



Philanthropy New Zealand

Tōpūtanga Tuku Aroha o Aotearoa

The market impact of Quantitative Easing

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Harbour Asset Management



Quantitative Easing Explained

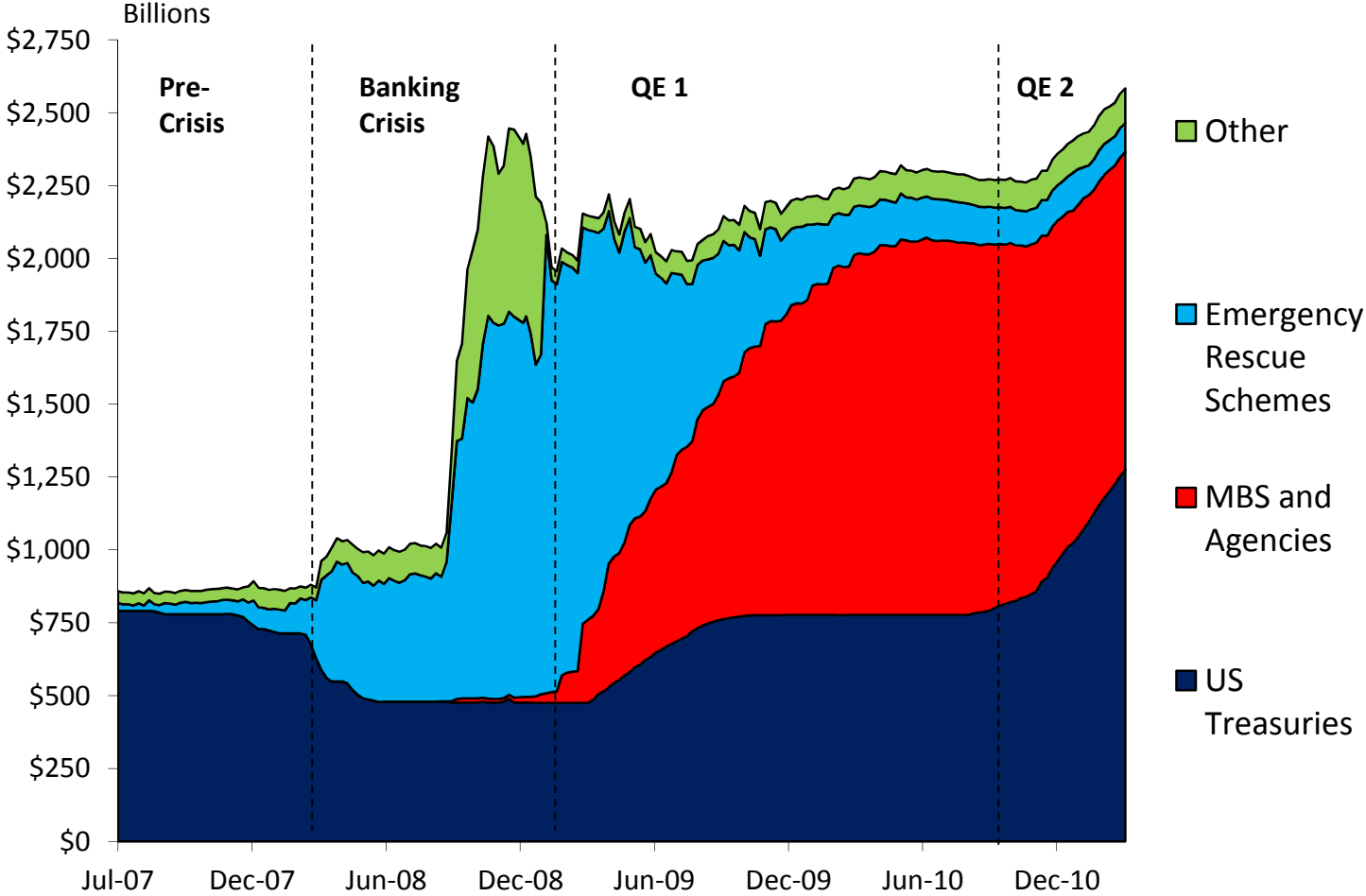
<http://www.youtube.com/watch?v=PTUY16CkS-k>

US Federal Reserve assets

The Fed balance sheet has expanded in distinct phases



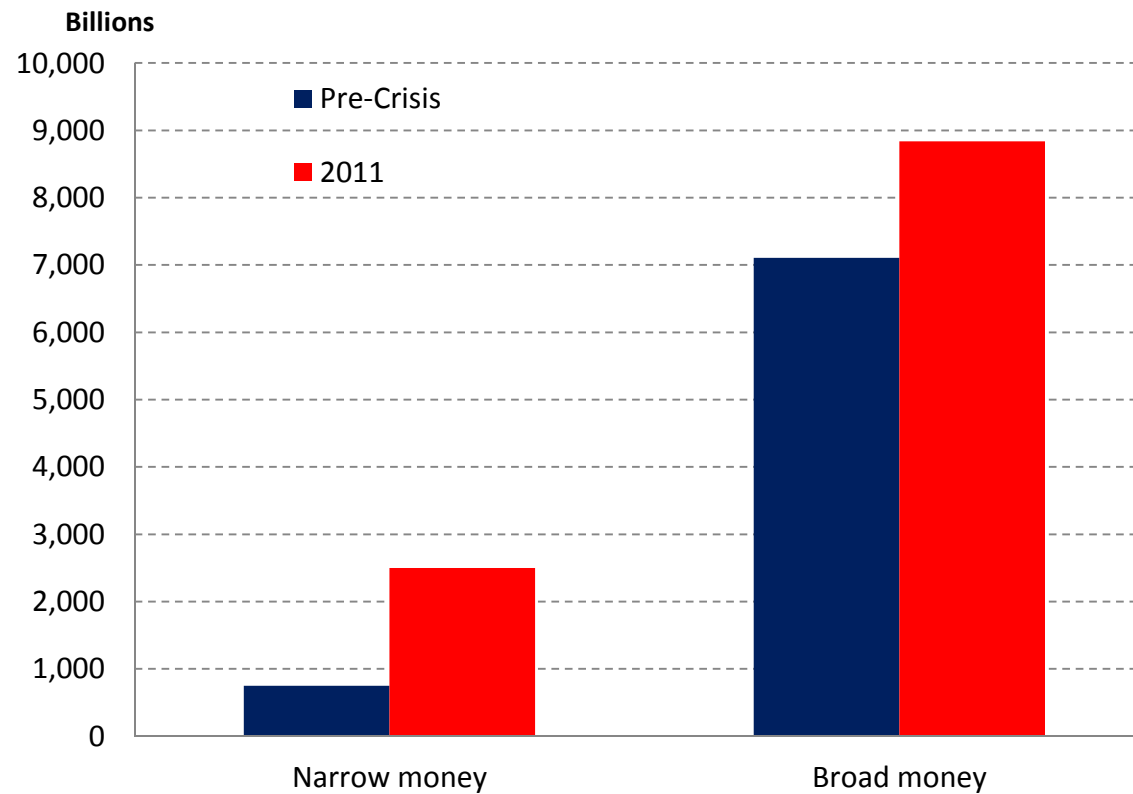
US Federal Reserve assets



The Fed balance sheet has expanded in distinct phases

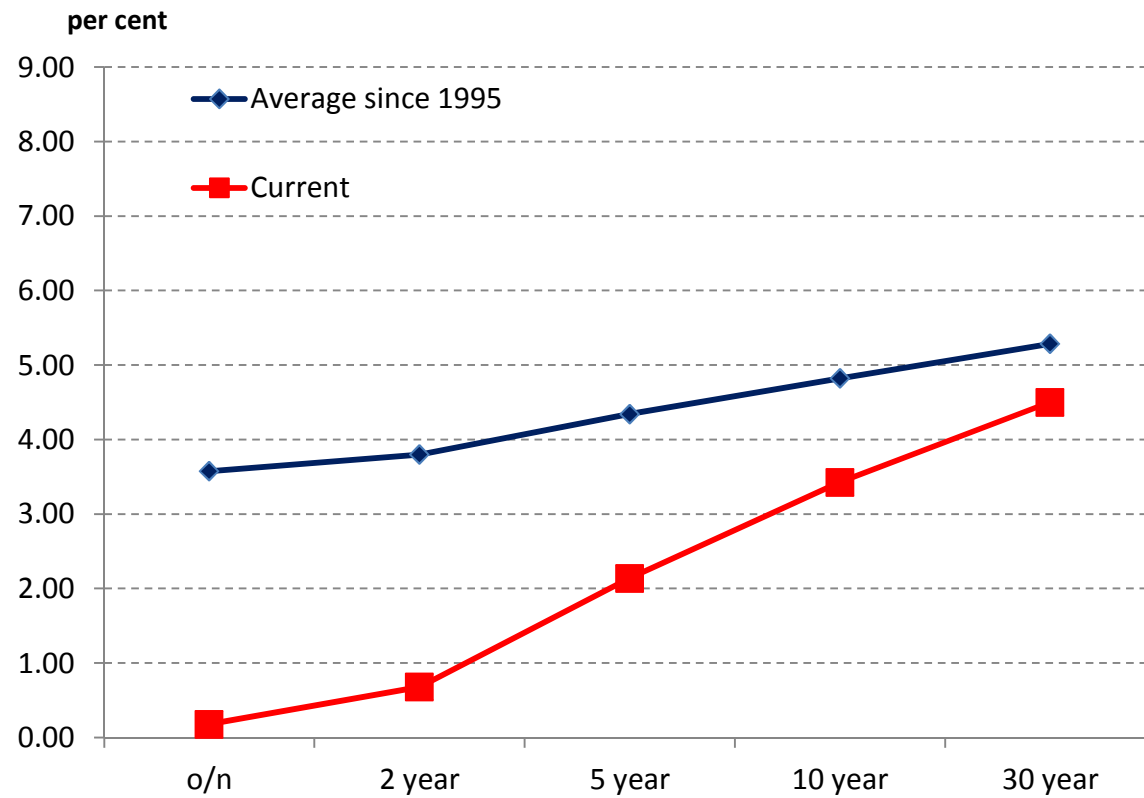


US narrow and broad money



Growth of Fed balance sheet not
matched by broad money growth

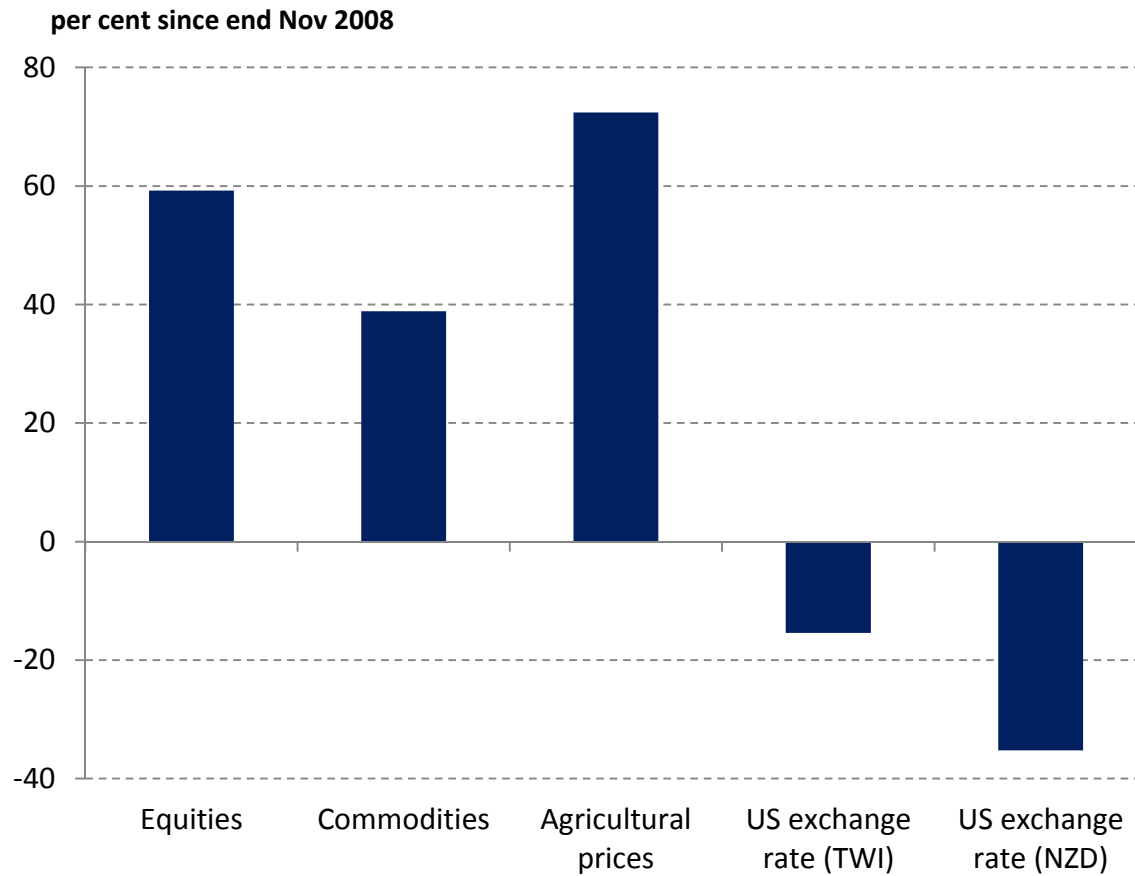
US government bond yields



QE has held down interest rates

Impact on asset markets

Impact on asset markets



QE has created a huge increase in asset prices;
and depreciation of the US dollar

The health of the US economy

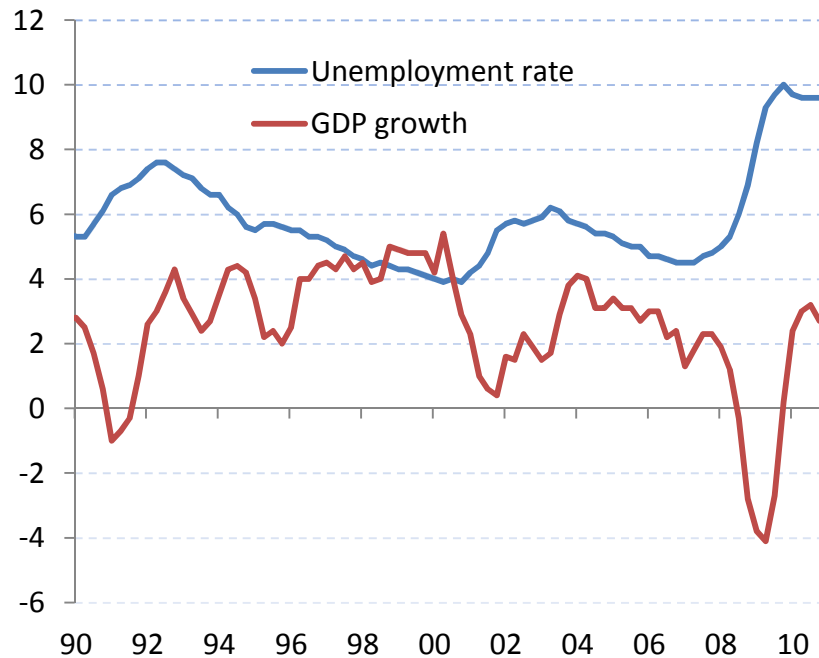
Economic activity



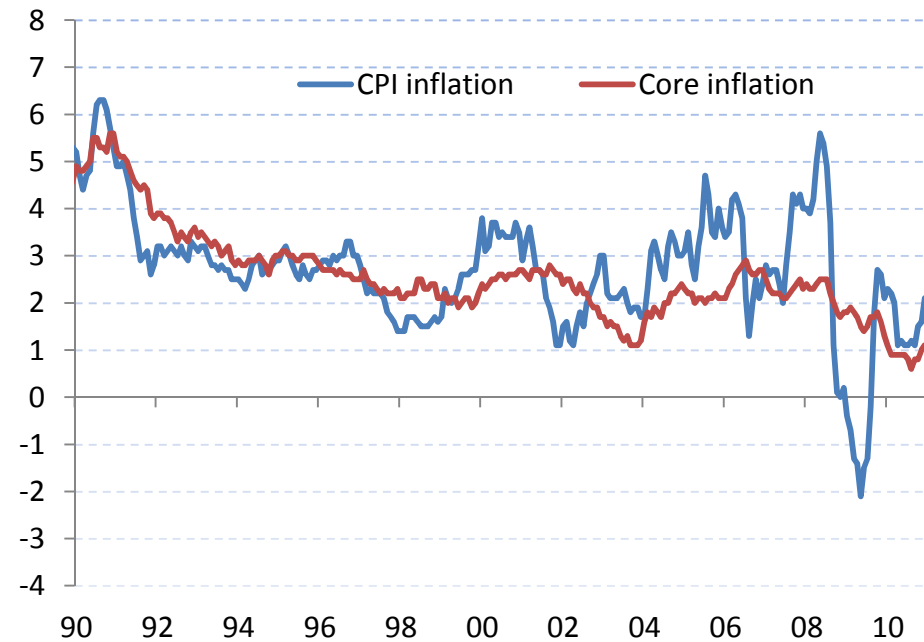
GDP growth is recovering, but unemployment is still high

The health of the US economy

Economic activity



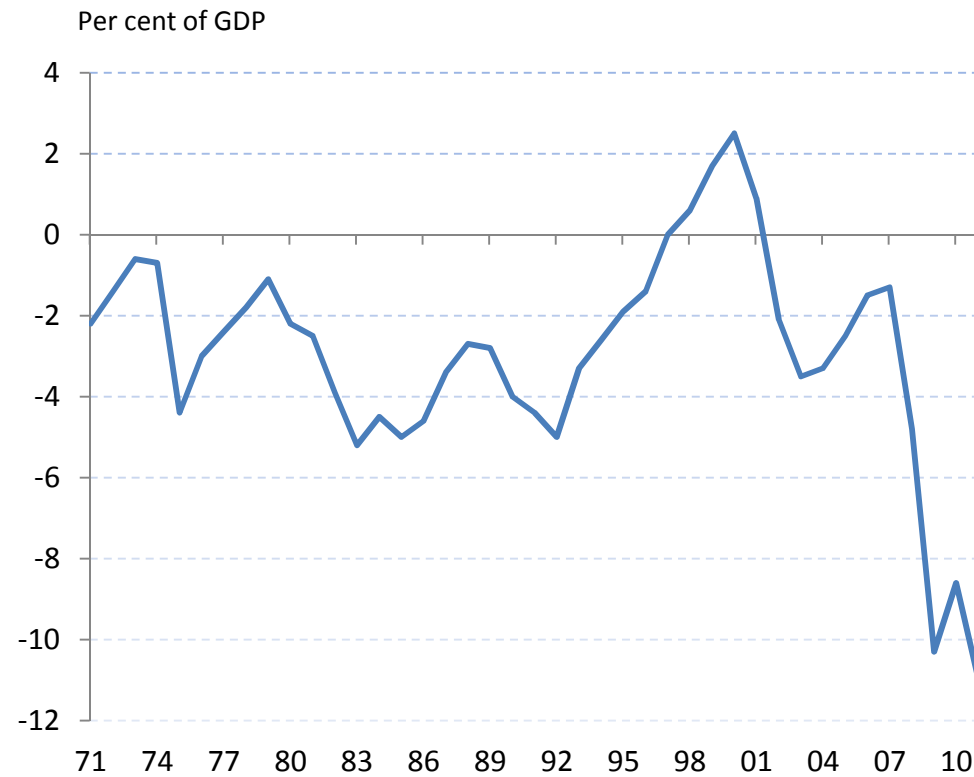
Inflation



GDP growth is recovering, but unemployment is still high and core inflation still low

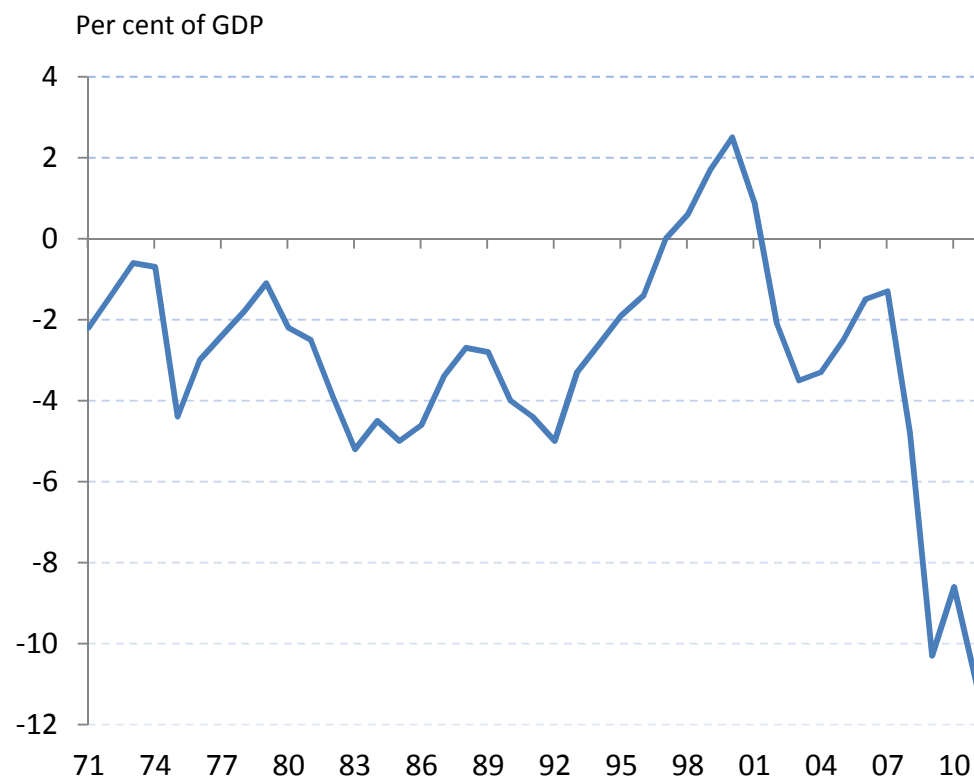
The health of the US government

Fiscal deficit



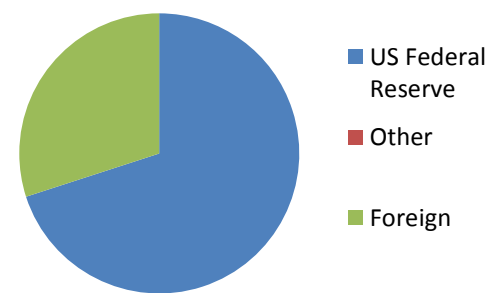
The health of the US government

Fiscal deficit

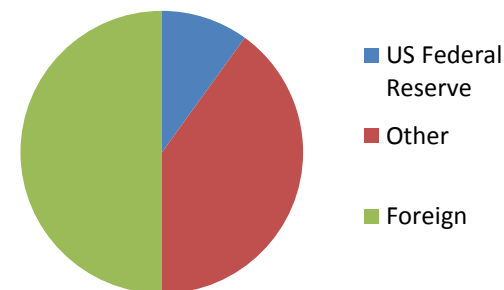


US Treasury market

Purchases since QE



Outstanding stock



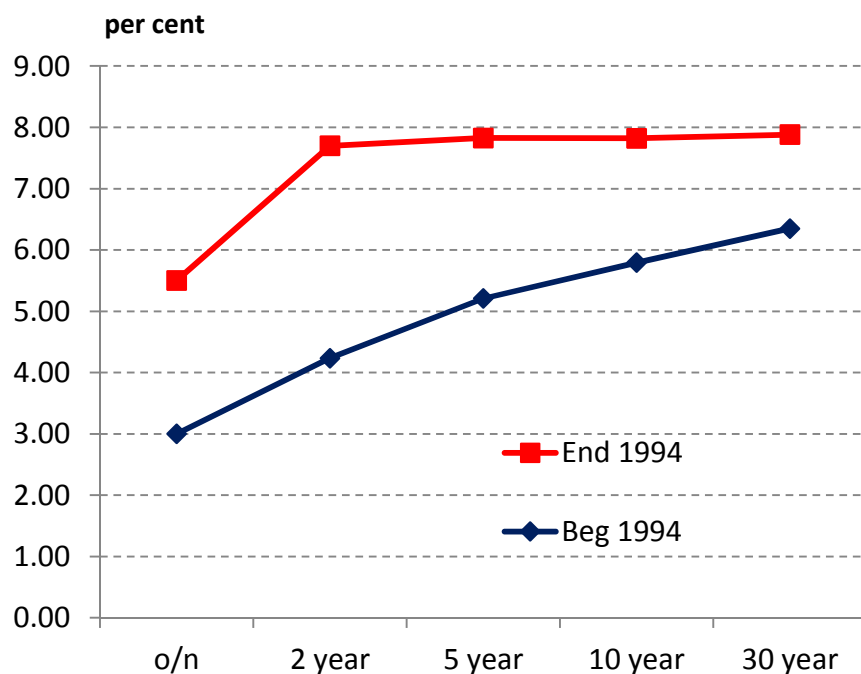
Who will buy US Treasuries when the US Fed has stopped purchasing?

Fed tightening: impact on US interest rates

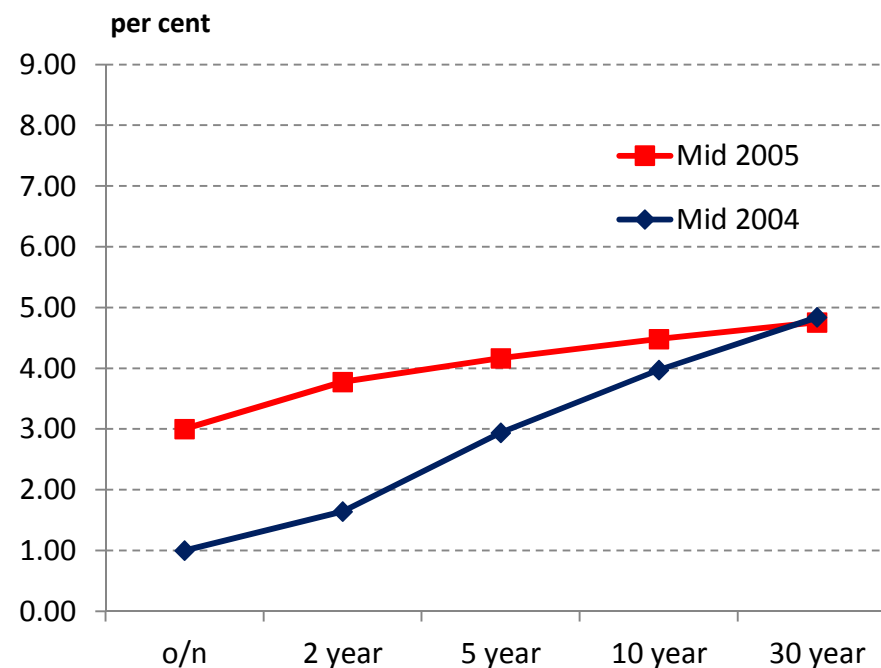
Could interest rates rise as sharply as 1994?

Fed tightening: impact on US interest rates

Post Savings and Loans Crisis



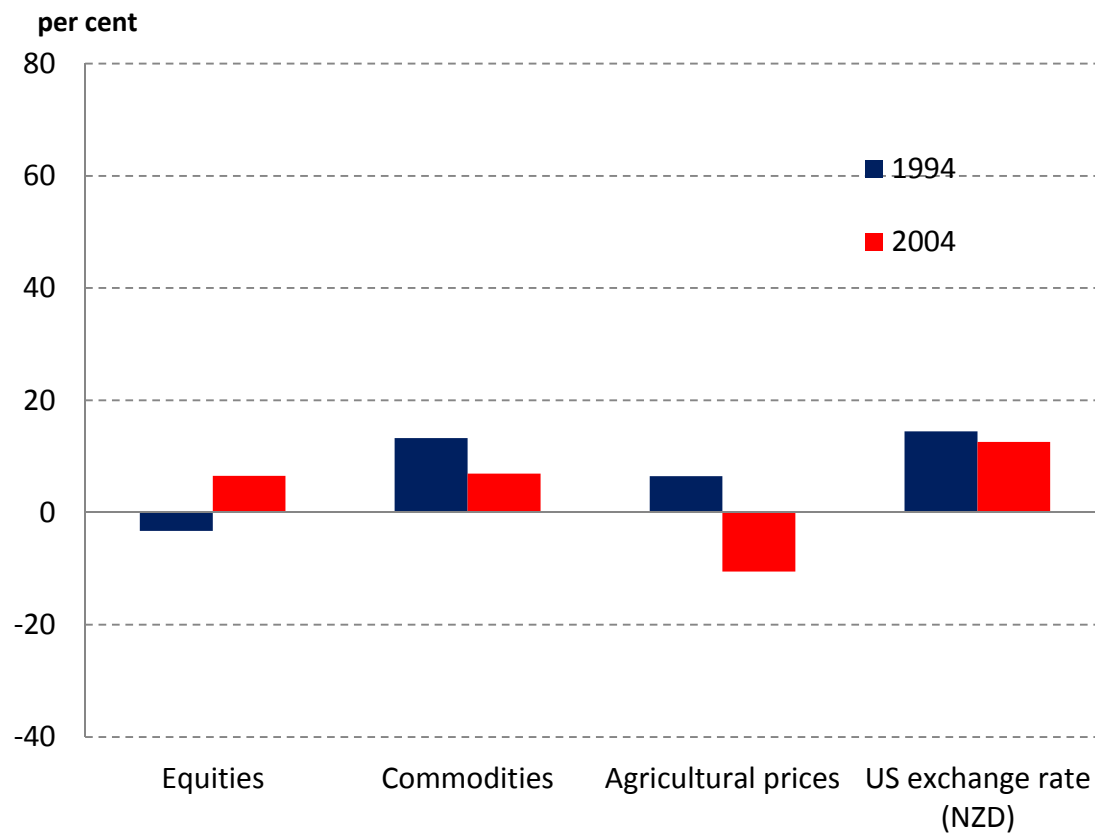
Post Tech Stock Bubble



Could interest rates rise as sharply as 1994?

Fed tightening: impact on asset markets

Fed tightening: impact on asset markets



Tightening phases see sluggish asset price growth; and appreciation of the US dollar

QE exit scenarios

“Hawkish Fed”

“Goldilocks”

“Inflation”

“Stagflation”

QE exit scenarios

“Hawkish Fed”

Fed raises interest rates too soon

“Goldilocks”

“Inflation”

“Stagflation”

Probability: 0%

QE exit scenarios

“Hawkish Fed”

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Gradual economic recovery

Fed raises interest rates gradually

Modest market impact

Probability: 60%

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“Stagflation”

QE exit scenarios

“Hawkish Fed”

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“Goldilocks”

Gradual economic recovery

Fed raises interest rates gradually

Modest market impact

Probability: 60%

“Inflation”

Fast economic recovery

Market interest rates rise before the Fed

Significant market impact

Probability: 30%

“Stagflation”

QE exit scenarios

“Hawkish Fed”

Fed raises interest rates too soon

Probability: 0%

“Goldilocks”

Gradual economic recovery

Fed raises interest rates gradually

Modest market impact

Probability: 60%

“Inflation”

Fast economic recovery

Market interest rates rise before the Fed

Significant market impact

Probability: 30%

“Stagflation”

No economic recovery

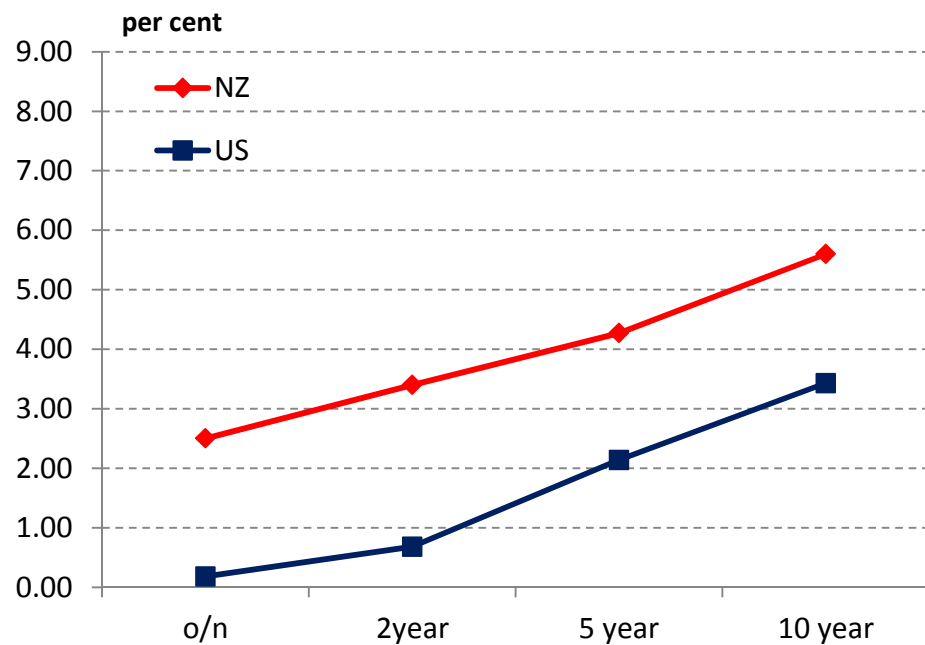
But cost pressures force Fed to raise rates to stop an inflation spiral

Very significant market impact

Probability: 10%

NZ government bond market

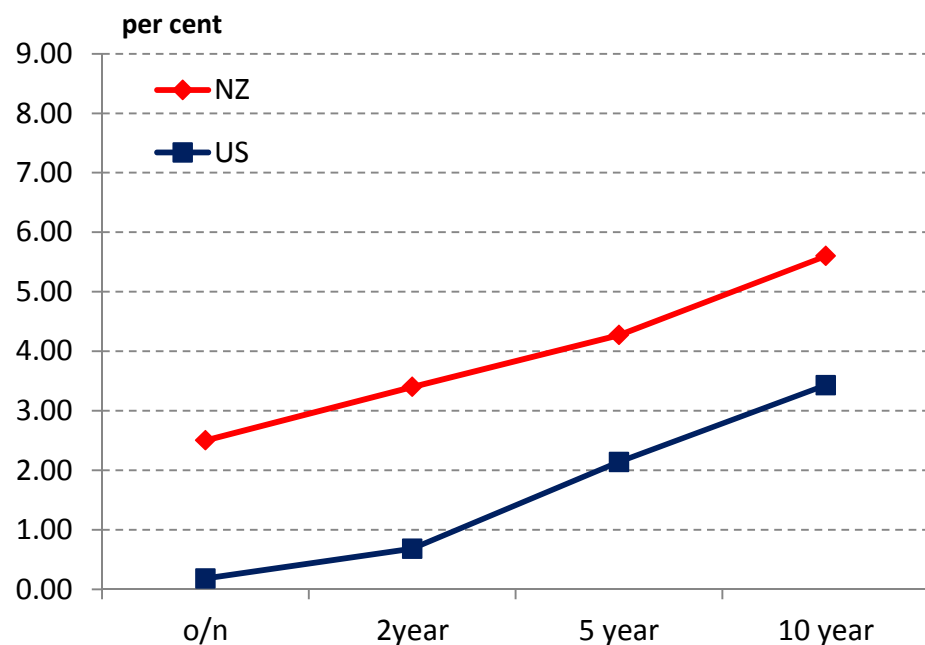
Level of interest rates



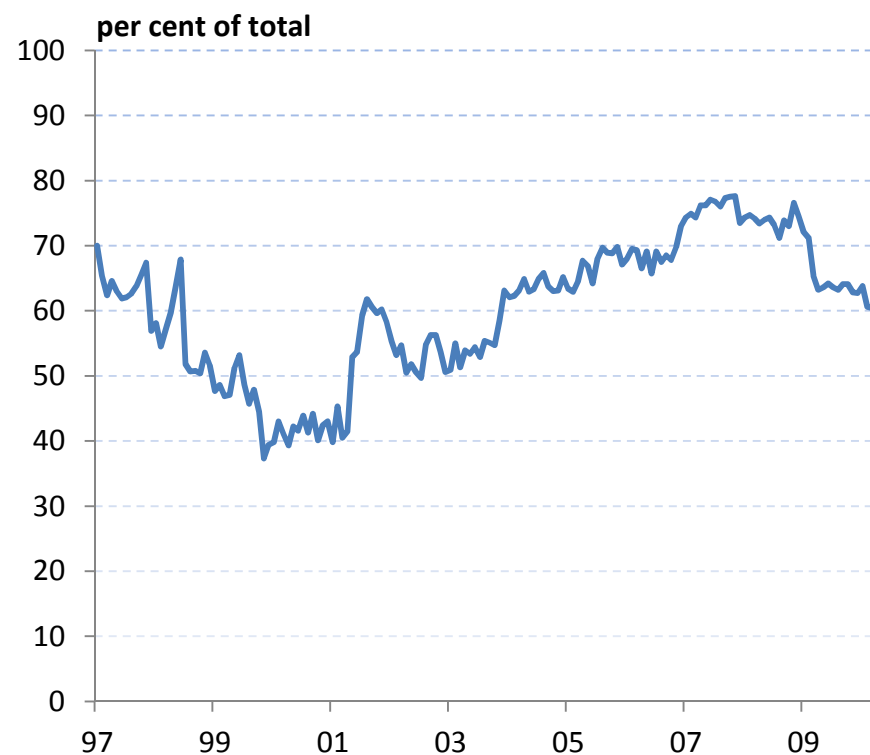
NZ interest rates already significantly higher than the US

NZ government bond market

Level of interest rates



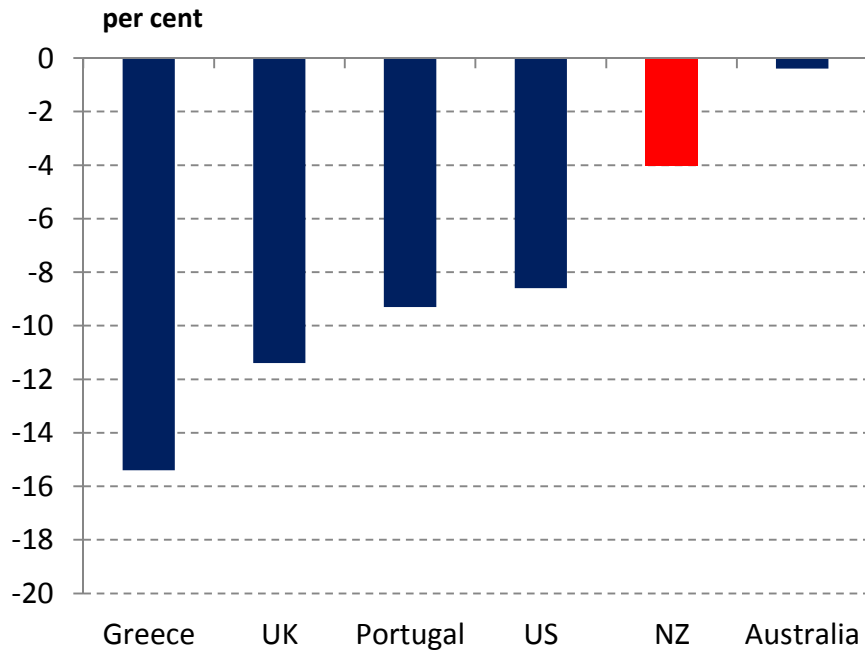
Non-resident holdings



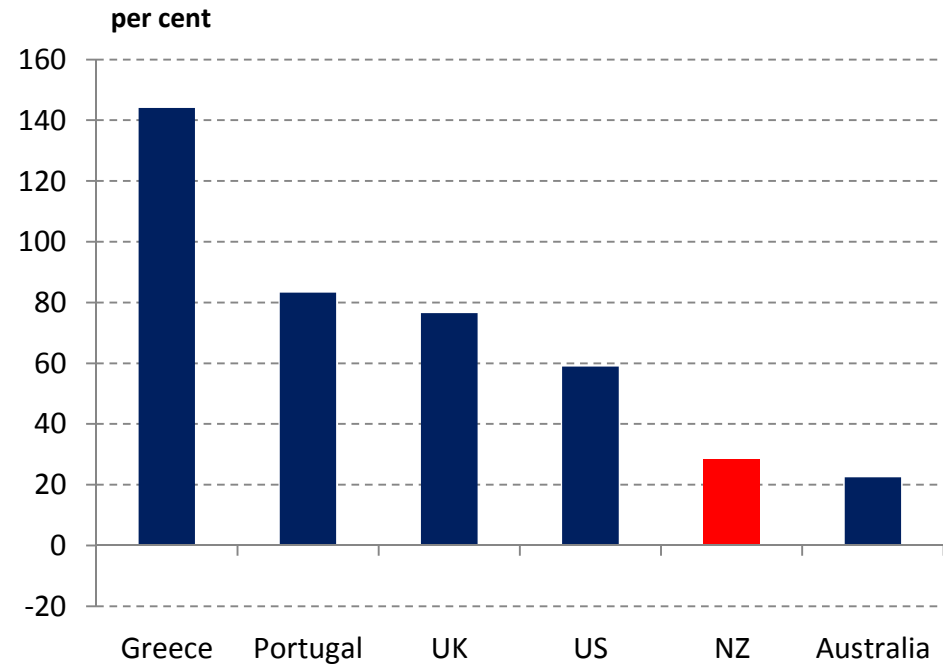
NZ interest rates already significantly higher than the US;
non-resident holdings not unusually high

NZ fiscal health

Fiscal deficit to GDP



Govt debt to GDP



NZ fiscal situation deteriorating, but good less ugly than others

Key questions

Key questions

	End March 2011	12 months ?
US 2 year rates	0.80%	
US 10 year rates	3.40%	
NZ Official Cash Rate	2.50%	
NZ 10 year rates	5.60%	
NZD/USD exchange rate	76 cents	
S&P 500 Equity Index	1,325	
Fonterra Payout	\$7.90-\$8.00	