Northern Trust | Wayne Bowers: Central Banks -- Monetary Stimulus Running on Empty?

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Following years of unconventional quantitative easing, unachievable inflation targets, and negative interest rates, investors are starting to question the inability of central banks to lift global growth prospects. Today, we will examine if the central bank monetary arsenal is becoming increasingly ineffective.

With mixed economic data in the United States and continuing deflationary pressures in Europe and Japan, investors remain fixated on central bank signals. While the US pauses and Japan and Europe still possess negative interest rates, there is growing concern that central banks may be running out of stimulus firepower and approaching the limits of monetary policy to stimulate growth.

In the past, markets may have held an underlying assumption the central bank has ruled financial markets with the ability to affect asset valuations, reducing the impact of fundamental information. But it's clear that central banks are failing to generate enough cyclical upswings to win against the structural forces constraining growth and inflation.

Monetary stimulus can continue to provide support, but may not be sufficient for a durable recovery. This can be seen in continued discussions around extreme measures, such as direct monetization or helicopter money.

The traditional approach for central banks in times of economic strain has being controlling interest rates to either cool or stimulate the economy. So far, two major central banks, the Bank of Japan and the European Central Bank, have acted to ease monetary policy by lowering interest rates into negative territory. It could be said the desired impact of these negative rates is not transferring through into consumer price inflation, causing a transition dilemma. In fact, the eurozone deflationary pressures have actually increased since the ECBs introduction of subzero rights in mid-2014.

Central banks will continue to be open and transparent with the market due to the number of policy measures currently deployed. Our expectation is for a continuation and possible deepening of negative rates for Europe and Japan, further asset purchases supporting risk assets, and direct lending initiatives openly discussed and potentially implemented.

We also expect to see a widening remit From national governments and central banks for continued financial stability and economic growth, leading to a greater overlap of both fiscal and monetary policy coordination. As these relationships mature, we may see central banks much lauded independence tag increasingly questioned.

Firstly, central bankers opinion still matter. Their policies may have lost some impact, but their opinions and stance on various matters still have an important part to play. This could be seen with Bank of England Governor Mark Carney, and his recent views on the upcoming Brexit vote.

Secondly, information derived from analyzing yield curves in the face of a turn in economic conditions, either higher growth or recession, may be muted. Investors can expect credit asymmetry and equity volatility with the latter increasing. Not only in absolute terms, but also relative to fixed income volatility.

We continue to support the growth perspective of lower for longer, and still hold firm on the view that a globally diversified portfolio offers the best case scenario for investors looking to ride market volatility.

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