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Less QE does not equate to QT

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The impending process of "tapering" in the US, i.e. the reduction of quantitative easing (QE) as a tool of monetary policy, revives memories of the "taper tantrum" of 2013. Back then, however, the markets were not alerted to the plans of the US central bank (Fed) at an early stage, and therefore reacted with surprise. Although greater financial market volatility can reasonably be expected in the event of brisk tapering of QE purchases, this time around it is changes in US fiscal policy that could prove more important for the development of the economy and corporate earnings.

Quantitative easing is the term used to describe the loosening of monetary policy by central banks through the purchase of securities, particularly government or corporate bonds. During the financial crisis of 2008/2009 and after the euro crisis of 2011/2012, expansionary monetary policy was an important – indeed necessary – supplement to cutting interest rates in order to stimulate the economy and financial markets. The same was true during the coronavirus crisis from the spring of 2020 onwards. The concept of QE was invented by Japan's central bank around 20 years ago, when it was trying to counteract excessively weak economic growth.

No one disputes that QE on the part of the world's leading central banks has contributed to stabilising capital markets and the global economy. In its absence, we might have seen a negative economic spiral lasting several quarters last year, as well as a prolonged financial crisis. And as we saw in the spring of 2020, dramatic market movements in both directions are possible during a crisis – downwards if central banks barely engage with QE or do so only minimally (as at the start of the coronavirus crisis), and upwards if central banks make unlimited amounts of liquidity available. The equity market slump and recovery in 2020 both unfolded in record time. What this tells us is that the impact of QE manifests itself primarily in a psychological effect and the corresponding change in the risk premium of various classes. The actual effect of direct monetary liquidity is only felt following a certain time lag. As a rule, the impact on the global economy of changes in long-term interest rates, i.e. the yields available on longer-dated bonds, is felt only at a much later stage.

> "Where the development of the US economy is concerned, fiscal policy is at least as important as monetary policy."
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> Gérard Piasko, Chief Investment Officer

Back in 2013, the Fed's rather inept communication of the impending scaling-down of bond purchases came as a surprise to the market, triggering the so-called "taper tantrum". As the markets had not been prepared for this development, the announcement of the tapering of QE in 2013 resulted in a clear (albeit short-lived) equity market correction – modest in the US and Europe, but much more dramatic in the emerging markets due to the effect of a stronger US dollar. With this experience, the Fed is surely now fully aware of how gradual and cautious it has to be in the tapering of QE. In particular, Fed Chairman Jerome "Jay" Powell, who famously had to do an abrupt monetary policy U-turn following the equity market correction in 2019, is likely to think twice before initiating any radical change. In other words, this time around the markets are likely to be better prepared than in 2013 for the tapering of QE as announced by the Fed. However, it has often been the case in the past that any change in monetary policy has gone hand in hand with an increase in volatility across all asset classes.

During the coronavirus crisis, the loosening of monetary policy was additionally accompanied by huge economic stimulus in the form of government spending – i.e. fiscal stimulus. As the posting of cheques and other forms of fiscal stimulus had a greater and more direct impact on the US and global economy than monetary policy during the coronavirus crisis, more restrictive fiscal policy for 2022/2023 would be more dangerous for the economy than the impending tapering of QE. Tapering does appear to make sense if central banks are to have more "ammu-

nition" at their disposal to support markets once again in the event of any threat of recession looming at a later stage. It should be emphasised that while any tapering of bond purchases by the Fed would constitute a reduction in QE, it would not be tantamount to QT ("quantitative tightening"), i.e. more restrictive quantitative monetary policy. In the past, the Fed has only resorted to the latter at an advanced stage of the economic cycle. This involved the Fed actively selling bonds, which is not the same as purchasing fewer bonds.

Conclusion: A slight change in US monetary policy involving a tapering of QE, i.e. a reduction in bond purchases, is not the same as QT, which is an actual tightening of monetary policy. This is particularly true if the tapering process is signalled and placed in its proper context through careful communication at an early stage. Nonetheless, greater market fluctuations in all asset classes are quite possible against a backdrop of QE tapering.

Gérard Piasko

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