



THE STAGE OF MONETARY POLICY NORMALISATION AND QUANTITATIVE TIGHTENING AROUND THE GLOBE

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19 September 2023

What does QT do? Broad range of answers

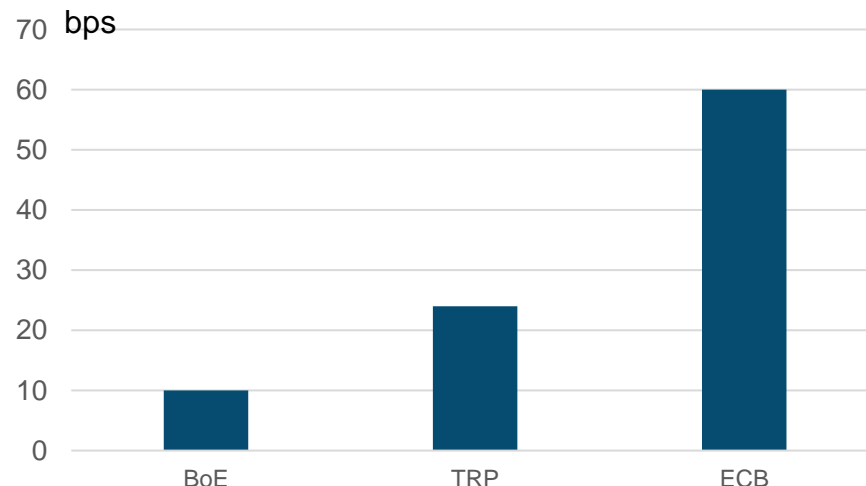
- **Ask market participants**
 - BoE survey says first year BoE QT raised Gilt yields by **10bps**
- **Yield curve model**
 - ECB says QT raised 10-year yields by **60-70bps**
- **Reverse engineer estimate from ECB QE VAR model (T. Rowe Price approach)**
 - ECB pre-pandemic QE implemented in calm times – no market stabilising channel
 - Removing signalling channel from pre-pandemic ECB QE estimate gives QT effect of **24bps**
- **Central banks want to accelerate QT, but yield effect estimates very uncertain**

QT Impacts Economies in Fewer Ways Than QE

(Fig. 1) It mainly influences exchange rates, asset prices, and bank activity

Channel	Description	Operates in QE	Operates in QT
Market stabilizing	When markets are dysfunctional, QE can improve liquidity and reduce liquidity term premia	✓	✗
Confidence/Uncertainty	QE improves economic outlook by reducing the risk of the worst outcome (reducing uncertainty)	✓	✗
Policy signaling	Asset purchases signal policy rate will remain low for longer	✓	✗
Exchange rate	Foreign exchange moves in response to rate differentials	✓	✓
Portfolio rebalance	Pushes up prices of assets bought, and investors buy other assets, pushing up their prices as well	✓	✓
Bank lending	A rise in deposits expands banks' balance sheets	✓	✓

Estimated QT effect on 10-year yield



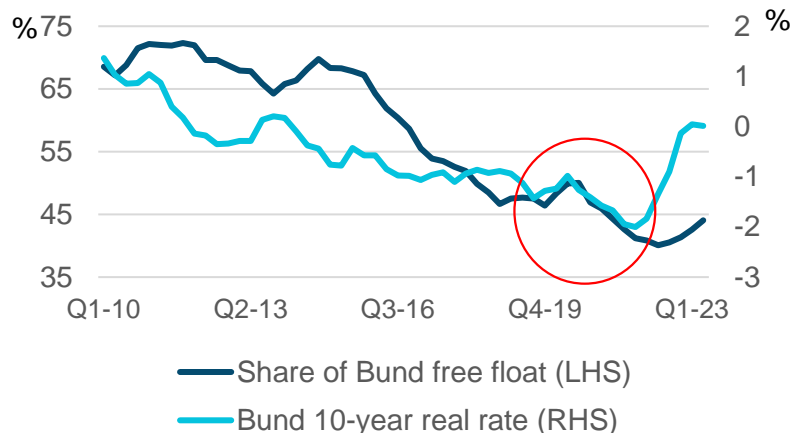
As of 30 September 2022. Source: Analysis by T.Rowe Price.

As of 13 September 2023. Sources: BoE, ECB and T.Rowe Price.

Can QT affect markets via supply & term premia?

- **Is QT fully priced into bond markets? Not if net supply matters**
 - Theory says supply shouldn't matter, but then QE can't work via portfolio rebalancing
 - There is a correlation of Bund free float and real 10-year Bund yield in the pandemic
 - Large Bund net supply expansion in 2023 will become smaller in 2024
- **Term premia collapsed at the ZLB. Are they about to come back?**
 - QE compressed term premia across the world in the very beginning of asset purchases. Perhaps term premia will therefore only come back at the end of QT.
 - Term premia rose a bit due to inflation term premia. Real rates term premia?

Bund free float vs Bund 10-year real rate



As of 13 September 2023. Sources: IMF and T.Rowe Price.

Bund 10-year Term premium



As of 13 September 2023. Sources: ECB and T.Rowe Price.

International transmission stronger than expected?

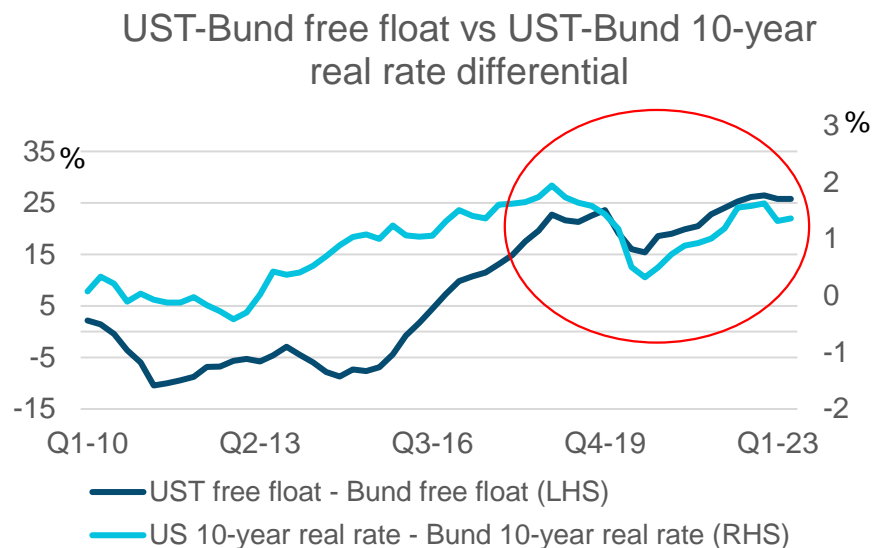
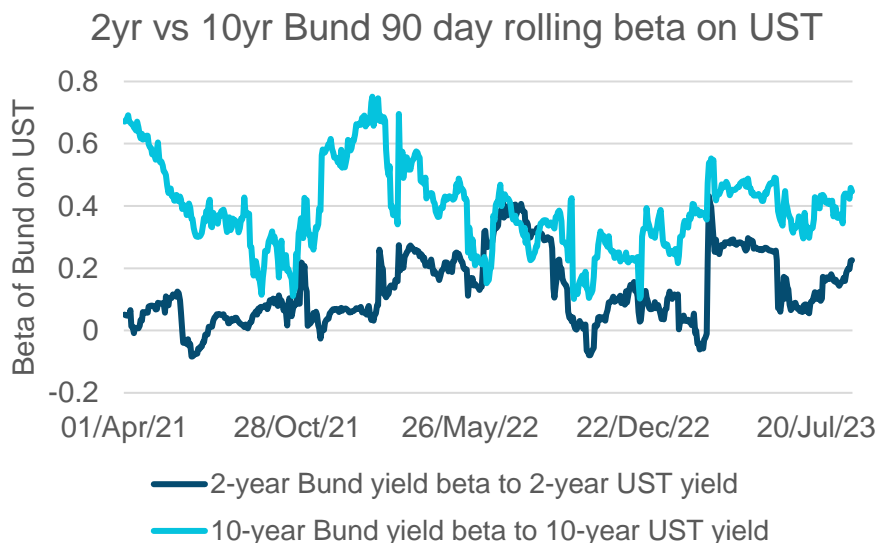
- **QT international transmission probably stronger than with policy rates**

- 10-year Bund beta on UST higher than 2-year Bund beta on UST
- FX is likely a smaller release valve for the long end of the curve

- **Relative free float of sovereign bonds likely to matter across countries**

- Excess UST free float over Bund free float can explain US-Bund 10-year real rate differential in recent years → Greater risk of spillovers down the line?

- **Are central banks & market participants underestimating these channels?**



As of 13 September 2023. Sources: Bloomberg Finance L.P. and T.Rowe Price.

As of 13 September 2023. Sources: Bloomberg Finance L.P. and IMF.



Open Questions

- **What is the effect of ECB QT in your view?**
- **Does net supply matter more than pre-QE?**
- **BTP net supply will increase vs Bund net supply in 2024. Will spreads widen significantly?**
- **How large are international spillover effects?**
- **Could the QT effect via term premia come further down the line?**
- **Will QT continue, even as central banks begin to cut policy rates?**



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