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Weekly Digest

Week ending **03 April 2016**

Quantitative Exhaustion: is QE a victim of its own success?

While it had been used before, Quantitative Easing (QE) really only came into our collective consciousness when the US Federal Reserve first used it post the financial crisis. The purpose of QE is to firstly support or push the prices of assets higher, which in turn results in an enhanced feeling of wealth for the holders of those assets and secondly, because many of the purchased assets were fixed income securities, QE served to pull down interest rates. This rendered low risk fixed income assets unattractive in terms of their total returns, which pushed investors into riskier assets in search for better yields. QE is now a cornerstone of central bank extraordinary monetary policy, and has been used to great effect. Yet recent activity by the Bank of Japan (BoJ) and European Central Bank (ECB) has placed increasing reliance on negative interest rather than relying solely on tried and tested QE.

This has led to suggestions that QE is, perhaps, losing some of its punch; are we now in the era of Quantitative Exhaustion? An important tenet of monetary policy is that, for it to be impactful, it should have an element of surprise. QE has become such ubiquitous tool in terms of monetary policy that there is undoubtedly a risk that its use has become too mainstream in nature, leading to diminishing returns in terms of its use. A reduced impact is not the same as being obsolete, however, and it is telling that central banks, while relying less on QE to provide new stimulus, are extremely reluctant to begin to unwind the huge volumes of securities amassed under QE. Arguably this is because to do so would be a huge surprise today, and would result in a large and – probably – negative impact on economic activity and confidence, which could readily filter through to real economic activity.

Developed market inflation remains stubbornly low, which calls into question the efficacy of a swath of extraordinary monetary policy tools used in recent years. This misses the substantial impact on inflation from dropping commodity prices globally, but the likelihood now seems to be that the major mathematical impact of falling input prices is behind us and should stabilise or lead to inflationary pressures in coming months. Furthermore, central banks such as the ECB and BoJ continue to act so as to put pressure on their currency through negative interest rates. A weakened local currency will aid a country's competitiveness in the context of global peers leading to export led activity whilst, at the same time, pushing import prices up in local currency terms, which should be inflationary.

From a longer term perspective, there are a large number of unknowns in terms of QE's impact and these may, in time, tarnish QE's reputation: more QE is probably storing up longer term problems such as inflated asset prices and bubbles, as well as reducing pressure on governments to take much needed structural reform measures. Negative interest rates are not without issues either, with concerns over bank profitability in this environment being one of the reasons that bank share prices were so weak earlier this year. It seems that ECB's introduction of measures to address this, in particular the new Targeted Long Term Refinancing Operation and the cut to zero of its refinancing rate, demonstrated the ECB's acute awareness of this problem and a clear message that robust bank profitability is important for the credit transmission policy.

Source: Bloomberg. Returns in US dollars unless otherwise stated.

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The **Marketplace**

- US Fed strikes dovish tone
- US economic data improves
- US Dollar weakens
- Eurozone experiences modest price inflation
- UK economy grows 2.1% in 2015

Market **Focus**

USA

- On Tuesday (the 29th March 2016), the Chair of the US Federal Reserve, Janet Yellen, made some surprisingly dovish comments in a speech to the Economic Club of New York. Alongside speaking of the need to "proceed cautiously in adjusting policy", Ms Yellen also spoke of the asymmetric effect that using "conventional monetary policy to respond to economic disturbances" will have while the base rate of interest remains low.
- The expectation of a rate hike at the Open Market Committee's April meeting finished the day at 28%, having been 38% at the end of the previous week.
- These comments came before some relatively positive data. The US consumer confidence index improved during March, with the reading of 96.2 outperforming expectations of no change on last month's 94.0. On Friday, the non-farm payrolls beat expectations once more, adding 215,000 jobs during March; however the unemployment rate increased very slightly to 5.0%.
- Post Yellen's speech, the US dollar initiated a steady daily decline which continued until Friday and the positive payrolls announcement, which resulted in a minor rebound for the greenback. The currency finished the week down by 1.7% against a basket of international currencies.

Europe

- Data out of the Eurozone was mixed over the week. While consumer price inflation during March was positive, at 0.2%, the year-on-year figure remains negative at -0.1%. The economic confidence index for the euro area reached a 13-month low, after falling 0.9 points to 103.0.
- The European Central Bank's measure of money supply grew 5% in the year to February: a direct impact of the bank's asset purchase programme, which was stepped up early last month.

UK

- The revised UK GDP figure for the fourth quarter of 2015 came in at 0.6%, an improvement on the third quarter's 30-month low of 0.4%. The year-on-year growth of the economy at the end of December stood at 2.1%, versus a 2.8% growth rate in both years prior.

James Klempster & Jonathan Adamson

Source: Bloomberg. Returns in US dollars unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 01 Apr. 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	1.8%	0.6%	1.8%	2.2%
United Kingdom	GBP	0.7%	-0.5%	-0.4%	-6.9%
Continental Europe	EUR	-0.6%	-1.3%	-8.3%	-15.0%
Japan	JPY	-3.8%	-3.4%	-15.0%	-13.1%
Asia Pacific (ex Japan)	USD	0.7%	-1.5%	0.3%	-13.0%
Australia	AUD	-1.7%	-1.6%	-4.3%	-10.6%
Global	USD	1.1%	-0.5%	-0.8%	-3.8%
Emerging Market Equities					
Emerging Europe	USD	2.6%	-1.9%	12.1%	-7.9%
Emerging Asia	USD	1.0%	-1.3%	0.6%	-14.0%
Emerging Latin America	USD	3.9%	-0.3%	18.8%	-11.9%
BRICs	USD	1.8%	-0.9%	0.4%	-17.6%
MENA countries	USD	0.0%	0.0%	-2.8%	-17.1%
South Africa	USD	4.4%	-2.2%	11.3%	-21.0%
India	USD	0.9%	-0.4%	-2.7%	-13.5%
Global emerging markets	USD	1.7%	-1.3%	4.4%	-13.9%
Bonds					
US Treasuries	USD	0.6%	-0.1%	3.3%	2.0%
US Treasuries (inflation protected)	USD	1.3%	-0.1%	4.6%	0.5%
US Corporate (investment grade)	USD	0.7%	0.0%	3.9%	0.4%
US High Yield	USD	0.3%	0.0%	3.3%	-3.7%
UK Gilts	GBP	0.4%	-0.1%	5.1%	2.9%
UK Corporate (investment grade)	GBP	0.4%	-0.1%	2.9%	0.3%
Euro Government Bonds	EUR	0.5%	0.1%	3.5%	0.8%
Euro Corporate (investment grade)	EUR	0.3%	0.1%	2.6%	0.6%
Euro High Yield	EUR	0.3%	0.1%	2.1%	0.0%
Japanese Government	JPY	0.2%	0.6%	5.3%	7.0%
Australian Government	AUD	0.3%	-0.2%	2.2%	1.5%
Global Government Bonds	USD	1.0%	-0.1%	6.6%	5.4%
Global Bonds	USD	1.0%	-0.1%	5.6%	4.3%
Global Convertible Bonds	USD	0.9%	-0.3%	-0.5%	-1.2%
Emerging Market Bonds	USD	1.0%	0.2%	6.1%	5.4%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 01 Apr. 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	3.3%	-0.2%	5.7%	2.7%
Australian Property Securities	AUD	-1.0%	-1.9%	3.5%	3.7%
Asia Property Securities	USD	-0.9%	-2.1%	-1.2%	-5.7%
Global Property Securities	USD	1.9%	-0.7%	4.1%	-0.4%
Currencies					
Euro	USD	2.0%	0.1%	4.9%	5.8%
UK Pound Sterling	USD	0.7%	-0.9%	-3.5%	-4.0%
Japanese Yen	USD	1.3%	0.8%	7.7%	7.9%
Australian Dollar	USD	2.2%	0.2%	5.3%	1.0%
South African Rand	USD	5.2%	0.5%	5.3%	-18.4%
Swiss Franc	USD	2.0%	0.3%	4.6%	0.9%
Chinese Yuan	USD	0.6%	-0.5%	0.2%	-4.4%
Commodities & Alternatives					
Commodities	USD	-2.1%	-1.5%	-2.4%	-23.8%
Agricultural Commodities	USD	0.1%	0.1%	-0.1%	-8.2%
Oil	USD	-4.4%	-2.3%	3.7%	-32.3%
Gold	USD	0.5%	-0.8%	15.2%	1.5%
Hedge funds	USD	0.3%	0.0%	-2.0%	-7.3%

* Estimate

Source: Bloomberg

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