QE: careful what you wish for

Institute and Faculty of Actuaries seminar

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QE: careful what you wish for

Overview

Global context

A. Factors shaping global activity

B. The UK's post-election challenges

C. Inflation risk: is the Fed falling behind the curve?

Unintended consequences of QE

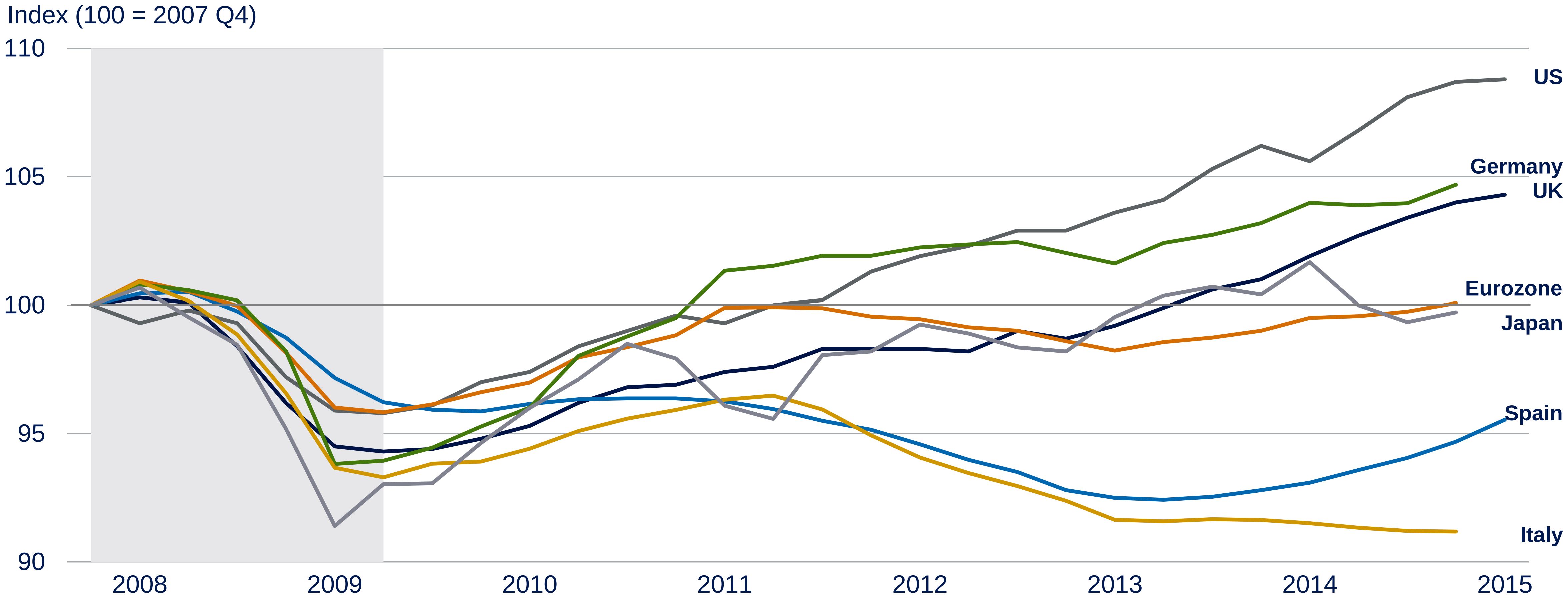
A. Liquidity boost

B. Impact on corporate behaviour

C. Asset shortages

Global snapshot

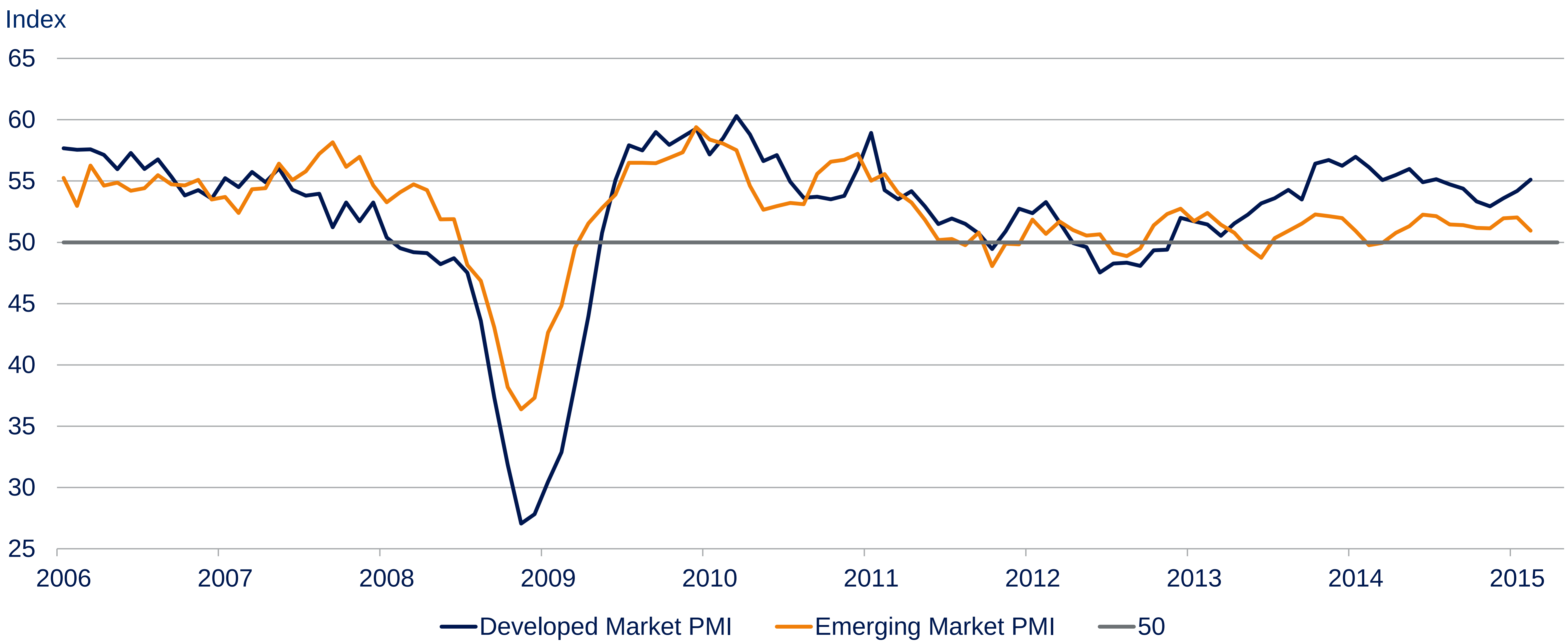
Advanced economies real GDP paths since the peak



Source: Thomson Datastream, Schroders, 1 May 2015

Global snapshot

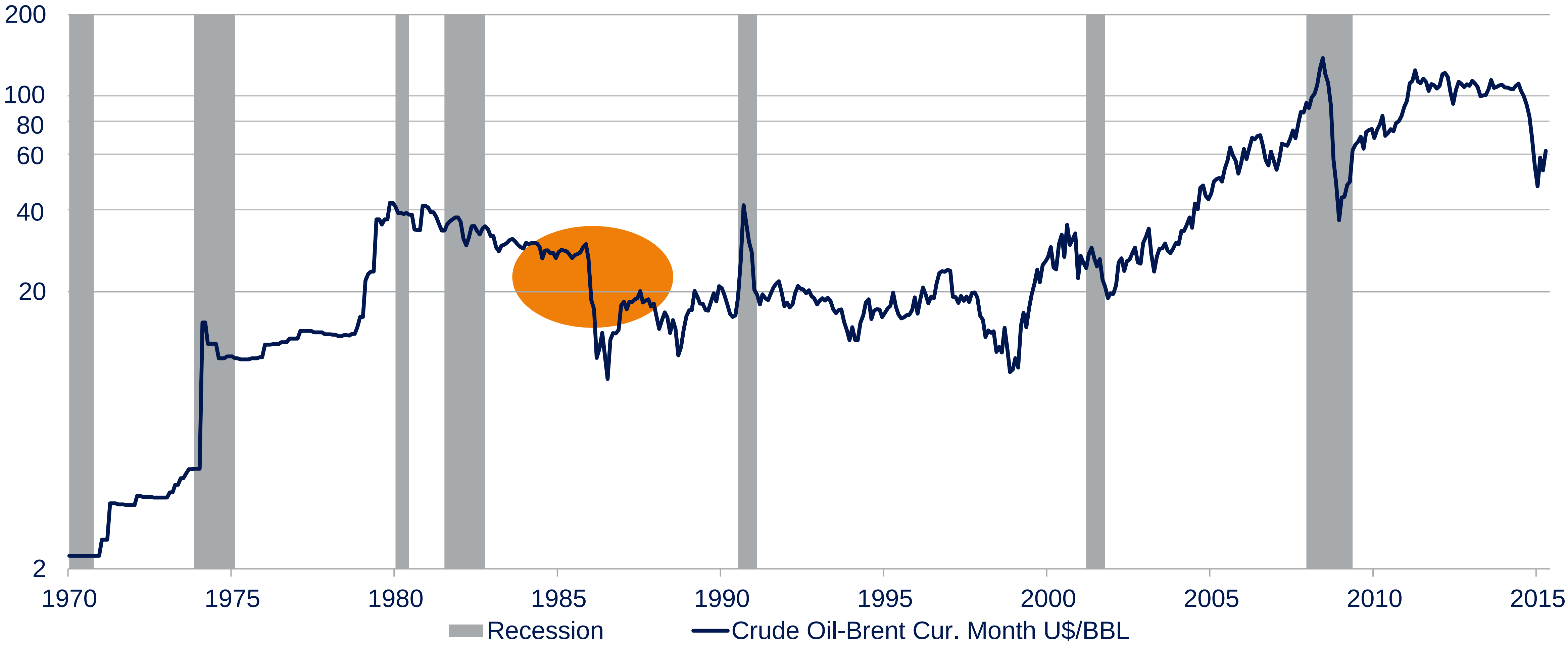
Emerging lagging developed recovery



Source: Thomson Datastream, Schroders, 27 April 2015. PMI – Purchasing Managers Indices

The oil shock

Saudis send price back to 2008 levels

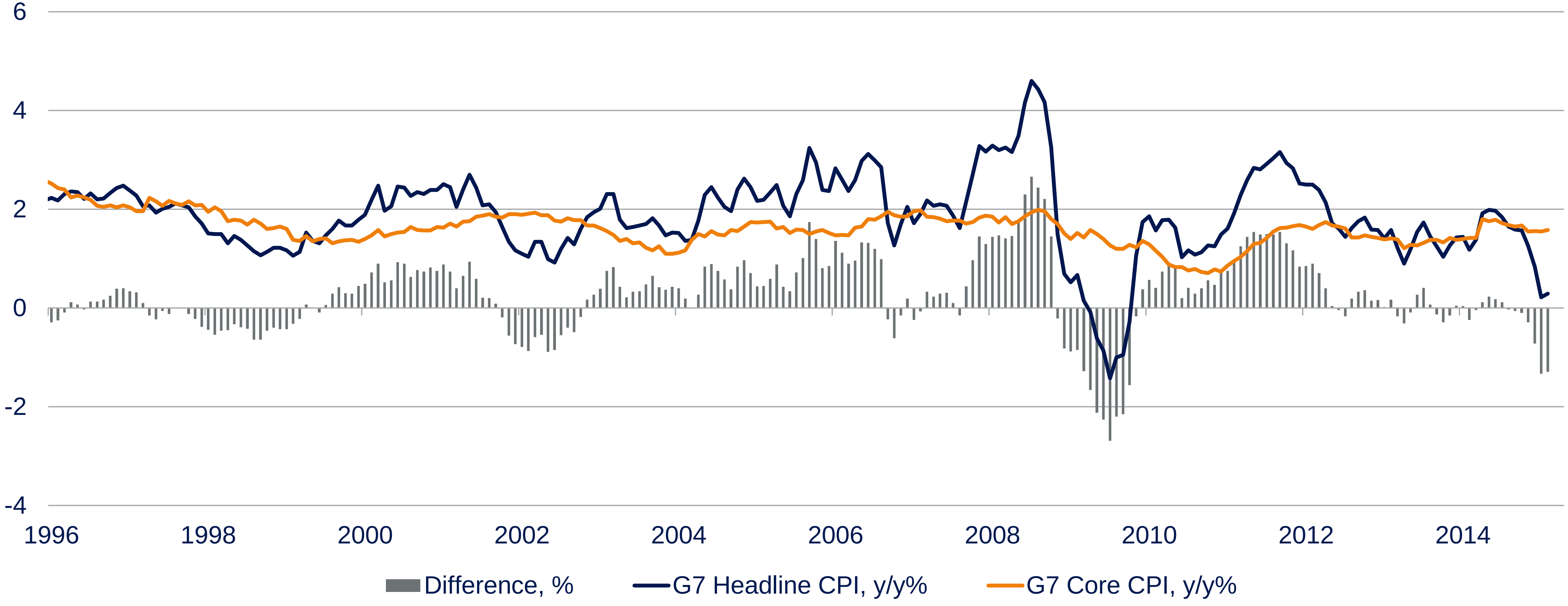


Source: Thomson Datastream, Schroders, 10 April 2015

Fear of deflation

Drop in headline inflation not followed by core

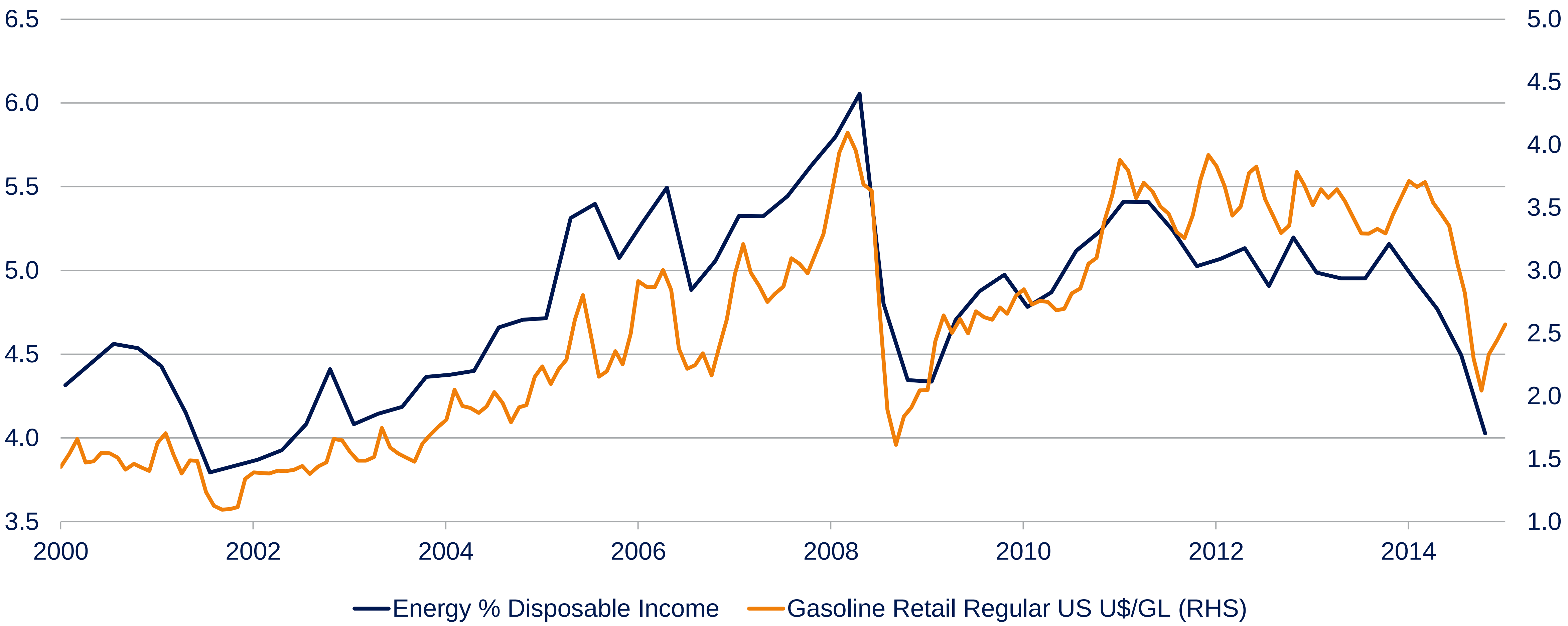
G7 headline and core CPI inflation



Source: Thomson Datastream, Schroders, 27 April 2015

Lower oil prices, good or bad for the world economy?

The energy tax cut in the US

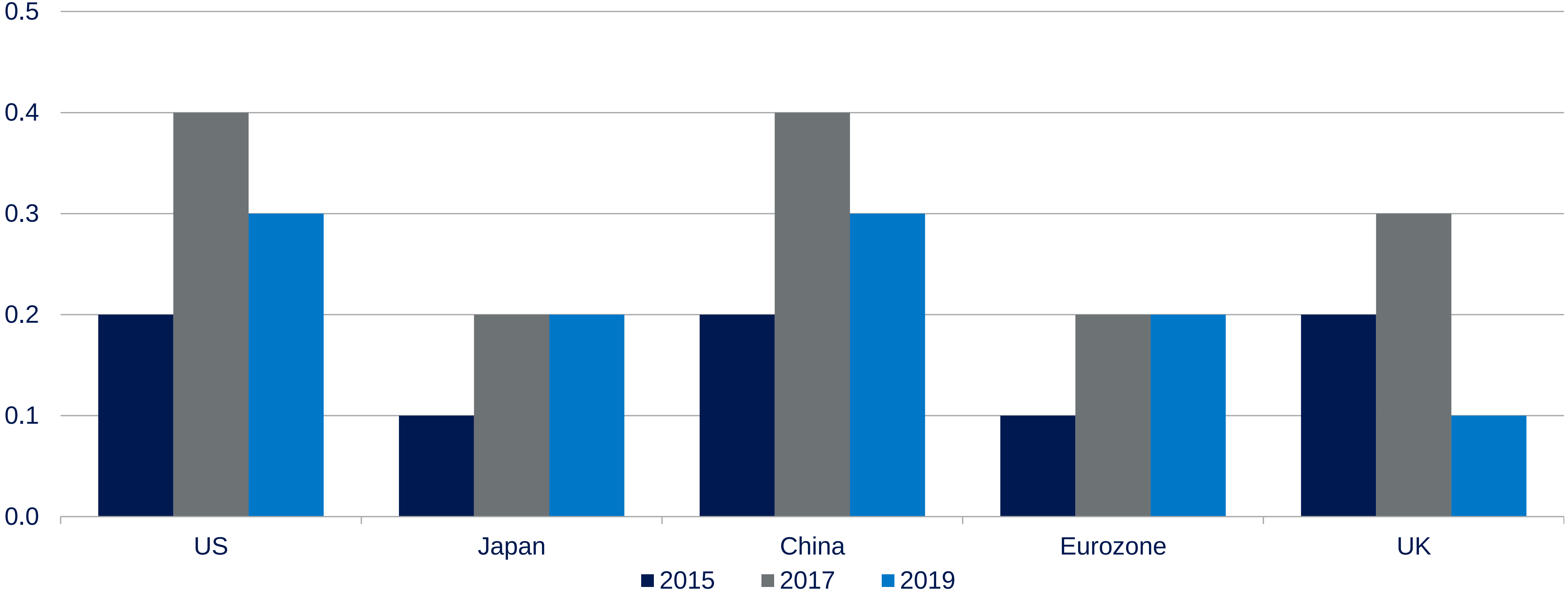


Source: Thomson Datastream, ONS, Schroders, 10 April 2015

Growth impact from lower oil prices

Benefit to energy consumers outweighs losses to producers

Cumulative marginal % point increase in real GDP from 10% fall in oil prices

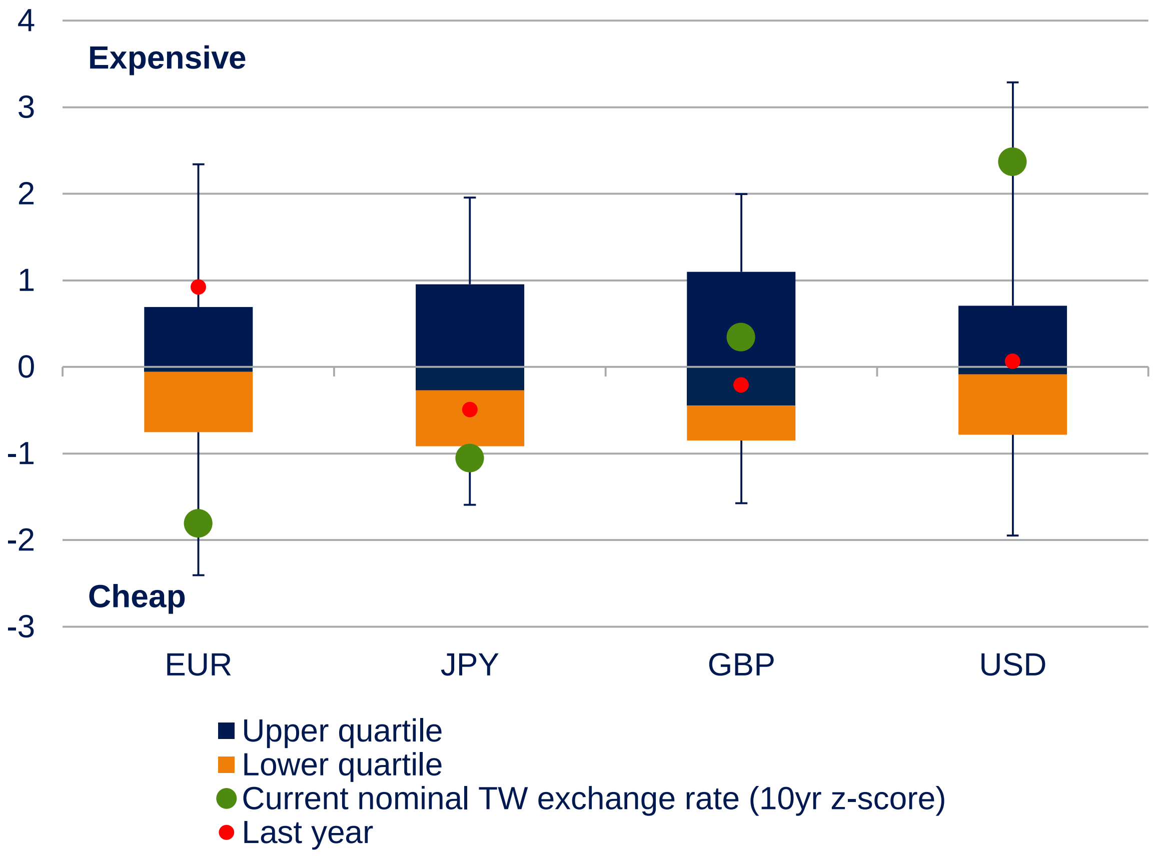


Source: Oxford Economics Forecast model, Schroders calculation, 1 December 2014

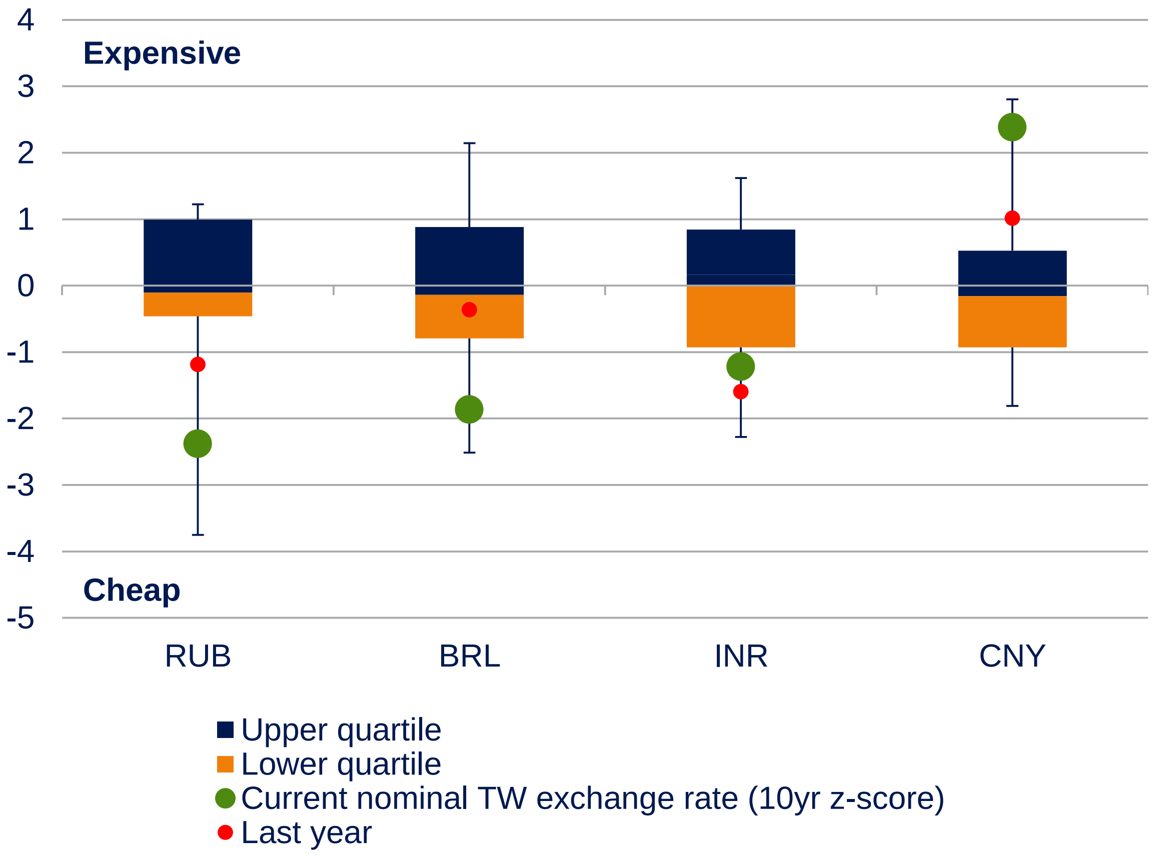
Currency wars: stealing an advantage

Trade-weighted exchange rates

Developed markets



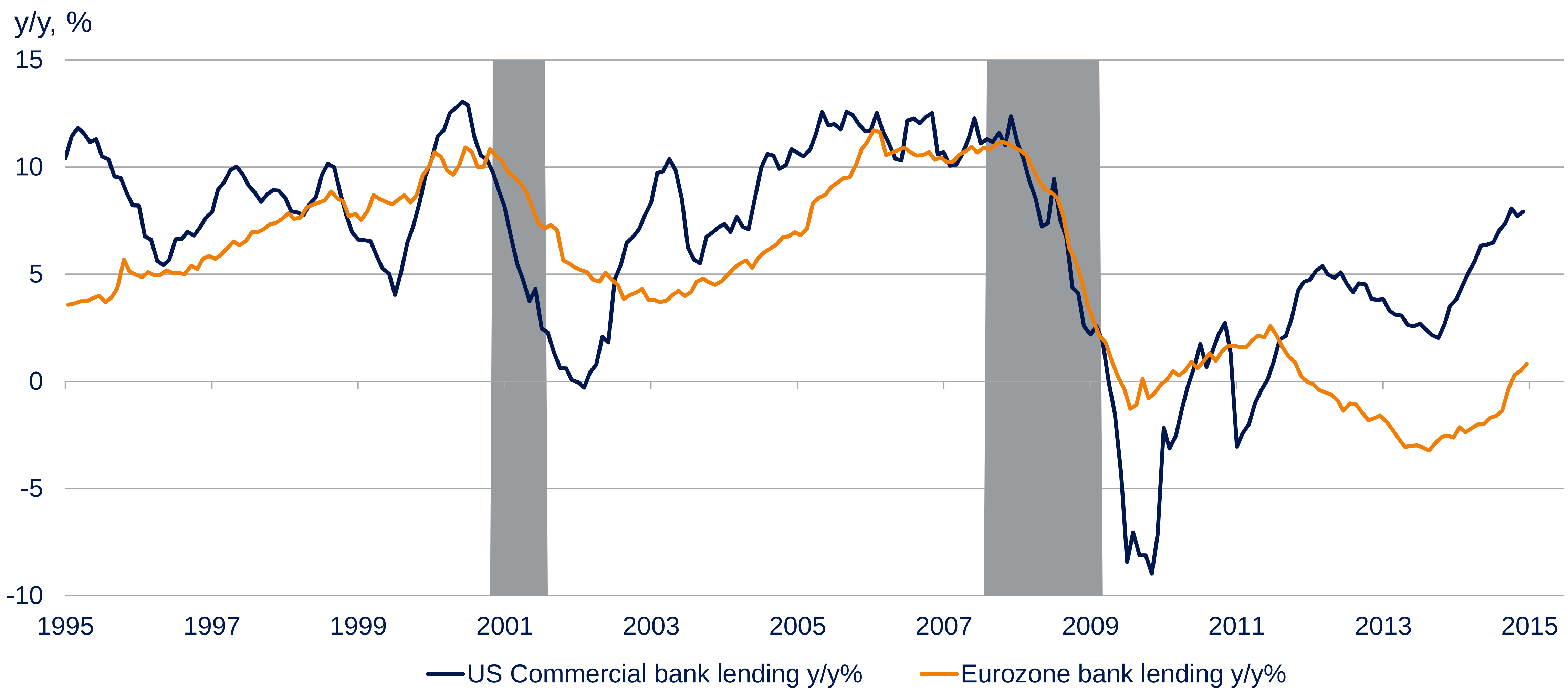
Emerging markets



Source: Thomson Datastream, Schroders, 1 May 2015

Turning point

Bank lending picks up in the Eurozone



Source: Thomson Datastream, Schroders, 1 May 2015

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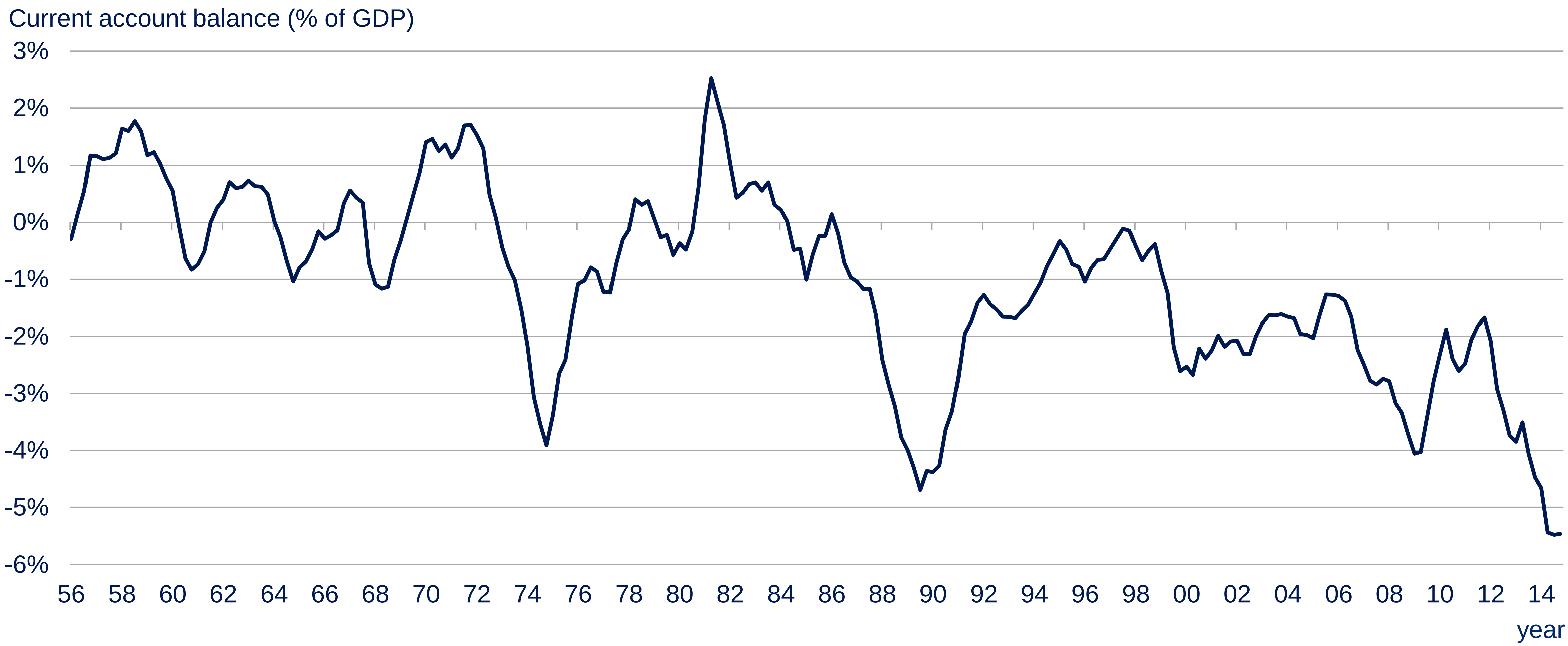
UK

Post-election challenges

Twin deficits pose challenge to UK

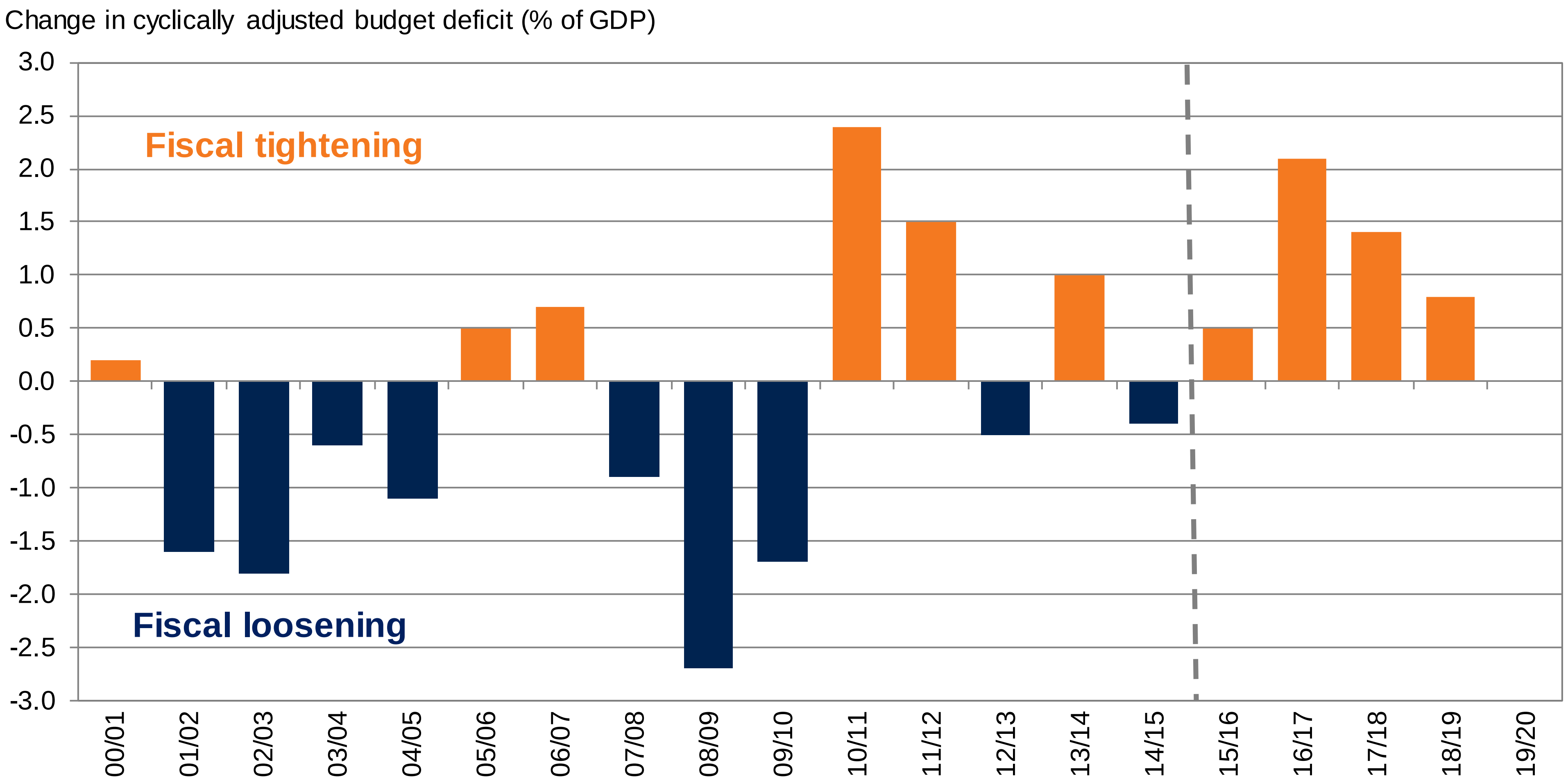
Record current account deficit



Source: Thomson Datastream, ONS, Schroders, 31 March 2015

Austerity set to resume

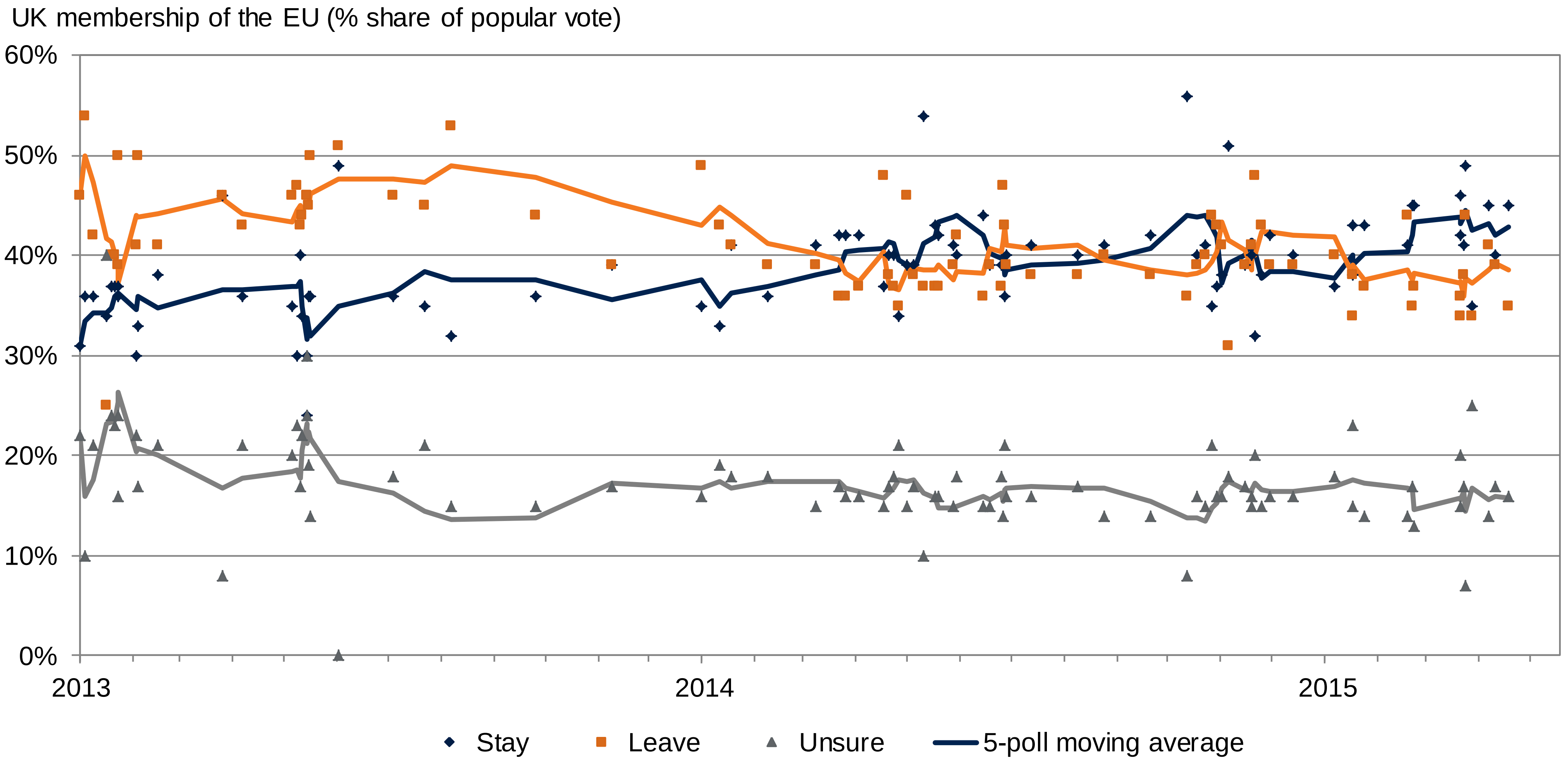
Policy to tighten further to meet government targets (OBR forecast)



Source: OBR, Schroders. Updated 18 March 2015.

‘Brexit’? What are the polls saying?

Voting intentions on an EU exit



Source: wikipedia.org, YouGov, TNS, Opinium, Survation, ComRes, Ipsos Mori, Financial Times, Schroders, last poll end date: 20 April 2015.

US: inflation risk

Fed falling behind the curve?

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Fed tightening due on normalisation of economy

Jobs calculator points to sub-5% unemployment in the US

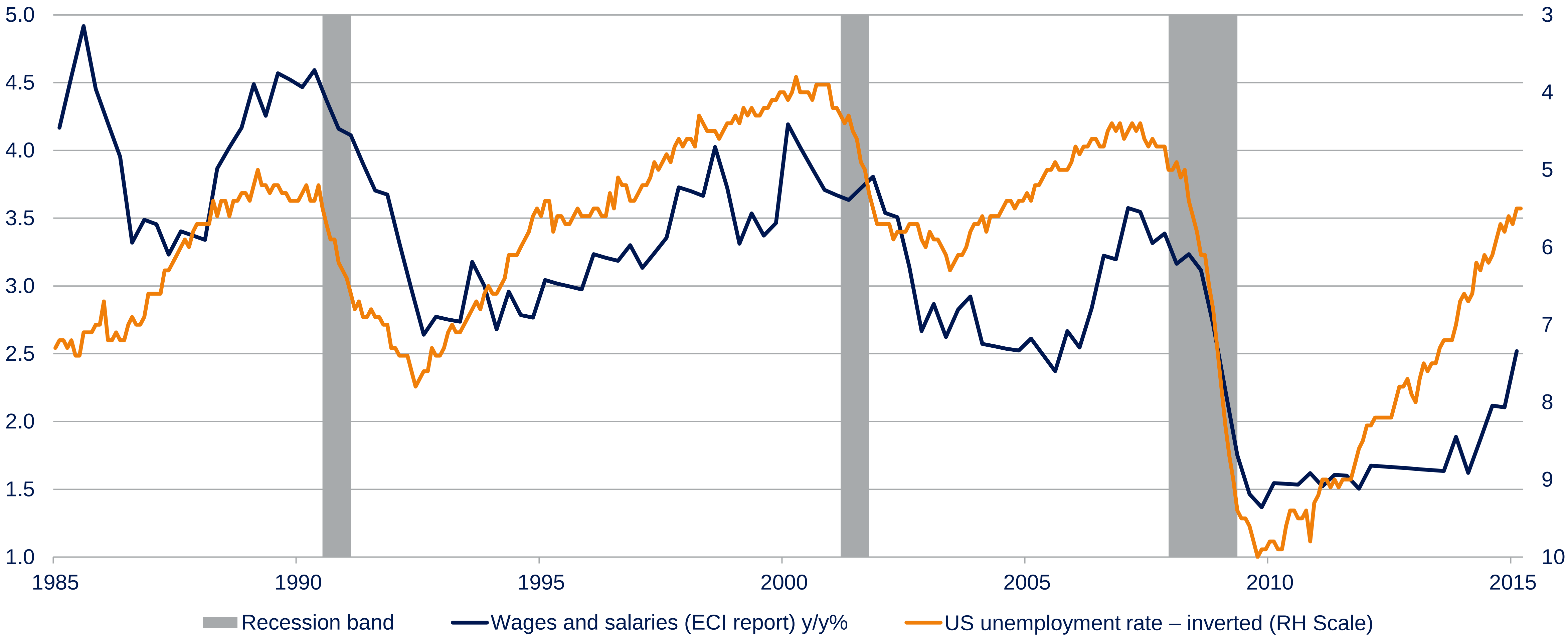
Monthly payroll growth for different unemployment rates in 12 months time		Unemployment rate			
		4.5%	5.0%	5.5%	6.0%
Participation rate	62.0%	102k	40k	-22k	-84k
	62.5%	197k	135k	72k	10k
	62.7%	235k	173k	110k	47k
	63.0%	293k	230k	167k	104k

- Weaker growth has pushed out our rate hike forecast, but labour market developments mean we still expect hikes to start this year
- The Atlanta Fed's jobs calculator suggests unemployment will fall below 5% in 12 months at current rates of payroll growth and trends in participation

The jobs calculator shows the rate of monthly non-farm payroll growth needed to deliver different rates of unemployment in 12 months time for different levels of labour market participation. The current 3 month trend in payrolls is 197k. Unemployment rate is 5.5% and participation 62.7%
Source: Atlanta Federal Reserve, Schroders, 26 April 2015

US wages and salaries begin to accelerate

Unemployment rate signals stronger pay growth



Source: Thomson Datastream, Schroders, 8 May 2015

QE: careful what you wish for

Some adverse consequences

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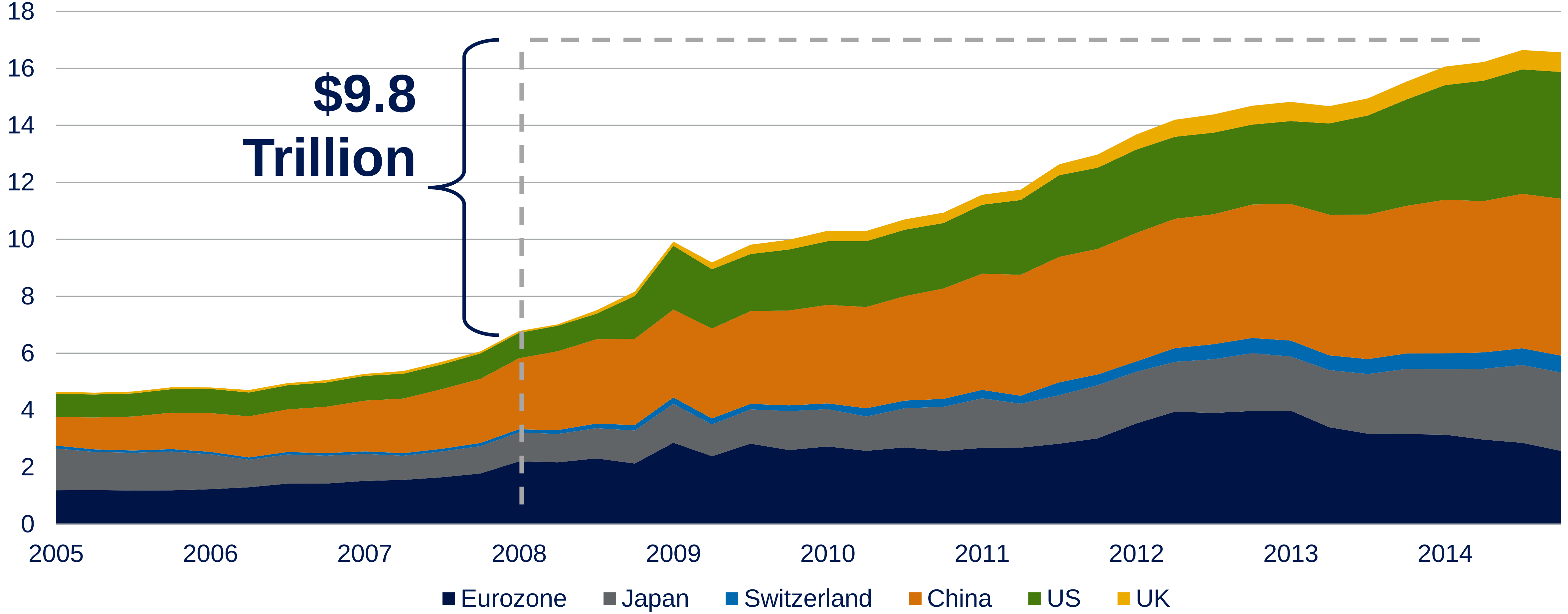
Liquidity: ECB and BoJ to pick up Fed baton

How much will spillover internationally?

Value of assets in central banks' balance sheets (trillions of USD)



Source: Thomson Datastream, Schroders, 2 February 2015

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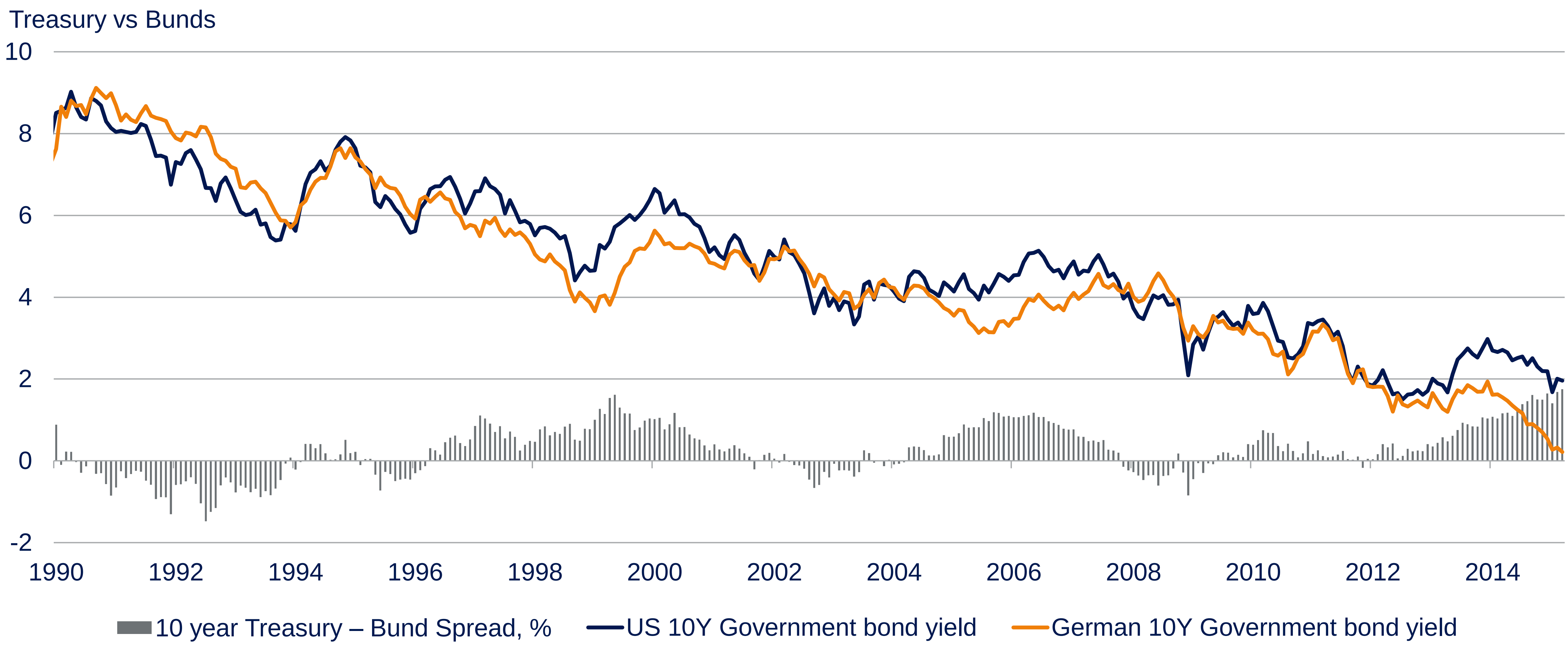
Spillover from ECB QE

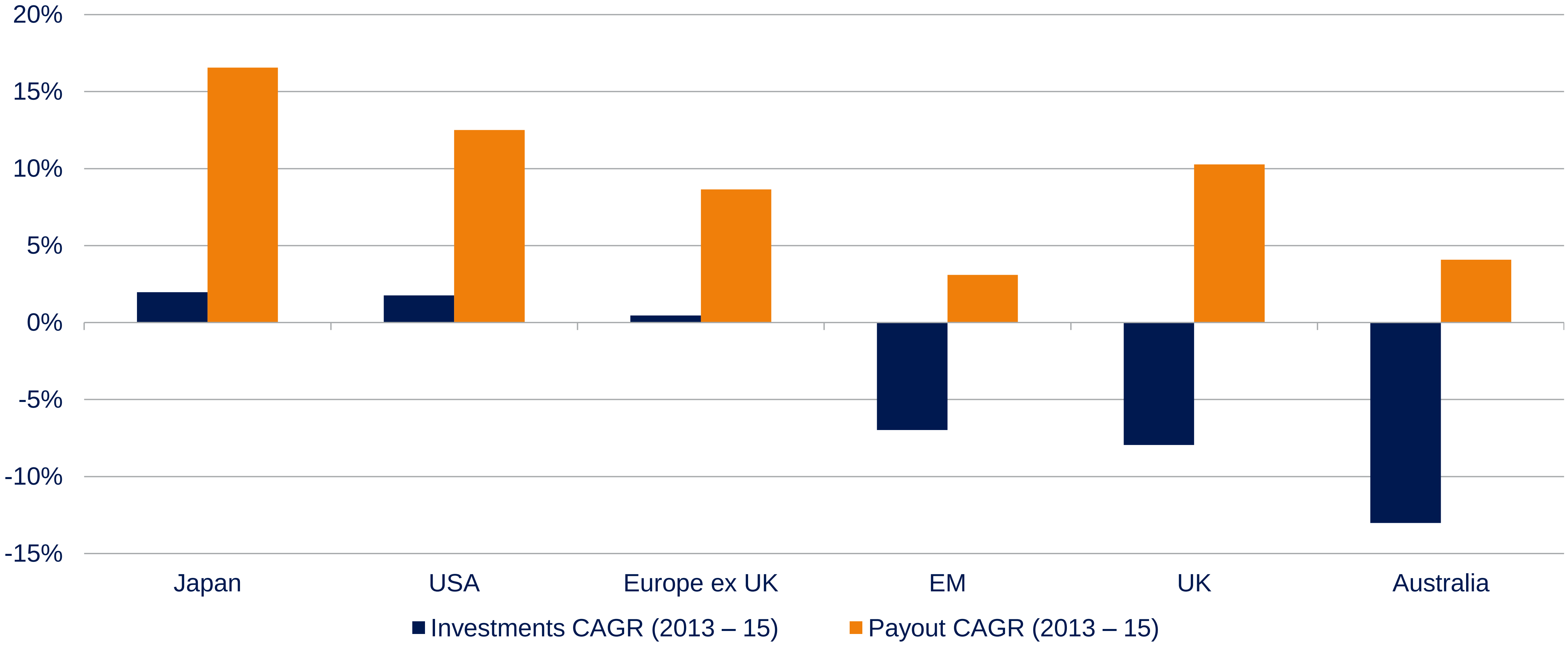
Fall in bund yields drives global search for yield



Source: Thomson Datastream, Schroders, 10 April 2015

Investment falls while payouts are on the rise

Investment and pay-out growth



Source: Citi Research, Schroders,19 March 2015. CAGR – Compound Annual Growth Rate

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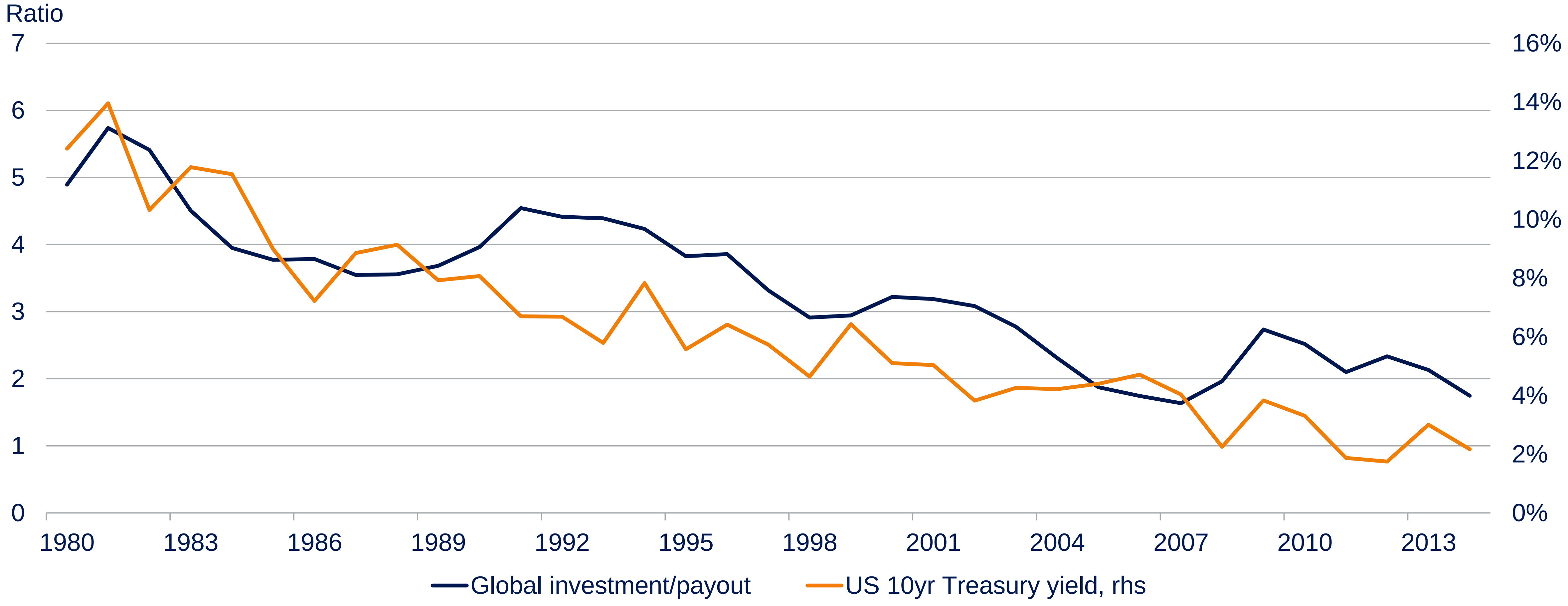
Bond yields and capex to pay-out ratio trending lower

Global investment /pay-out vs US Treasury 10 year yield



Source: Citi Research, Schroders, 19 March 2015

Some unintended consequences…

QE creates risk of weaker growth and shortage of high quality assets

- Financially repression forces investors to accept more risk and less liquidity in hunt for yield
  - Increased investor preference for “bond-like” equities
  - Companies run for cash rather than capex
  - Low growth equilibrium? Lack of economic risk taking => low growth, low interest rates, investors preference for bond-like co.’s, less risk taking…
- Central banks own an increasing % of sovereign debt, firms shrinking the equity market
  - Asset shortage for savers
  - Increasing focus on alternatives: property, private equity, hedge funds

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