Q&A-BOE may need to delay taper, but talk will intensify; Slow taper from ECB; Hard for c.banks to extend QE to fund green policies: Huw Van Steenis, UBS

The Bank of England (BoE) may need to delay its stimulus taper plan due to additional lockdowns on account of the COVID-19 Delta variant, **Huw Van Steenis, former senior adviser to Bank of England Governor Mark Carney and now chair-sustainable finance at Swiss bank UBS,** told the Reuters Global Markets Forum on Wednesday, September 1.

But taper talk is going to intensify into Autumn of 2021 and Spring of 2022 given inflation dynamics, Steenis said. For the European Central Bank (ECB), the base case for Steenis was "a slow taper first."

Steenis, who is also senior adviser to the CEO of UBS, said the era of monetary dominance is now passing, making it hard for central banks to extend their nearly decade-long "unlimited" easy money provisions to fund green policies.

COVID-19 has re-established the "efficacy of fiscal policy," though policymakers are still debating over how much of that stimulus should be focused on supply-side measures versus demand-side, Steenis said.

Following are edited excerpts from the conversation:

Q: What is your view on the raging inflation debate -- do you see it as transitory or persistent?

A: The base case is for a strong recovery and that inflation is likely to be transitory - notwithstanding the spike over the recent and coming months. But there is much uncertainty around his base case as we all know. I am encouraged that inflation in the euro zone is getting close to target, and the re-opening with higher vaccination is starting to be seen. But there are also structural issues - labour market tightness, especially in the UK post-Brexit, and imported inflation make this an even tougher conundrum for the BOE. Hence why the tapering debate is raging. In the UK, the risks do look higher of becoming higher and for longer given the structural issues – the labour market shortages at the moment are a keen focus. I think odds of overshoot (are) reasonably high.

Q: How soon do you see the ECB withdrawing its pandemic emergency purchase programme (PEPP)?

A: Euro zone is indeed interesting, and I suspect tapering - which the ECB had been signalling until recently was off the cards - is closer, although with a lag to the U.S. I have wondered over the last few years if the ECB has got the sequencing wrong with leaving reversing negative rates to the very end. I think negative rates have been a dangerous experiment and corrosive to the financial system - and more debate needs to be placed on the implications for financial stability and the transmission mechanism of these. I would think focusing on this early would be welcome - but my base case is that it’s a slow taper first.

Q: UK short-sterling futures indicate the BoE is on pace for a Q2 2022 hike -- how do you see that materialising?

A: These are very fluid times to say the least. After growth and inflation coming in strongly ahead - as vaccination roll outran ahead, the BOE is increasingly focused on the risks of inflation - but the committee remains largely dovish from what I can see. But as we head into the Autumn and Spring taper talk is going to become ever more intense given the inflation dynamics.

Q: Do you see the additional lockdowns due to the Delta variant, etc., forcing the BOE's hand to delay?

A: It’s definitely possible. One thing we haven’t discussed so far is how the green mandates may shift the levers for central banks - and to what extent green stimuli allow fiscal authorities to boost the economies - whilst this is more medium-term, particularly in the euro zone, this could be an interesting boost now that fiscal dominance has been reached.

Q: Would you elaborate on what " now that fiscal dominance has been reached" means?

A: After nearly a decade of QE infinity, as the fundamental paradigm shaping central banking and investors thinking, I suspect the era of monetary dominance is passing. We can already see through COVID-19 the new-re-found efficacy of fiscal policy. Clearly, these are complex debates - especially how much should be focused on supply side measures given a largely supply-side shock versus demand side stimuli. I suspect there is far more to do on the supply side - but again I am encouraged (by) how many companies have pivoted over the last 18 months.

Q: Are there any money market issues we should be on the lookout for as the BOE exits?

A: In a nutshell, it's to try to have taper with tantrum - but easier said than done. Investors are so conditioned to cheap money that risk assets and govvies are all elevated. I am particularly interested in how many mini tantrums we have seen from both the shifts in investors views and today's market structure. But it's the big moves which will be the keenest focus. Hence, why gradualism and strong signalling (are) order of the day.

Q: What action do you expect from the ECB – as it will take greater account of climate change in its core policy decisions?

A: Given the mandates, the primary focus has to be risks to financial stability - and so climate-related stress tests are likely to be one of the most important tools. Central banks will tread carefully as first-time exercises, but we can already see some lessons from the French exercise - that insurers are likely to see far more risk than banks. That it's fairly long-tailed - but there are pockets where weather-related risks may grow strongly. But the ECB will clearly go further.

Q: Do you see regular QE being replaced by climate QE now, and therefore, no end to easy money policies?

A: The mandate for a whole economy stimulus – and the dogma of QE being it is a temporary stimulus, even if the markets know it looks semi-permanent – means it is difficult to get a strong tilt. Second, how would the ECB or others make very aggressive exclusions - given the composition of indices. Third, and probably most importantly, a whole economy transition requires transition finance to those industries which need it! Take autos - today UBS research suggests 86% of U.S. car manufacturers' capex over the next five years is to EVs (electric vehicles) but is just over half for European car manufacturers. Should you not buy European firms for not tilting? Surely, helping them finance the transition is key - with some engagement from asset owners where they see a firm is lagging. These are complex issues where central banks will wish to tread carefully - so more likely they use some of the off the shelf green tilt indices and top up with green bond purchases in their own pension fund to signal the direction. My base case is green repo is a very long way off, but tilting bond purchases to green bond indices could be quite close around the corner.

Q: What measures do you expect the BOE taking ahead of Britain hosting the COP26 in November?

A: First, I strongly suspect that the UK will provide strong backing to at least three of Mark Carney's four-point plan for private finance. That is - 1) Enhance reporting - where the Chancellor has already said TCFD (Task Force on Climate-Related Financial Disclosures) will be economy-wide; 2) Focus on risk management - where climate scenario stress testing will become mandatory for not just financial firms but also pension funds; 3) Focus on returns and new markets - such as the voluntary carbon market; And 4) Public-private partnerships to help funding to flow to emerging markets transition - it is a bit less clear given the governments views on international aide - but support for some reform at development banks is possible.

Q: Should the onus of promoting sustainable investments lie with governments or central banks, or a bit of both?

A: The transition to a low-carbon economy will require one of the largest re-wirings of the global economy ever - some $3.5 trillion per annum for the next decade on one forecast. I suspect the green revolution - like the industrial and tech revolutions - will be fuelled by capital markets and private sector risk taking. But this needs to be in tandem with government action. Pump priming carbon capture or renewables, changes in legislation, green infrastructure and the like - the heavy lifting is for governments, not central banks. But I do think there is a legitimate role by central banks are financial stability and market integrity - hence transparency in the data and climate stress tests may prove to be the most catalytic tools. On green, like on digital currencies, is keeping a keen eye on innovation. Getting the right balance between new rules and innovation is critical.