ON CALL WITH WSJ

Tune in on Thursday for a live conversation with our Brexit journalists on why the U.K.'s effort to leave the E.U. is creating so many difficulties. Register Now

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

https://www.wsj.com/articles/a-central-banking-domino-effect-is-in-motion-11553168467

ECONOMY

A Central Banking Domino Effect Is in Motion

Policy U-turns from the Fed and ECB are cascading around the world

By Brian Blackstone

Updated March 21, 2019 8:35 a.m. ET

ZURICH—Abrupt changes in the policies of the world's largest central banks have rippled through smaller economies, leaving them with the prospect of low and even negative interest rates for years to come despite having mostly healthy economies.

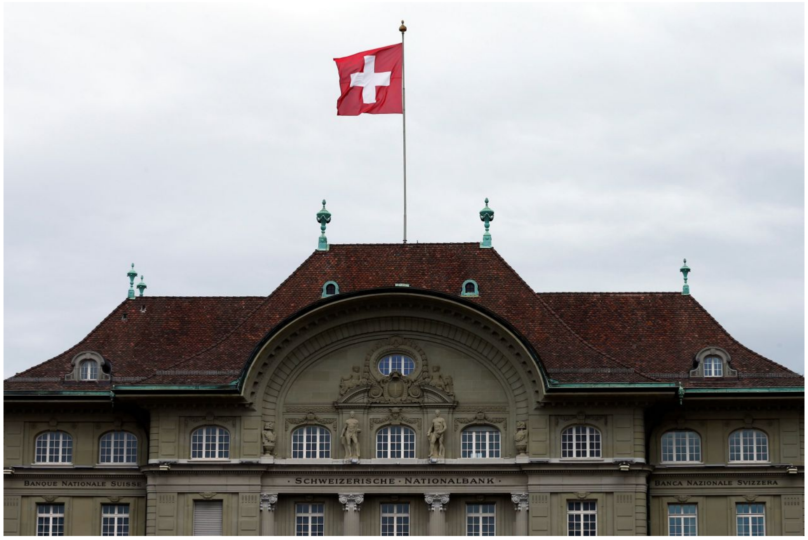
The danger is that these easy-money policies could fuel destabilizing bubbles in real estate and other asset markets. They may also leave banks with little ammunition to respond to the next economic downturn.

Economies like Switzerland's, whose central bank signaled no change in its negative-rate policies for years to come, are small compared with the U.S. and eurozone. Still, they are home to major global banks and companies that are sensitive to exchange rates and financial conditions. With financial markets so interconnected, problems in small countries can quickly spread to larger ones.

On Wednesday, the Federal Reserve left its key policy rate in a range between 2.25% and 2.5% and indicated that it is unlikely to raise rates this year. In late 2018, officials had signaled they expected between one and three increases this year.

Two weeks ago, the European Central Bank went further, saying it would launch new stimulus to support the eurozone economy via cheap loans for banks. It also said it expected to keep its key interest rate at minus 0.4% at least through 2019, a longer horizon than before.

The Swiss National Bank said Thursday that it would keep its policy rate at minus 0.75%, where it has been since January 2015, and reduced its inflation forecast to 0.3% this year and 0.6% in 2020. The SNB cited weaker overseas growth and inflation and "the resulting reduction in



A national flag flutters in the wind atop the Swiss National Bank's headquarters in Bern. PHOTO: RUBEN SPRICH/REUTERS

expectations regarding policy rates in the major currency areas going forward."

Norway's central bank took an opposite turn, raising its policy rate by 0.25 percentage point to 1% and signaled more increases this year. Norway's reliance on oil production sets it apart from other European countries because higher oil prices provide a stimulus to its economy that its neighbors don't receive. Its currency, the krone, rose about 1% against the euro after its decision.

Still, Norway's bank lowered its long-term rate forecast, citing "a more gradual interest rate rise among trading partners."

RELATED

- The Fed's New 'Normal' Looks Worrisome (March 20)
- Heard on the Street: ECB's Latest Stimulus Will Help Banks More Than the Economy (March 7)
- Swiss Paradox: Booming Economy, Negative Interest Rates (Sept. 20, 2018)

Norway's central bank may not be alone in raising its key interest rate this year. While leaving its key rate unchanged Thursday, the Bank of England reaffirmed its expectation that "an ongoing tightening of monetary policy" will be needed if the U.K. leaves the European Union on agreed terms and with a period in which to adjust to new trading terms. But it also acknowledged that should Brexit be abrupt, a cut in its key rate might be needed.

Here's why Fed and ECB decisions matter for countries that don't use the dollar or euro: Switzerland and countries near the eurozone but not part of it—like Sweden and Denmark—rely on the bloc for much of their exports and imports. That makes growth and inflation highly dependent on the exchange rate. Central-bank stimulus tends to weaken a country's exchange rate, so when the ECB embraces easy-money policies as it did two weeks ago it tends to weaken the euro against other European currencies such as the Swiss franc. Because the ECB is so large, Switzerland and others can do little to offset it.

In a sign of Switzerland's dependence on ECB policy, the franc strengthened slightly against the euro Thursday even after the SNB cut its inflation forecasts. "They are hostage to the fortunes of what the ECB does," said David Oxley, economist at Capital Economics. Many analysts expect the SNB to stay on hold this year and next.

Like Switzerland, central banks in Sweden and Denmark have had negative policy rates for many years, and analysts say that is unlikely to change soon. Capital Economics expects Sweden's Riksbank to keep policy rates—including a minus 1% deposit rate and minus 0.25% lending rate—on hold into 2021. It is set to make a policy decision next month.

"The gravity pull is very strong" from the Fed and ECB, said Sebastien Galy, macro strategist at Nordea Asset Management. "The consequence is [non-euro central banks in Europe] mostly end up importing policy from the ECB, so you end up with housing bubbles and a misallocation of capital."

The negative interest-rate policies are also costly for commercial banks. In Switzerland, banks have paid the SNB nearly 7 billion francs ($7 billion) to store funds since 2015. Danish banks have paid 3.1 billion kroner ($0.5 billion) since 2014 as a result of their central bank's negative deposit rate, currently at minus 0.65%.

It isn't just Europe that is affected by the actions of big central banks. On Thursday, Bank of Korea Gov. Lee Ju-yeol signaled he would maintain the current pause in policy tightening, saying the Fed's "more-accommodative-than-markets-expected" statement would allow his bank "more leeway" in taking action.

The BOK last raised rates in November, and the consensus among economists is that it will now stand pat this year.

Indonesia's central bank kept rates unchanged for a fourth meeting in a row Thursday. The Philippine central bank stayed its hand, too.

With the Fed expected to keep rates on hold into 2020, "this may afford Bank Indonesia a window to reverse its stance and cut policy rates in the near term," and give the Philippines leeway for an easier stance, said analysts at ING Bank.

—Paul Hannon in London and Kwanwoo Jun in Seoul contributed to this article.

Write to Brian Blackstone at brian.blackstone@wsj.com

Copyright © 2019 Dow Jones & Company, Inc. All Rights Reserved

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