18 January, 2021

Raising alarm in FED's balance sheet reduction?

The incoming Biden administration $1.9 trillion relief plan is meant to boost the economic recovery and constrain the pandemic, from state and local aid and more unemployment benefits to mass vaccinations.

The Congress has recently passed a $900 million stimulus package in December 2020 and the Covid-19 pandemic relief programme in March 2020 was also over $2 trillion.   Altogether, the stimulus package up to this moment is already over $3 trillion.   In contrast, the spending package in response to 2008 financial crisis is just around $800 billion.

The subsequent economic stimulus packages have given hopes to the outlook for rebound and raised a question if FED will start to 'delisting', and the first move might be reduce in new bond purchase.

Stop increasing in balance sheet?

The market watchers started to pay attention on whether the US FED will have any intention to change its current bond purchasing plan, in terms of stop buying or even reducing bonds in order to remove the underpinnings from the US bond market and global risk assets. Currently, Federal Open Market Committee committed to keep buying bonds at a pace of at least $120 billion a month until the economy has a 'substantial further progress' towards full employment and inflation target. Investors were concern about whether the Fed would stop buying or even reduce bond purchase in late 2021.

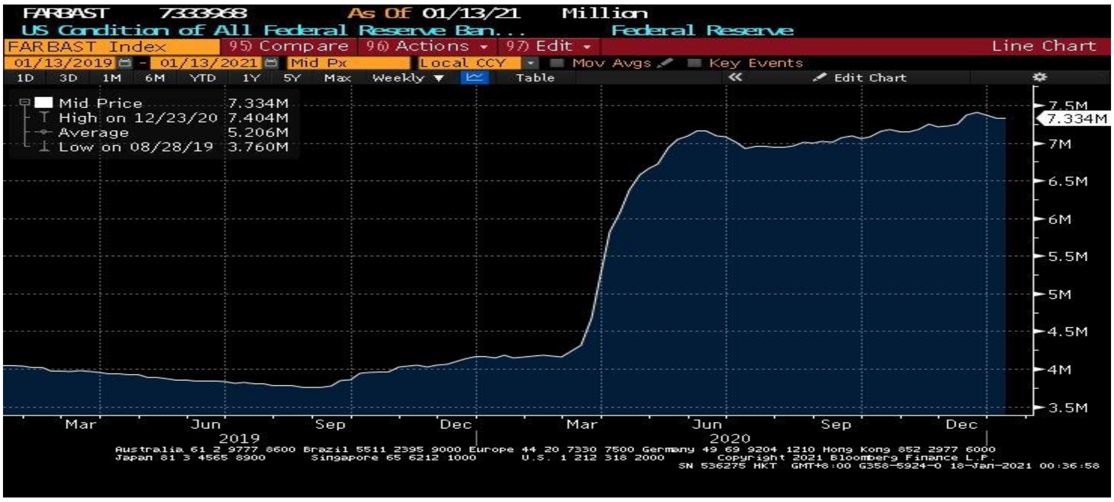
Powell's speak

Last Thursday, Federal Reserve Chairman [Jerome Powell]() said in a web symposium that with the U.S. economy still far from its inflation and employment goals, it is too early for the Federal Reserve to discuss changing its monthly bond purchases. He affirmed his commitment to keeping interest rates low for the foreseeable future even as he expressed his positive view to US economic recovery. He dispelled the talk of a premature reduction in the central bank's massive bond-buying campaign, saying "now is not the time" to hold that discussion. The speech from Powell keep the market calm even though at least four previous Fed Chairman have recently said that a strong economy could prompt discussion of tapering of bonds late this year.

'Let the World Know'

"Now is not the time to be talking about exit from the $120 billion in government securities the Fed is buying each month. He further pointed out a lesson of the global financial crisis, is be careful not to exit too early." Powell also pointed out that currently the Fed has not set any date on when to consider reducing debt purchases, and promised that when the economy improves substantially, if the delisting conditions are met, Powell emphasized that the Fed will 'let the world know' and well in advance of active consideration of beginning a gradual taper of asset purchase.

Federal Reserve balance sheet: though it remained almost flat in Q3 2020, another uptrend has been clicked in since Q4 2020, reflecting that the Fed still pumping money into market

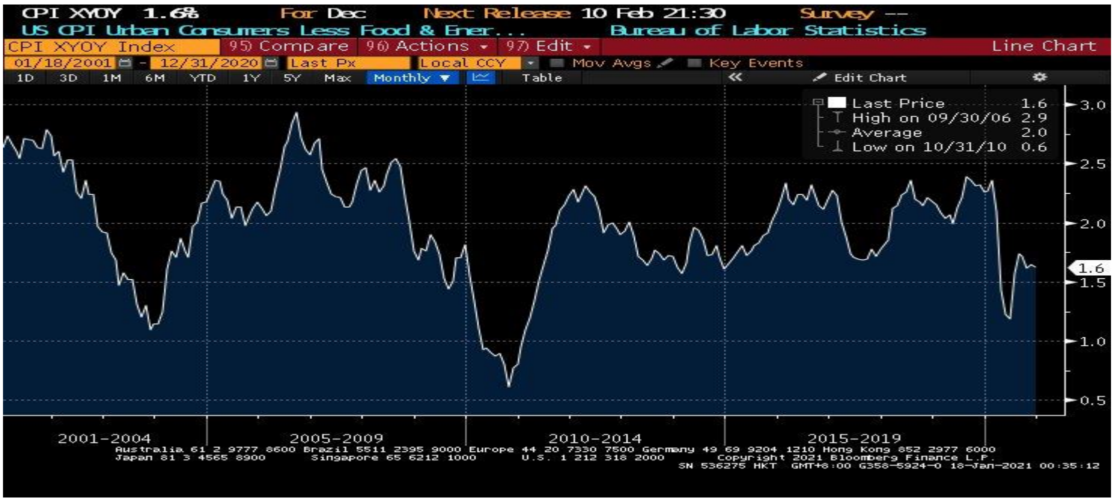


Source: Bloomberg

Hyperinflation?

Some market watchers claimed that the current ultra-loose monetary policy is possibly to increase inflation and in response FED might not be able to maintain the current ultra-loose monetary policy. However, we believe that it is less likely to have significant inflation in the coming future. According to the records in the past 20 years, the global inflation rate were trending down continuously, even some countries were under deflation risk. It is believed that the strong productivity in China and other Asian countries led to disinflationary pressure around the world.

U.S. Core Consumer Price Index: after the 2008 financial crisis, although the Federal Reserve increased the money supply substantially, inflation has never been higher than 2.5% in the past ten years



Source: Bloomberg

The Fed has no intension to change to "Hawk" in short term

Central banks took extraordinary action to stimulate the economy by slashing interest rates and expanding the money supply. Powell and some Fed officials claimed that in short term it will continue to keep the ultra-loose policy in the foreseeable future even the economy recovers significantly.

However, looking at the recent U.S. employment and retail sales figures, reflecting the US economy is still being hard hit again by the resurgence of pandemic. Therefore, under no conditions the FED will change their policies for now.

But why does the market worry about the Fed's action?

Central banks across the world played a role in orchestrating the recovery in the financial markets cannot be understated. With the Federal Reserve leading the way, which took extraordinary action in ultra-loose monetary policy so that the financial market, such as the stock market could sharply rebound from the bottom in March and set records high afterwards. Therefore, once the Fed started quantitative tightening, the global stock market tipped over right on schedule.

For example, in May 2013, the then Chairman of the Federal Reserve Board Bernanke mentioned 'TAPERING', which refers to reduction, not the elimination, of Fed asset purchases. After the speak of Bernanke, the U.S. 10-year Treasury bond interest rate rose sharply from about 1.5% in May 2013 to 3% in December 2013. However, Fed stopped the bond purchasing plan in October 2014.

U.S. 10-Year Treasury Bond yield rose sharply from about 1.5% to 3% in about half a year in 2013 after Fed Chairman speak

Source: Bloomberg

Sources: Bloomberg, Reuters, WSJ, Financial Times, Ycharts

For any comments, please send email to us at info@asset-mg.com.

Asset Management Group

Unit 02, 40/F, 118 Connaught Road West, Hong Kong

Telephone: (852) 3970 9595 Facsimile: (852) 3107 0932