Draghi-Carney Seek Independence Day Break From Bernanke Exit (2)
2013-07-05 10:08:20.279 GMT

(Updates with euro, bonds in fifth paragraph. See TOP CRIS for more on the European debt crisis.)

By Simon Kennedy, Jennifer Ryan and Jana Randow
July 5 (Bloomberg) -- European central bankers broke new ground to protect their economies from a U.S.-led surge in bond yields, indicating they will keep benchmark interest rates low for longer than investors bet.
With rising market borrowing costs posing fresh threats to weak expansions, Bank of England Governor Mark Carney and European Central Bank President Mario Draghi gave greater clarity over their monetary policy thinking yesterday in the hope financial markets will correct.
The pound and euro slid against the dollar, while bonds and stocks rose as both officials used rhetoric to distance themselves from Federal Reserve Chairman Ben S. Bernanke's signal that the U.S. is preparing to start unwinding its $85-billion a month bond-buying program later this year. That had sparked a global selloff in bonds, forcing up yields in economies less able than the U.S. to cope with tighter credit.
"The ECB and BOE are declaring their monetary independence from the rising U.S. rate trend," said Michael Saunders, chief western Europe economist at Citigroup Inc. in London. "It's the right thing to do, because European economies need low rates."
The euro slid 0.3 percent to $1.2881 at 11:57 a.m. in Frankfurt, after dropping 0.7 percent yesterday. Portugal's 10-year bond yield, which climbed as high as 8.11 percent on July 3, slid 30 basis points to 6.972 percent. Italian yields dropped a second day.

'Downward Bias'

Carney, marking his debut at the helm of the BOE as the first foreign governor in its 319-year history, went first as the U.K. central bank released a rare statement in which it said the recent increase in market rates "was not warranted by the recent developments in the domestic economy."
Less than two hours later, Draghi told reporters in Frankfurt that the ECB planned to keep its interest rates low or even lower for an "extended period" and that it was injecting a "downward bias in interest rates for the foreseeable future."
The central banks turned to words over deeds as both kept their key interest rates at 0.5 percent, matching the median

forecasts of economists surveyed by Bloomberg News. The BOE also left its bond-buying program unchanged at 375 billion pounds ($565 billion).

Britain's currency slid 1.4 percent yesterday, and was little changed at $1.5050 as of 1:26 p.m. in Tokyo. The euro was also little changed, at $1.2901 after a 0.7 percent drop yesterday.

Bond Rout

The statements followed a rout in bond markets triggered by Bernanke on June 19. Ten-year U.K. government bond yields rose to 2.59 percent on June 24, the highest since 2011. In the euro-area, Portugal's 10-year yields climbed above 8 percent this week for the first time since November amid concern austerity fatigue is taking its toll. Rates also rose in Italy and Spain, both of which have struggled to grow amid Europe's debt crisis.

With short-term borrowing costs so low, central banks worldwide are increasingly adopting what economists call forward guidance to persuade investors they should restrain yields on bonds. That's vital for the health of economies because it is those longer-term rates which typically dictate the lending rates paid by governments, companies and homeowners.

"What the central banks made very clear is perhaps the relation we saw in the past, where once the U.S. started to hike interest rates that was closely followed by other central banks, maybe that is not the case this time around," said Martin van Vliet, an economist at ING Bank NV in Amsterdam.

'Dialing Back'

U.S. central bankers have nevertheless gone to great lengths to stress that a slowing of quantitative easing doesn't spell an imminent end to low interest rates. Officials are talking about a "dialing back" rather than an exit, according to Fed Bank of Dallas President Richard Fisher.

"Recent central bank communication has had the look and feel of a globally co-ordinated action to pour cold water over financial market expectations of early rises in short-term interest rates," said Nick Kounis, head of macro research at ABN Amro Bank NV in Amsterdam.

The clearer communications in Europe mark a new strategy from both central banks. The BOE has tended to release a statement only when changing policy and several officials have questioned the potency of giving guidance. At the ECB, Draghi and predecessor Jean-Claude Trichet routinely said they never pre-committed on policy decisions.

BOE Analysis

The latest efforts are nevertheless softer than those adopted elsewhere. The Fed, for example, has previously set time frames for loose policy and went further in December by saying it wouldn't raise its rates until specific inflation and unemployment thresholds were breached. The Bank of Japan says it is focusing policy on achieving 2 percent inflation in two years.

The BOE is studying whether to pursue more formal guidance, and the analysis due for release next month will have "an important bearing" on August's policy discussions, it said.

Before then, the central bank will publish minutes of yesterday's meeting on July 17, showing how Carney and other officials voted on stimulus

Investors "believe that the statement is a downpayment of a more substantive commitment to maintain low rates to be unveiled in August," said Simon Ward, chief economist at Henderson Global Investors in London.

Two Pillars

Trevor Greetham, director of asset allocation at Fidelity Worldwide, said the U.K. is likely to echo the Fed by saying it will keep policy loose until unemployment falls to 6.5 percent so long as inflation expectations remain tame. Still, some BOE officials, including chief economist Spencer Dale, have raised concern about signposting policy. Among the concerns is a risk to credibility if they had to renege on a commitment, and the fact that inflation is faster than the bank's 2 percent target.

Draghi said the ECB's use of guidance was "unprecedented" and backed by all 23 members of the Governing Council after several forms were debated. It may have been a compromise after what he described as an "extensive discussion" about cutting interest rates. He said the bank kept an open mind on whether to drop the deposit rate below zero.

The ECB's ability to mimic the Fed is limited because its main focus is on inflation, and unemployment rates vary across its 17 nations.

2015 Outlook

It hasn't built formal frameworks or set specific economic targets for assessing the course of rates, according to an official familiar with its deliberations. Instead, officials will rely on the central bank's traditional "two pillar" approach, a setup that looks at both money supply and a range of economic indicators, the person said.

Still, Tom Vosa, an economist at National Australia Bank in London, said that with Draghi saying monetary policy is expected to support activity into 2014, it may take until 2015 for the ECB to tighten.

The U.K. and euro-area economies might recover under current policies if recent data are an indication. While euro-area unemployment rose to a record 12.2 percent in May, confidence in the currency bloc jumped to the highest level in more than a year in June and a gauge of manufacturing and services output improved for third month.

In the U.K., services and manufacturing growth accelerated to their fastest in more than two years in June, while construction expanded the most in more than a year.

"U.K. and euro-zone monetary policy looks to be heading the same way for a period of time," said Vosa, a former Bank of England economist. "They are now dependent on the evolution of real economic data as they try to distance their own domestic bond and interest rate markets from those of the U.S."

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