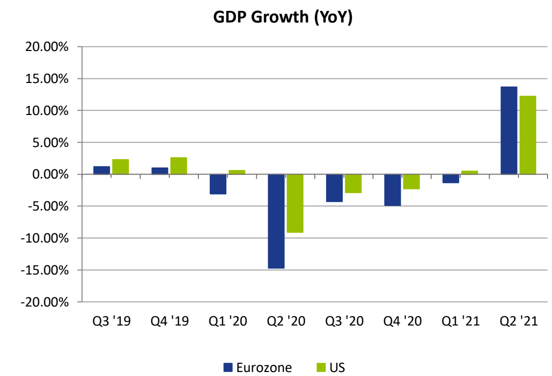
Before an answer can be given to that question, it is important to understand what changed since interest rates decreased. Low interest rates allowed banks to raise money relatively cheaper. They could then lend this money out at relatively favourable interest rates, for example in the form of loans and mortgages. The low mortgage interest rates made it more attractive for people to take out a mortgage. This resulted in lower monthly costs, but also in the possibility of being able to borrow more. This has led to an increasing demand for owner-occupied houses. This is one of the reasons why house prices in the Netherlands have increased so substantially.

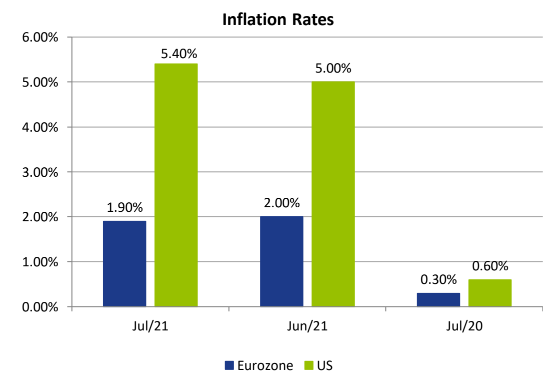
Another area that has been considerably affected by interest rate fluctuations is the stock market. Various empirical studies have revealed that the value of shares is affected by changes in the interest rate. The most direct effect of a fluctuation in interest rate on the stock market is caused by the calculation of the value of stocks by discounting future distributions with an interest rate. Lowering the rate therefore increases the value of a stock. In addition to this effect, the stock market is also affected by interest rates in another way. Low interest rates make bonds, the main substitute for shares, less attractive to invest in. This is because a bond is freely tradable debt and is therefore subject to the policy interest rate. Investors are, given the low return on bonds, more willing to take risks when holding or buying shares. Moreover, the value of shares can rise at low interest rates because companies can finance investments cheaper or refinance the more expensive loans. In this way, profits increase and therefore the price of the stock.

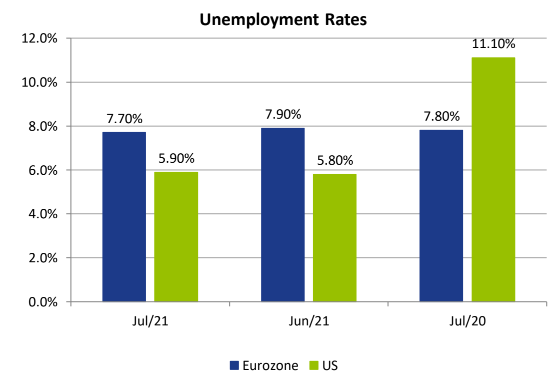
A low-interest rate that persists for a long time also introduces a number of risks. For example, the incentive to minimize debt decreases. If debt is not reduced, vulnerability to unexpected interest rate hikes and/or negative income shocks remains. In addition, pricing in financial markets is distorted as a result of instigated inflation, increasing the probability of asset price bubbles. Also consider house prices in this regard. In the event of an unexpected and substantial increase in interest rates, these bubbles could burst.

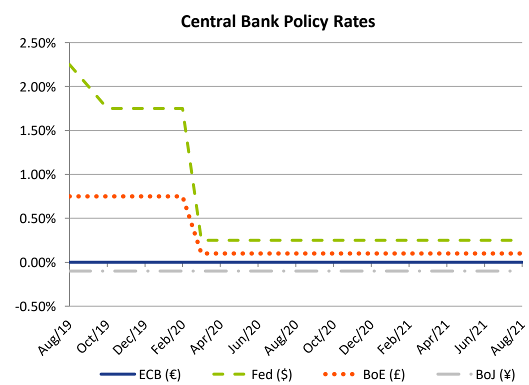
Taking only the previously mentioned into account, the expectation could be that with increasing interest rates, the housing and equity markets might collapse. However, the ECB and the Fed only allow policy interest rates to increase at a steady pace when they expect the economy to be strengthening to counteract high inflation. This means that interest rates will increase at a time when people have more to spend. The decline in the housing and stock markets caused by increasing interest rates is simultaneously offset by an increase caused by a stronger economy. In the short term, there will be a negative reaction to an increase in interest rates, mainly within the stock market, but in the long term it can be put into perspective by a growing economy. In addition, as a result of the credit crisis, central banks have increased regulatory supervision and banks are required to hold larger reserves to prevent a economic bubble from bursting.











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

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Review & preview

In a much anticipated speech on August 27th, Fed chairman Jerome Powell stated that later this year the Fed could commence tapering. The chairman indicated that signs of economic recovery, such as inflation or employment, are looking positive. If the trend continues, the Fed will ease its monetary policy before the end of the year. Earlier in August, several presidents of regional branches of the Federal Reserve already publicly stated to be in favor of cutting back on the bond-buying program. Jerome Powell now seems to share this opinion. The announcement of the Fed that tapering will commence could come as early as 21 or 22 September, when the Federal Reserve Board reconvenes.

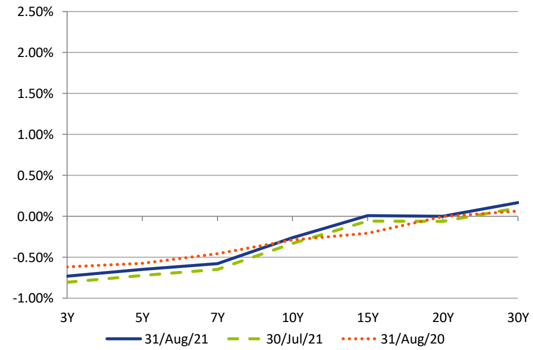
In August, the number of initial jobless claims in the United States has reached its lowest point since the outbreak of the corona crisis in March of last year. In the week of March 14, 2020, there were 256,000 applications. A week later, this rose to 2,923,000 and the following week to 5,985,000. Between August 9 and 15, there were 348,000 applications. The four week average also reached it lowest point since March 2020 at 366,500 applications. Analysts anticipated a decrease since the number of vacancies in the United States reached a record level in June this year, while in July a record number of new jobs were filed.

The Dutch economy also seemed to have emerged from the corona-crisis. In the first three months of this year, the economy shrank by 0.8%. However, last month numbers published by Statistics Netherlands showed that the contraction came to an end. In the second quarter of 2021, the economy grew by 3.1% compared to the first quarter and the year-over-year growth was estimated at 9.7%. Although, despite that recovery, the Dutch economy is still not at its pre-pandemic size. The GDP index that is calculated by Statistics Netherlands has been steadily increasing since base year 2015, until it reached a peak of 110.4 in the final quarter in 2019. In the second quarter of 2021 the index reached 109.5.

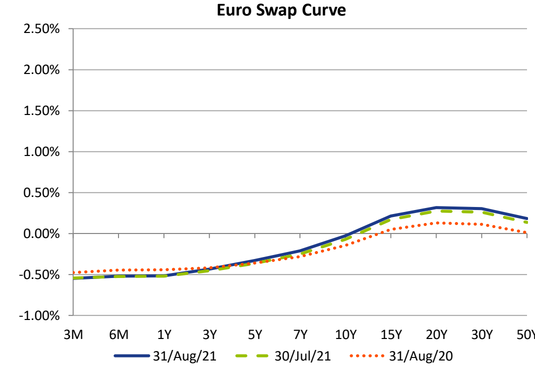
Agenda

9 September	Interest rate decision European Central Bank
10 September	Inflation figures United States
15 September	Inflation figures United Kingdom
22 September	Interest rate decision Federal Reserve (US)
23 September	Interest rate decision Bank of England
30 September	Inflation figures Eurozone

Dutch Government Bond Curve



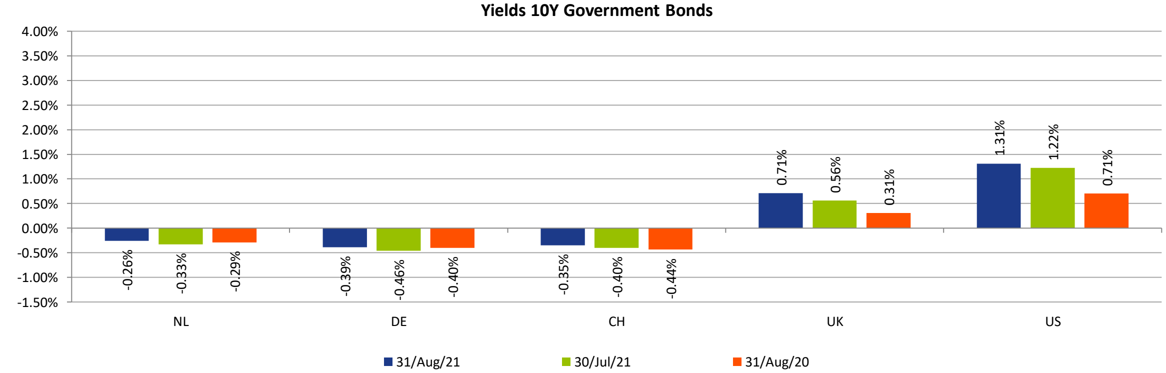
Euro Swap Curve



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	31/Aug/21	30/Jul/21	31/Aug/20
EUR/USD	1.181	1.187	1.194
EUR/GBP	0.859	0.854	0.893
EUR/CHF	1.081	1.075	1.079
EUR/JPY	129.920	130.225	126.405
EUR/DKK	7.437	7.439	7.443
EUR/SEK	10.184	10.198	10.319
EUR/CAD	1.490	1.481	1.557
EUR/AUD	1.614	1.616	1.618
EUR/CNY	7.630	7.669	8.175

Yields 10Y Government Bonds



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