



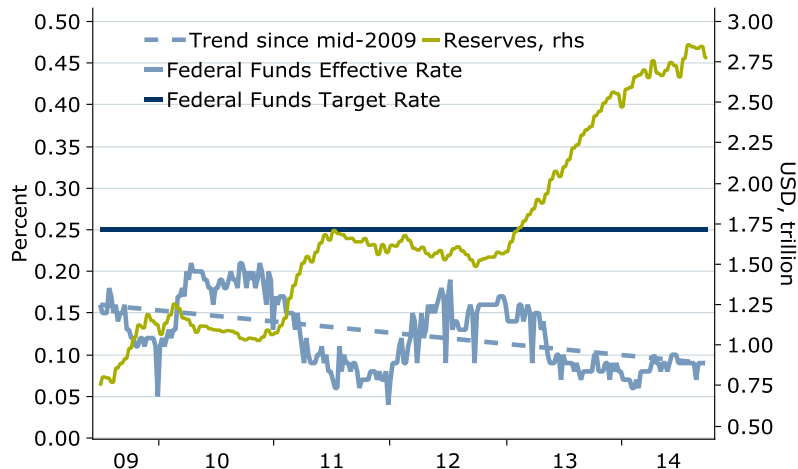
Quantitative Tightening Redux

Well, the problem with QE is it works in practice, but it doesn't work in theory – Bernanke (2014)

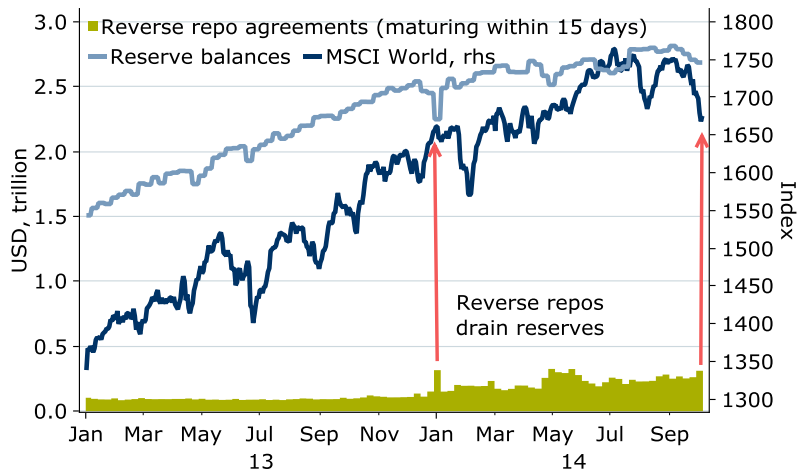
Martin Enlund, Chief Analyst, Global Strategy (Twitter: [@enlundm](https://twitter.com/enlundm))

Making it possible

Federal Reserve: Quantitative Tightening looms



Sources: Nordea Markets and Macrobond

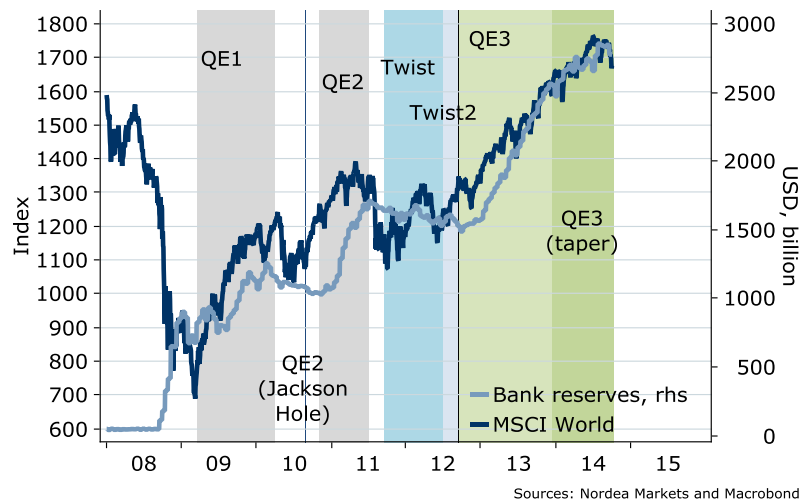
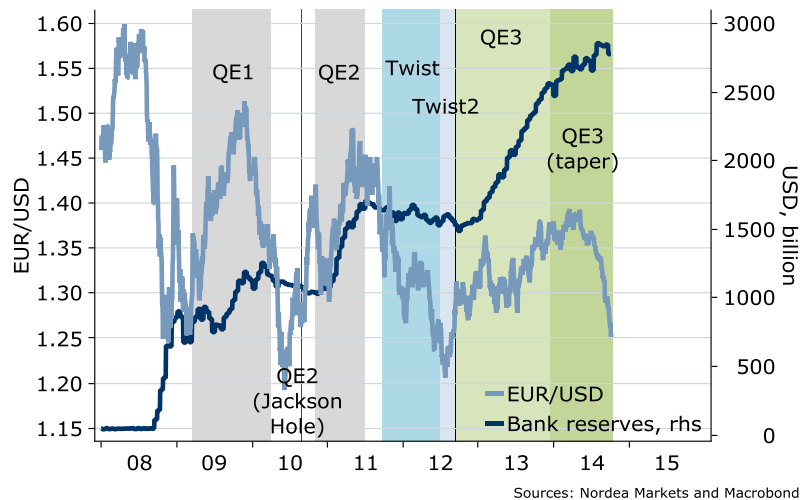


Sources: Nordea Markets and Macrobond

- The Fed will decide on a final 15bn reduction of its bond-purchase program October 29. Reserve growth will consequently stagnate or turn negative
- The Fed may actually need to absorb money (think sterilisation) in order to lift the Fed Funds rate substantially off the zero floor
 - This can be done via various facilities, one of which is the [ON RRP facility](#)
- Insofar facilities such as these are used there will be less reserves in the system

⇒ It could be that we should be thinking more about Quantitative Tightening instead of the end of Quantitative Easing

End of QE1 and QE2 made for volatile times



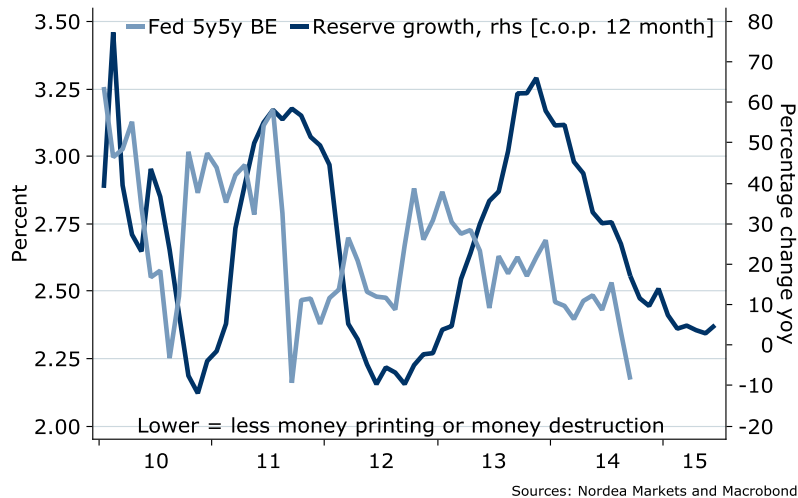
- The last two times the market was left without Fed QE support, the dollar strengthened and risk appetite deteriorated quickly
 - This happened during the spring of 2010 (Greece hit the fan in May) as well as during the summer of 2011 (Italy became engulfed in the European debt crisis)
 - Now, the US economy seem to be in a much better condition, so it could be that it can cope well with the Fed shutting of the liquidity spigot
 - But then again, the market *is* facing a regime change, with the shift from more dollars in the system almost every day, to fewer dollars in the system
- ⇒ How will the rest of the world cope with such a regime change?

If QE boosted inflation premiums, what will QT do?

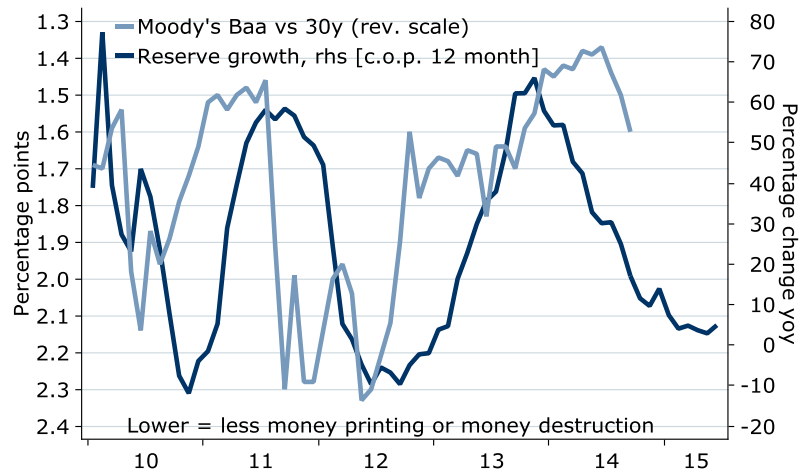
- If QE boosted inflation premiums, then, during QE programmes we should see higher break-even inflation expectations, higher long bond yields, steeper curves
 - We should arguably also see risky assets supported (credit spreads tighter and stock markets higher) as well as the dollar being undermined via the same inflation premium
- ⇒ In a *QT regime*, we should expect the opposite, which is exactly what we have been seeing recently

Quantitative Tightening and US bond markets

- Break-even inflation expectations have been easing since late 2012, with the recent downturn in line with the easing of reserve creation
- The US10y yield peaked the month after money creation peaked (in yoy terms) and have been under pressure since
- The 10y-5y curve has flattened tremendously

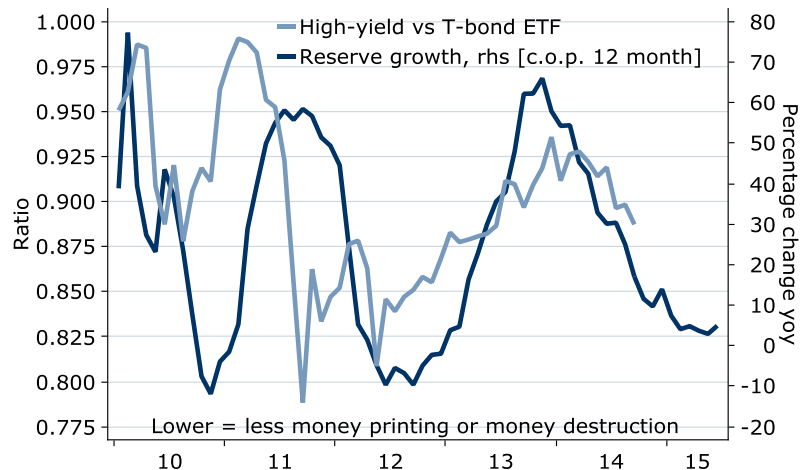


Quantitative Tightening and credit & stock markets

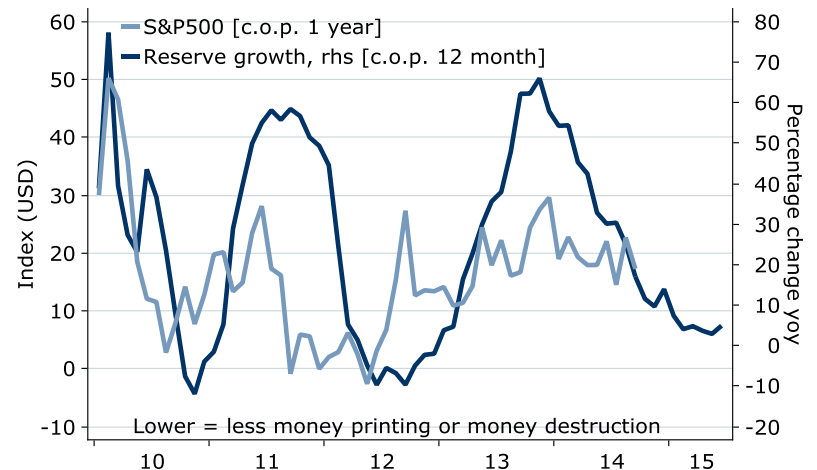


Sources: Nordea Markets and Macrobond

- Well-rated credit spreads have widened recently, possibly also attributable to the upcoming regime shift from the Fed (from QE to QT)
- High-yielding credits show the same pattern
- The S&P500 stock market have cooled down notably



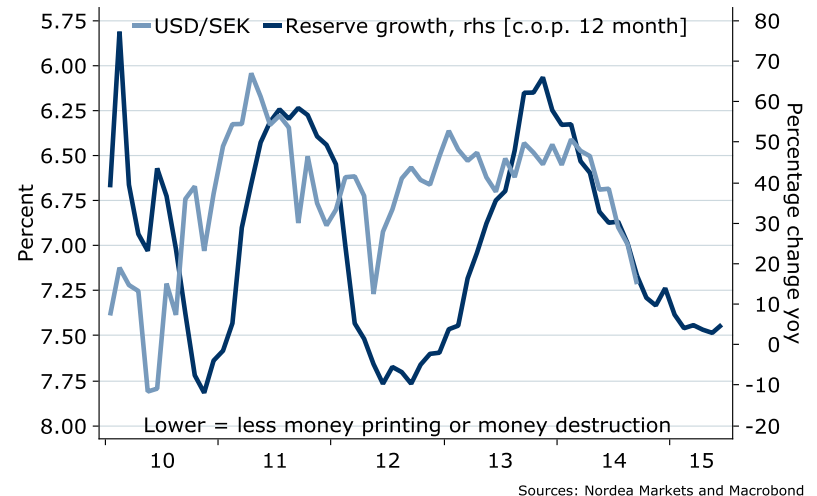
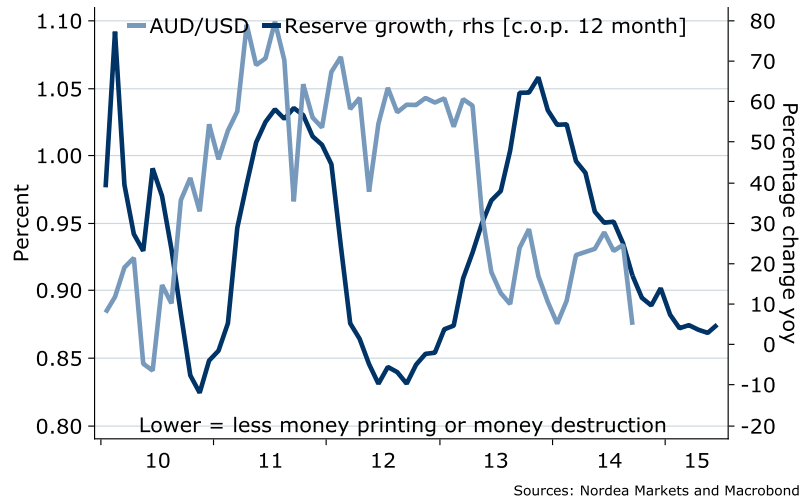
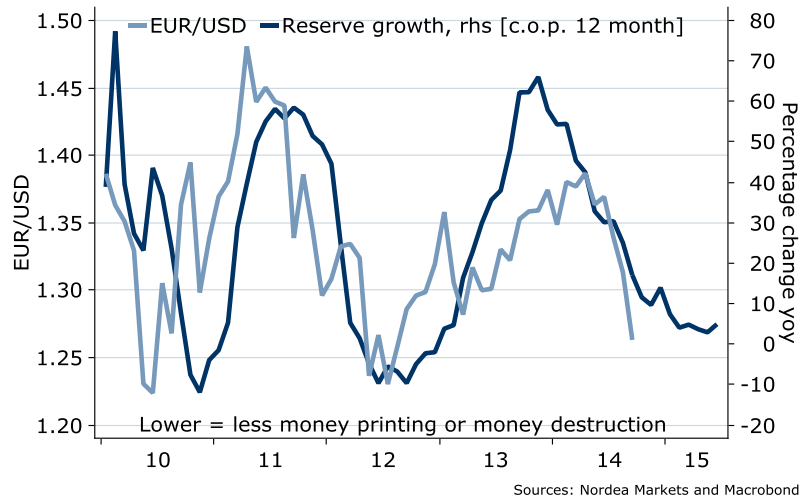
Sources: Nordea Markets and Macrobond



Sources: Nordea Markets and Macrobond

Quantitative Tightening and FX

- EUR/USD has been under pressure since May. This is consistent with a USD being repriced in a more costly direction due to the Fed's regime shift
- AUD/USD peaked already in 2011, but has been under renewed downward pressure recently
- USD/SEK has headed higher on the back of a lower EUR/USD



Thank You!

Nordea Markets is the name of the Markets departments of Nordea Bank Norge ASA, Nordea Bank AB (publ), Nordea Bank Finland Plc and Nordea Bank Danmark A/S.

Martin Enlund,
martin.enlund@nordea.com

The information provided herein is intended for background information only and for the sole use of the intended recipient. The views and other information provided herein are the current views of Nordea Markets as of the date of this document and are subject to change without notice. This notice is not an exhaustive description of the described product or the risks related to it, and it should not be relied on as such, nor is it a substitute for the judgement of the recipient.

The information provided herein is not intended to constitute and does not constitute investment advice nor is the information intended as an offer or solicitation for the purchase or sale of any financial instrument. The information contained herein has no regard to the specific investment objectives, the financial situation or particular needs of any particular recipient. Relevant and specific professional advice should always be obtained before making any investment or credit decision. It is important to note that past performance is not indicative of future results.

Nordea Markets is not and does not purport to be an adviser as to legal, taxation, accounting or regulatory matters in any jurisdiction.

This document may not be reproduced, distributed or published for any purpose without the prior written consent from Nordea Markets.