QE tapering and estimated effects

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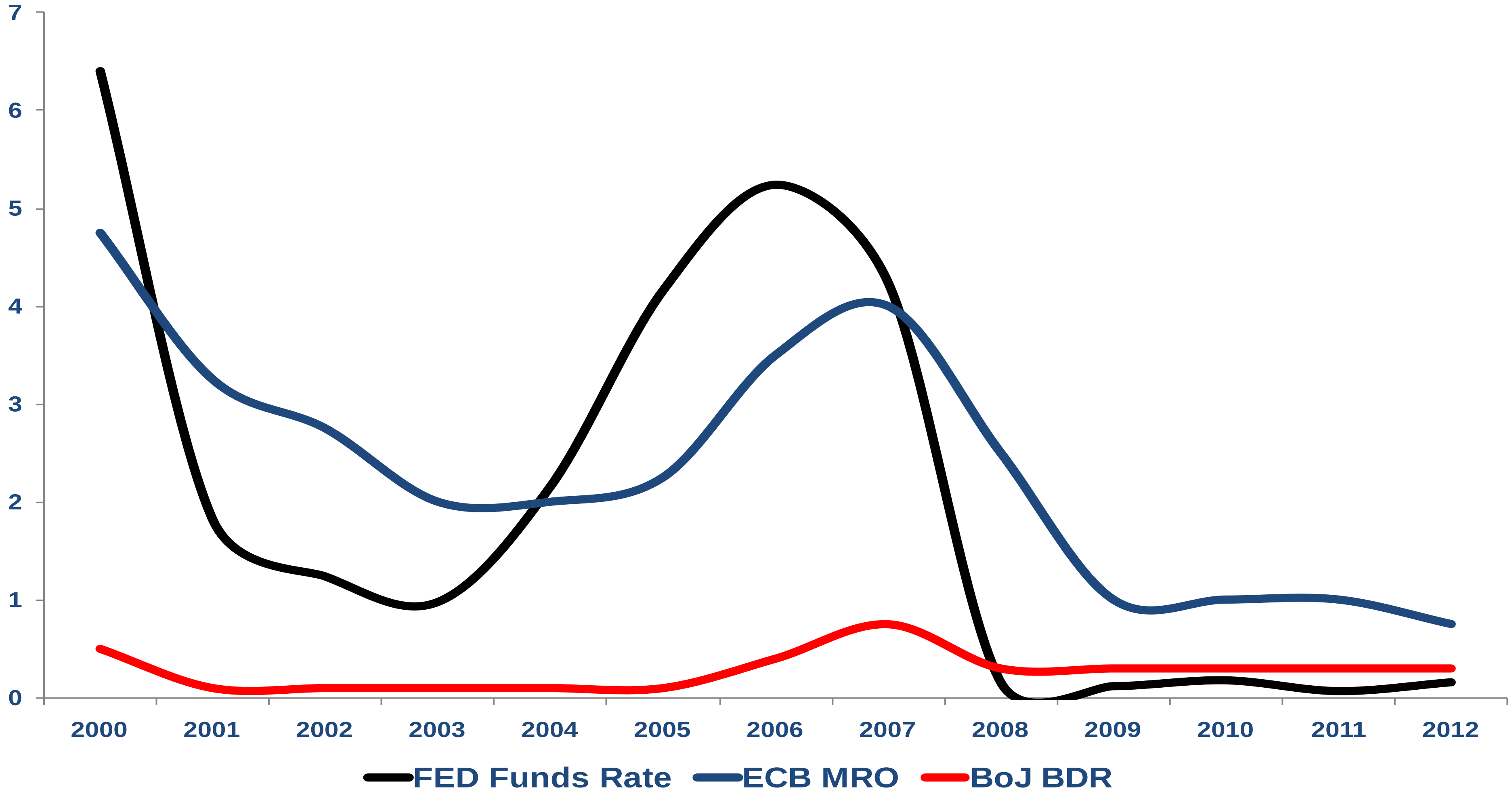
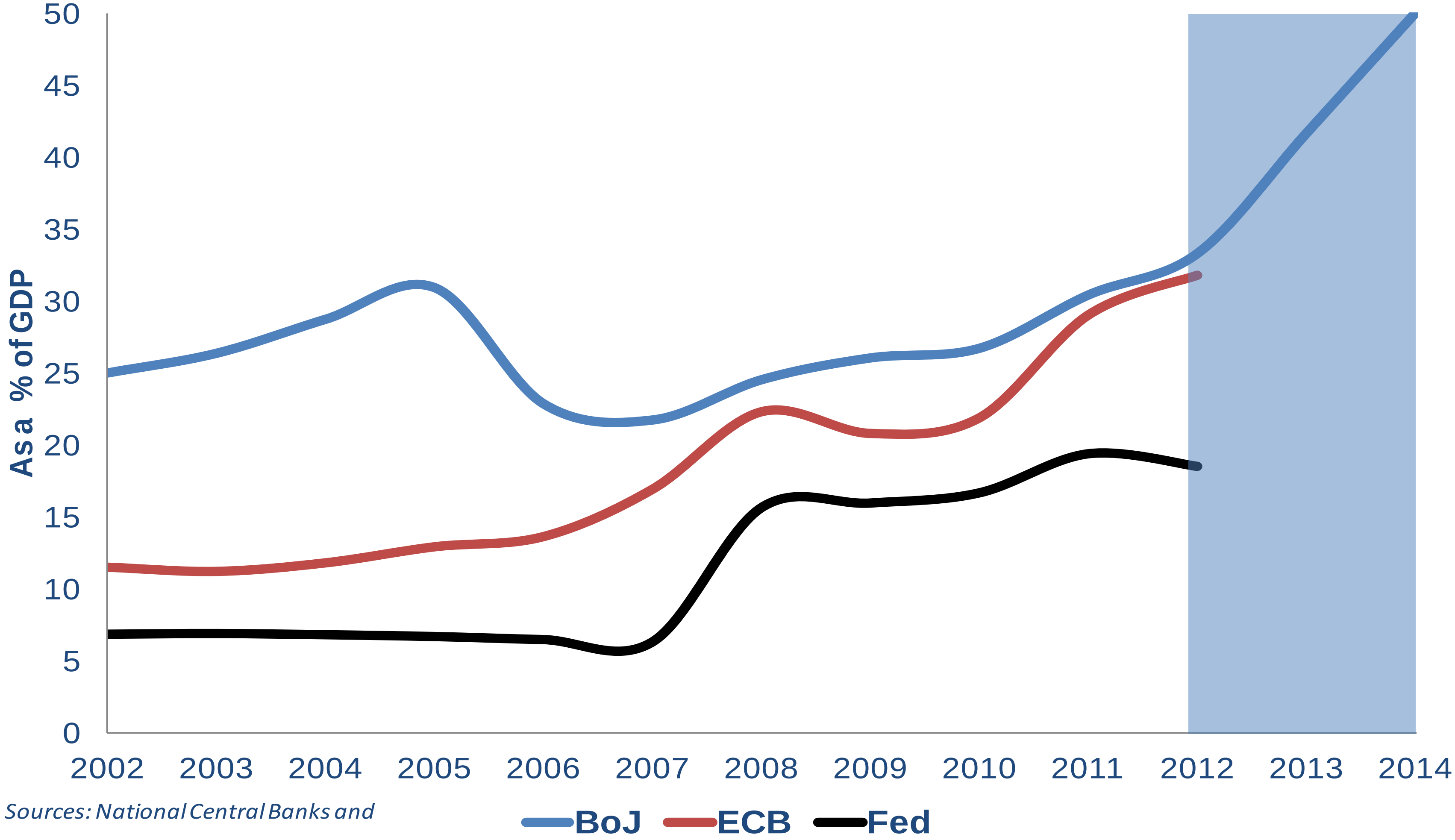
MIS/PIIE Semi-Annual Sovereign Economic Panel, Washington, DC, 10 October 2013,

Why QE? Well, crisis policy actions and the ZLB…



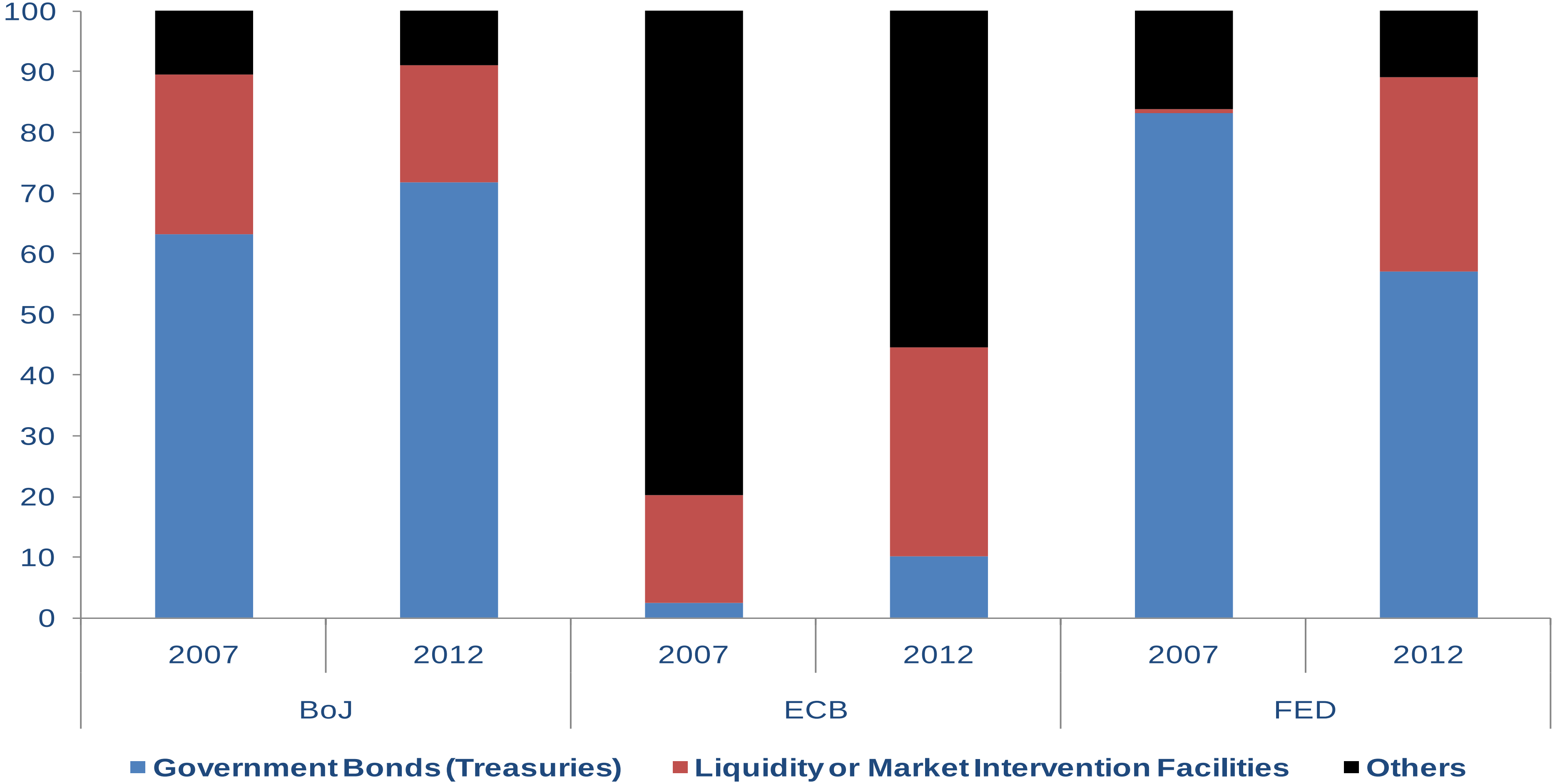
Sources: National Central Banks

So, liquidity was (amply) provided: size of the CBs balance sheets increased…



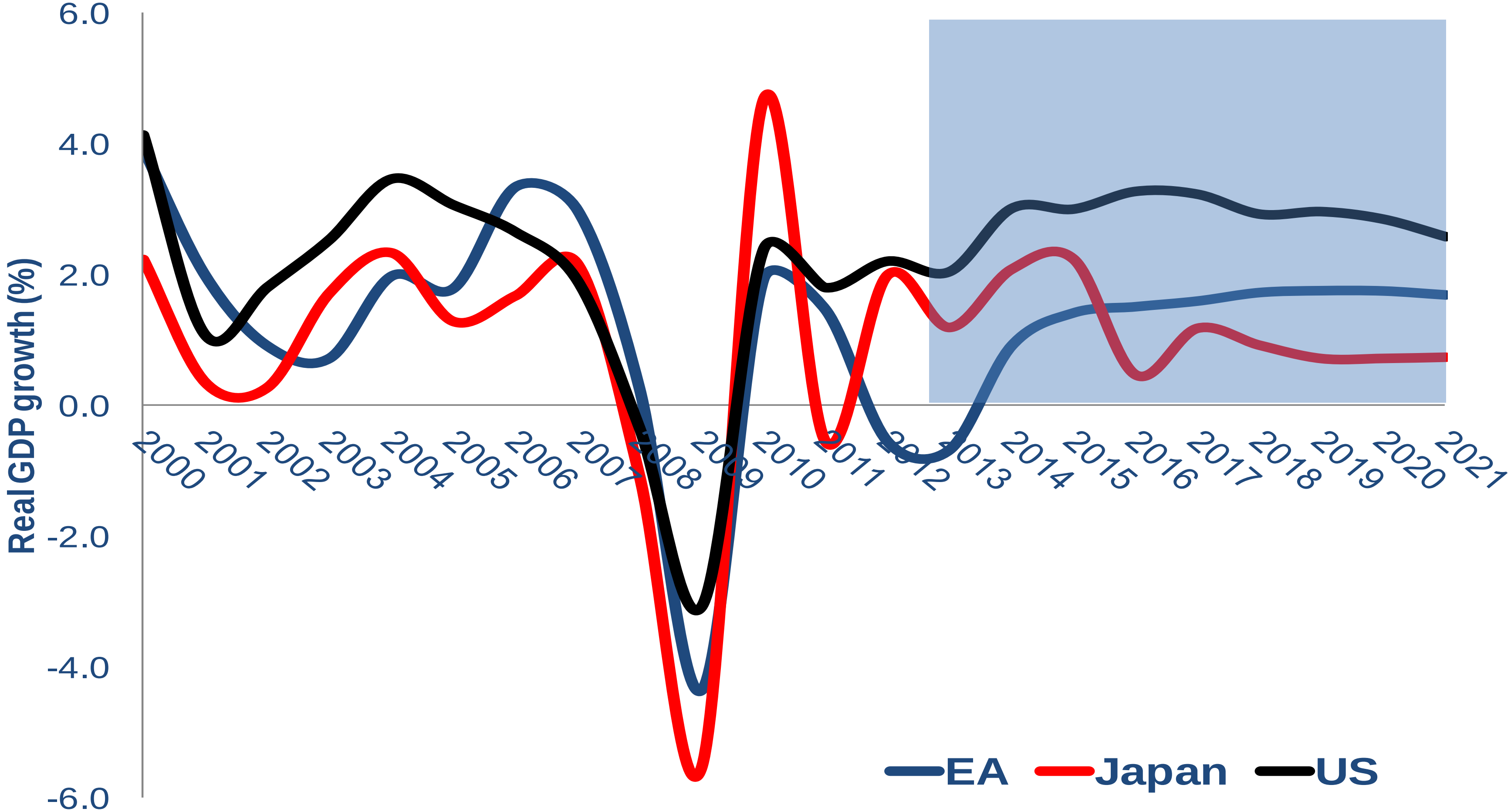
Sources: National Central Banks and

...and its composition changed (below, assets side).



Source: National Central Banks

But why QE tapering discussion now? Well, the crisis is over…



Source: Oxford Economics

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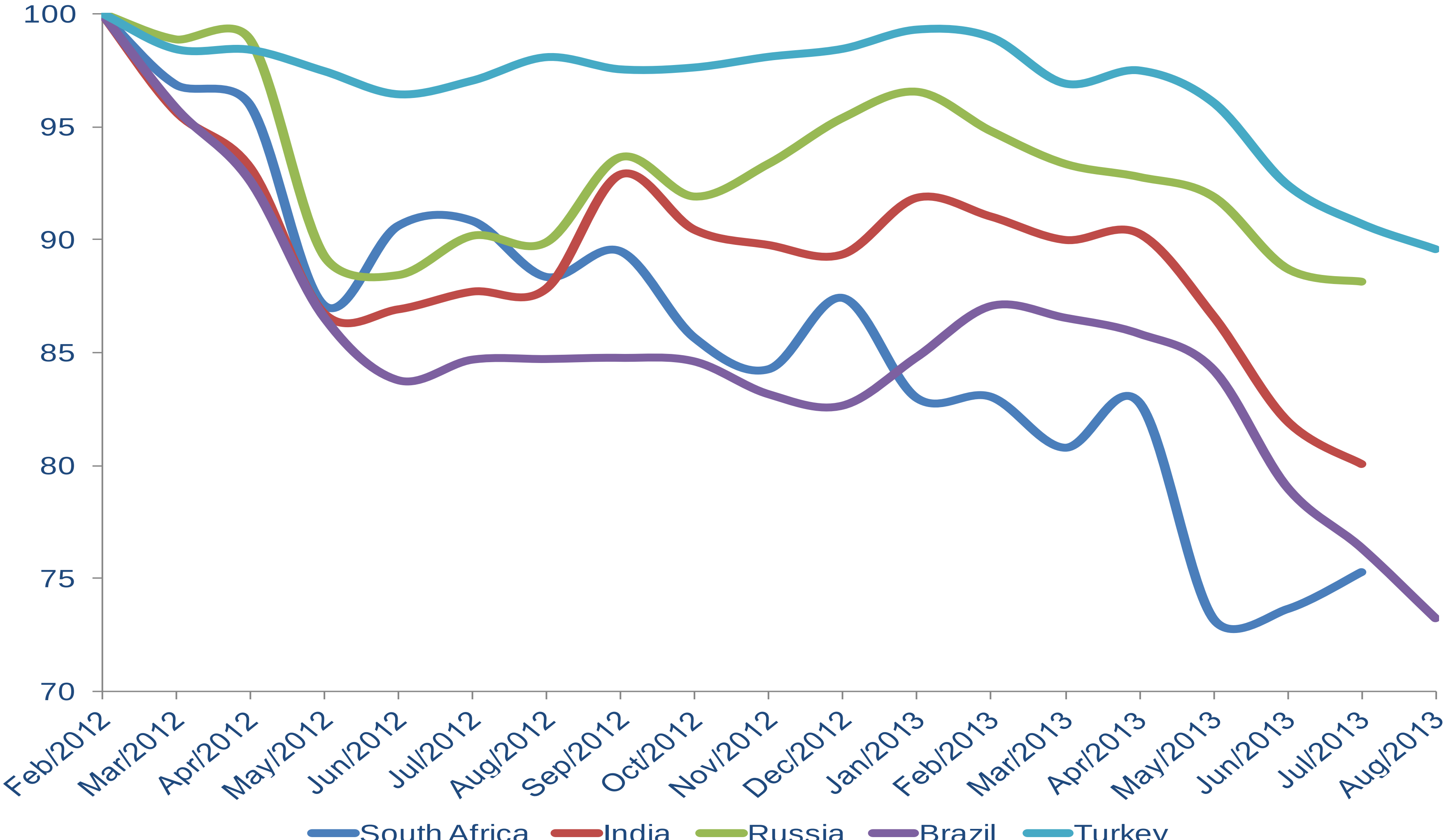
Tapering transmission channels

- With the QE, developing (and some developed...) economies have been benefiting from a) access to additional capital flows created by the excess liquidity (looking for yield, given their higher nominal interest rates than in the US) and b) lower global overall costs of capital
- Conversely, the effects from “tapering” would them be felt via capital outflows and higher overall costs of capital
- Some examples of that have already been observed, notably concerning some limited “hot money” capital outflows and exchange rate depreciations

Going down: nominal exchange rate to the USD in selected Developing economies (February 2012=100)

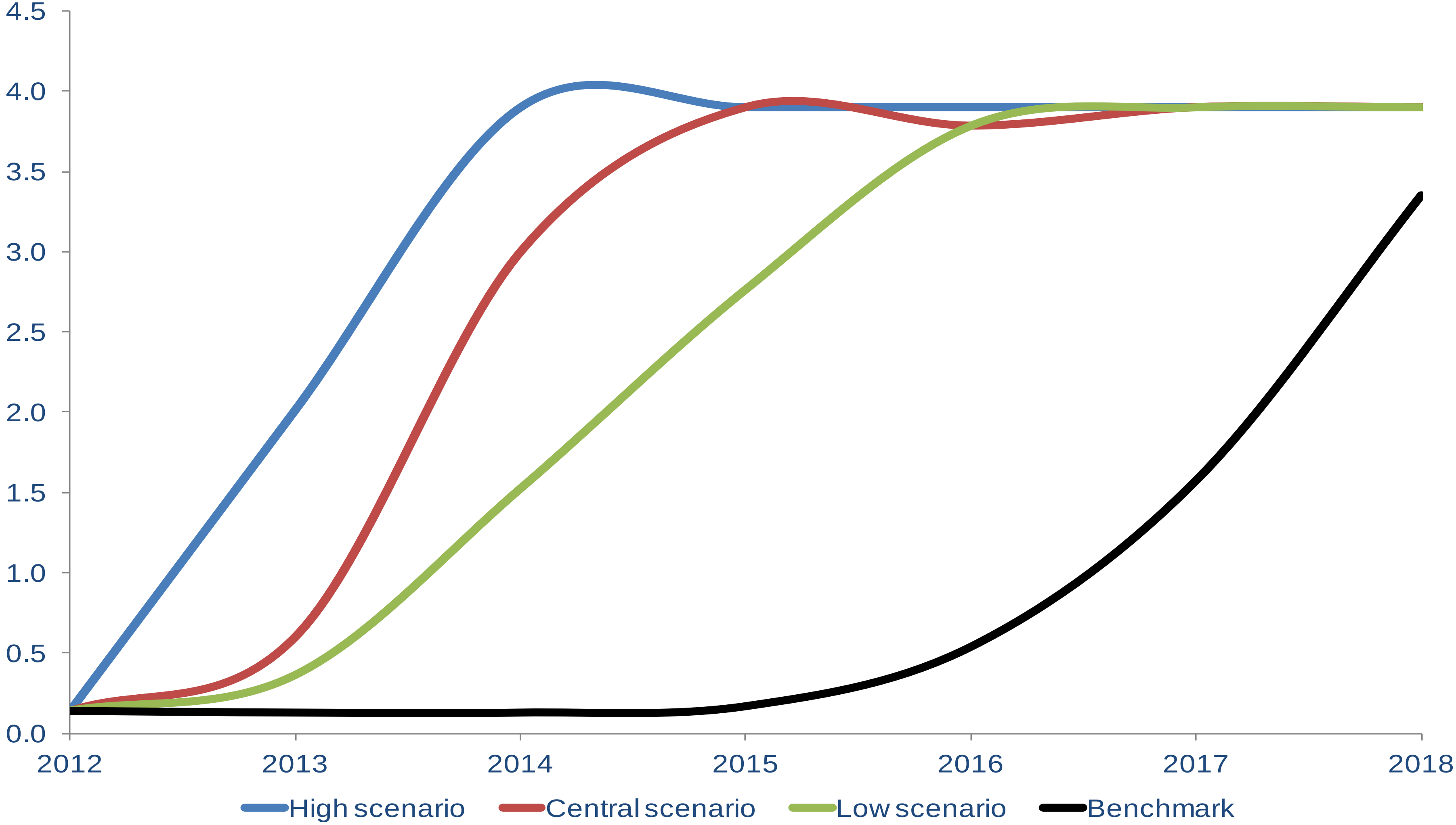


Source: IMF

Scenarios and benchmark

- One should stress that in the benchmark the Fed funds rate would return to its long-term level in any case by 2018, as, again, the current very low level is historically *exceptional* and therefore *temporary*
- One of the implications of this is that the alternative scenarios will have progressively smaller effects in relation to the benchmark (as a matter of fact, the effects largely peak around 2016)
- Scenarios are “High”, where adjustment happens fully and immediately, “Central”, where it is completed by mid-2014 (similar to the time frame of the Fed 2004 tightening), and one in which this happens only by the end 2016 (“Low”)

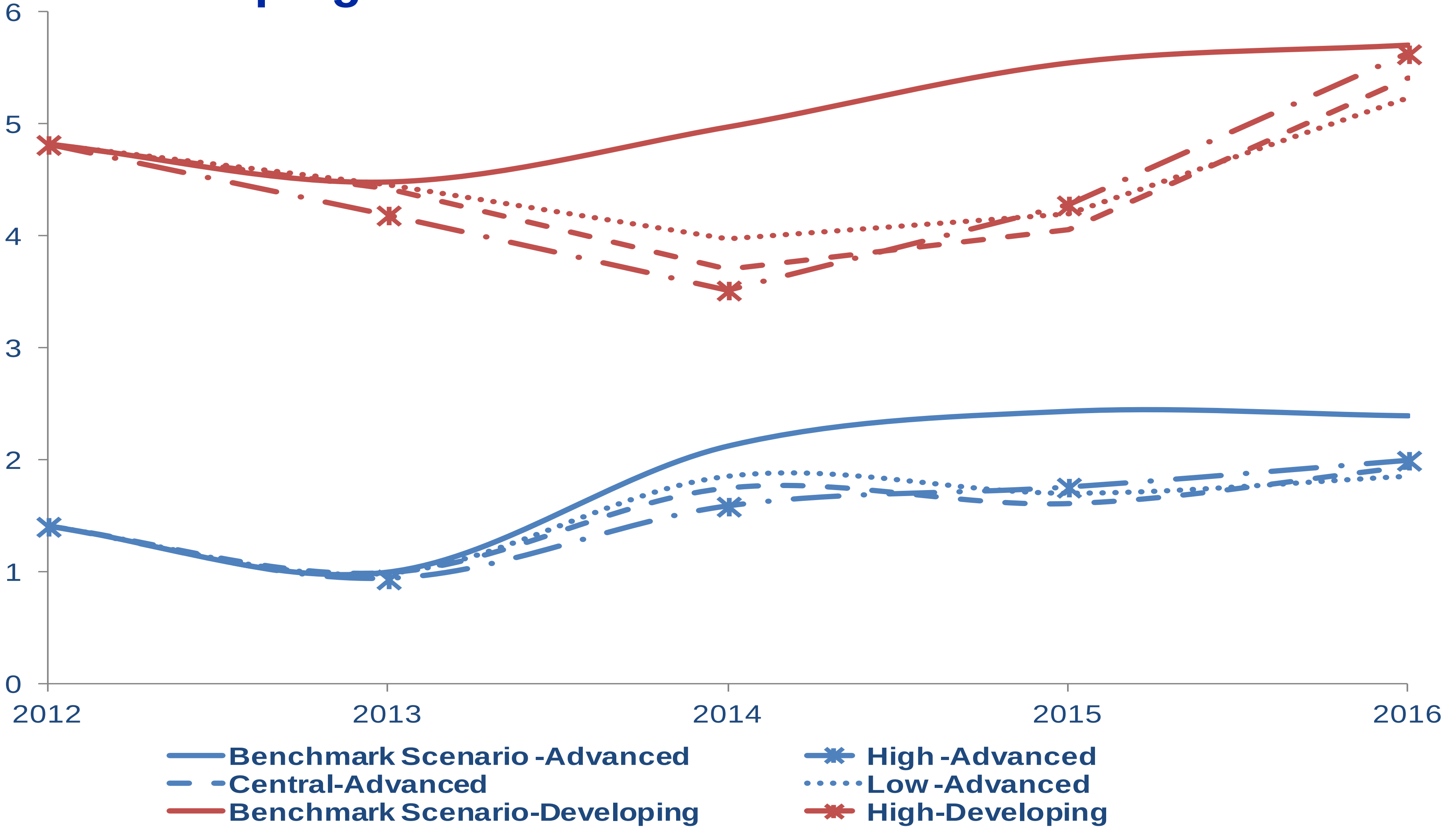
Interest rate scenarios and benchmark (interest rate, p.p)



Scenario results: developed and developing

- The aggregate outcomes in terms of GDP for developed and developing countries are shown next: as it turns out, losses, in relative terms (i.e., the cumulative growth loss in relation to the benchmark) are actually higher for *developed* countries than for developing ones
- Namely, developed economies have a cumulative 2013-2016 GDP growth loss of 1.6%-1.7% (depending on the scenario), on a benchmark average growth of 2% p.a., compare with, respectively, 2.8%-3.1% and 5.2% p.a. for Developing economies
- It should be pointed out that the losses, in all cases, are a) **temporary** and b) of a **relatively limited dimension**

Scenarios and benchmarks: GDP growth (%), developed and developing

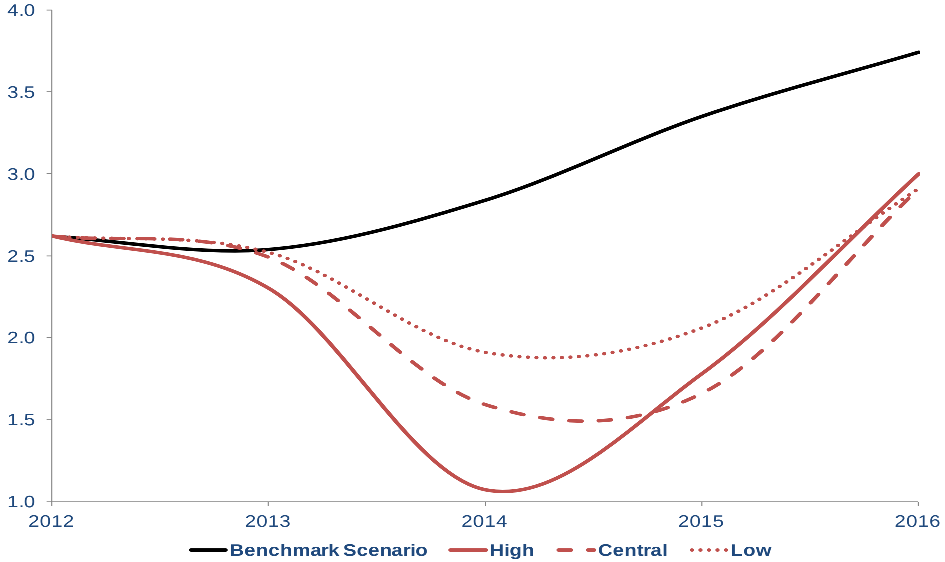


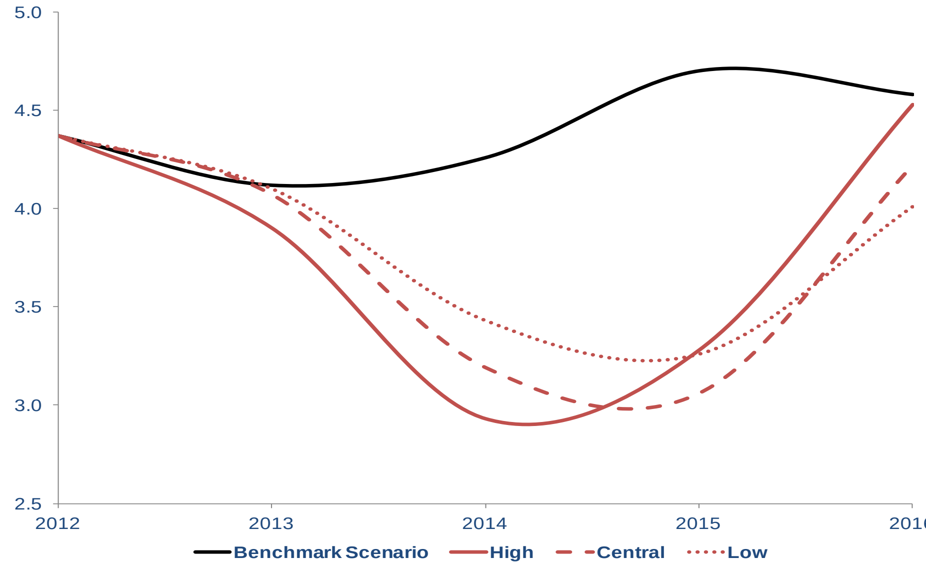
Scenario results: developed and developing regions

- Among developed countries, *Japan* is hit the hardest, with a 2.1% GDP loss (average of the three scenarios). There, the continuation of a strong quantitative easing policy (one of Abenomics "three arrows") leads to inflation, which prevents a full downward adjustment of the Yen, causing competitiveness loss, a worsening of the Japanese current account balance and GDP loss. Capital outflows complement that effect, as interest rates fall

- Among individual developing regions, Latin America has a *estimated* 3.1%-4.3% cumulative GDP loss, followed by Asia, with a 2.9%-3.1%. Eastern Europe and Africa face much smaller hits

Scenarios and benchmark: GDP (%), LatAm and Asia





Country specific results: GDP and CAB

- Latin America has the highest estimated losses, driven by large falls in growth in all major economies, from Brazil to Mexico. They also last for longer than in other regions
- In Developing Asia, larger losses happen in Indonesia, South Korea and China, with more limited effects in India
- As concerning the current account balances, several countries experience an improvement, but of different sizes
- Japan is the developed economy with the largest worsening, for the reasons described earlier. Hungary is the developing economy with the largest CAB fall, while South Korea benefits the most

Country specific tables: GDP

Cummulative real GDP losses in relation to benchmark by 2016 (peak)-%			
	Low Scenario	Intermediate Scenario	High Scenario
Japan	-1.9	-2.2	-2.3
Euro Area	-1.3	-1.4	-1.4
China	-3.3	-3.4	-3.2
India	-1.0	-1.0	-1.0
Indonesia	-4.1	-4.6	-4.7
South Korea	-4.7	-5.3	-4.8
Czech Republic	-0.9	-1.2	-1.9
Hungary	-3.7	-3.6	-3.7
Poland	-1.8	-1.9	-1.9
Turkey	-1.7	-1.8	-2.0
Russia	-4.2	-4.6	-4.5
Brazil	-3.9	-4.9	-5.4
Chile	-4.6	-5.7	-5.4
Mexico	-3.4	-3.4	-2.9
South Africa	-2.9	-3.6	-3.9

Some (diverse) policy responses…

» The figures presented before are, of course, of *estimated* effects. Countries would have some policy tools available to them to at least partially cushion the shock. Below are examples of some reactions that have already taken place:

» Brazil

1. Eliminated some of the capital controls from 2010-11 “hot money” period
2. Interest rate increases
3. New central bank credit lines

» Turkey

1. Removal of upper limits on repos

» India

1. Some new capital controls
2. Interest rate increases
3. New central bank credit lines
4. Asset purchase programme

Related research

» US Tapering Effects Likely Relatively Limited and Temporary for Developed and Developing Countries (158800) moodys.com

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