# Mizuho Insights: QE & Asset Markets

MIZUHO

**Economics & Strategy | Asia ex-Japan**

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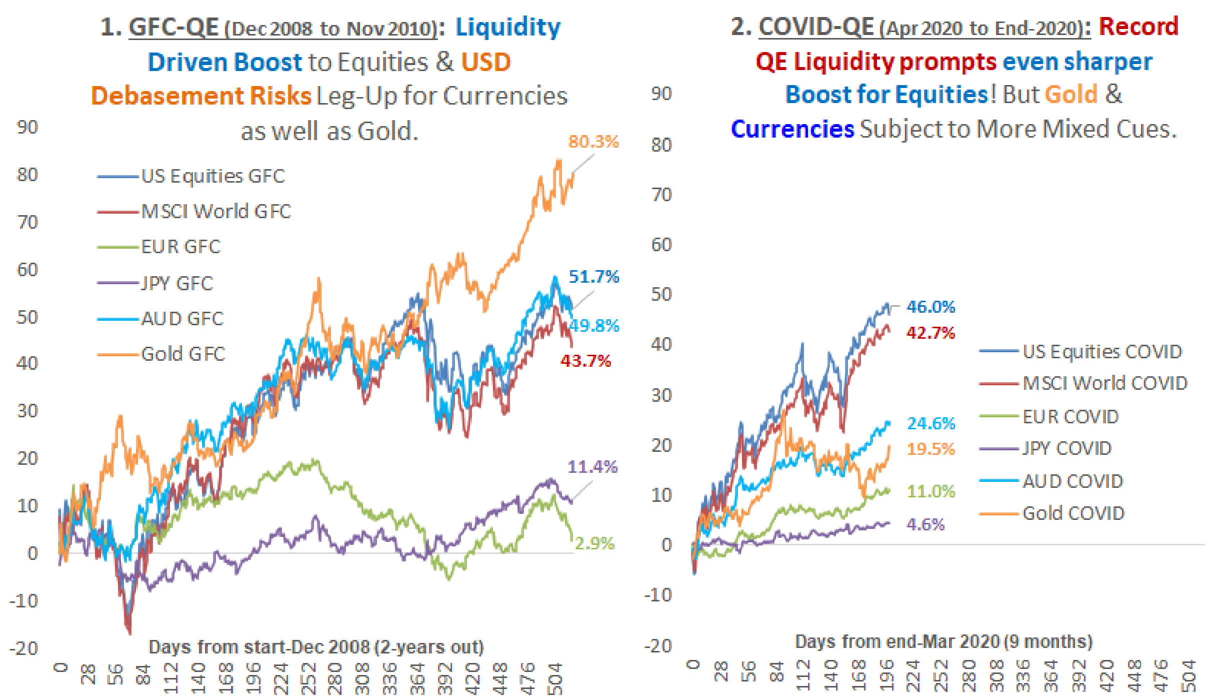
## QE: The Uni-QE Game in (a post-COVID)Town?

*"We are not all in the same boat. We are just in the same storm."* – **Unknown**

**In a Nutshell: QE will remain the elephant (or bull) in the room through 2021, if not 2022**; in spite of the vaccine and largely indifferent to the "Blue Wave". In which case, a **broad-based boost to asset markets is par for the course**. **But** equally, despite echoes of GFC QE, **resultant COVID QE-fuelled asset market boom may differ** in the **details**; **nuanced distinctions** based on **scale of monetary deluge**, **shifts in relative debasement risks from more prevalent global QE** and **the context of vaccine reflation interacting with FAIT***. For a start, the **unprecedented scale of global QE liquidity** may provide more **emphatic lift for equities**. But QE **may only slow, not stop, a rise in nominal yields as reflation expectations set in**; **although an out-run of inflation expectations** will probably **dampen real yields more effectively**. Consequent **bearish USD trend is likely to be more differentiated** (with *high-inflation, "twin deficit EM FX likely to under-perform*). And **Gold's buoyancy as outright fiat hedges**, while not fatally undermined, is **subject to episodes of headwinds/volatility from higher nominal yields**.

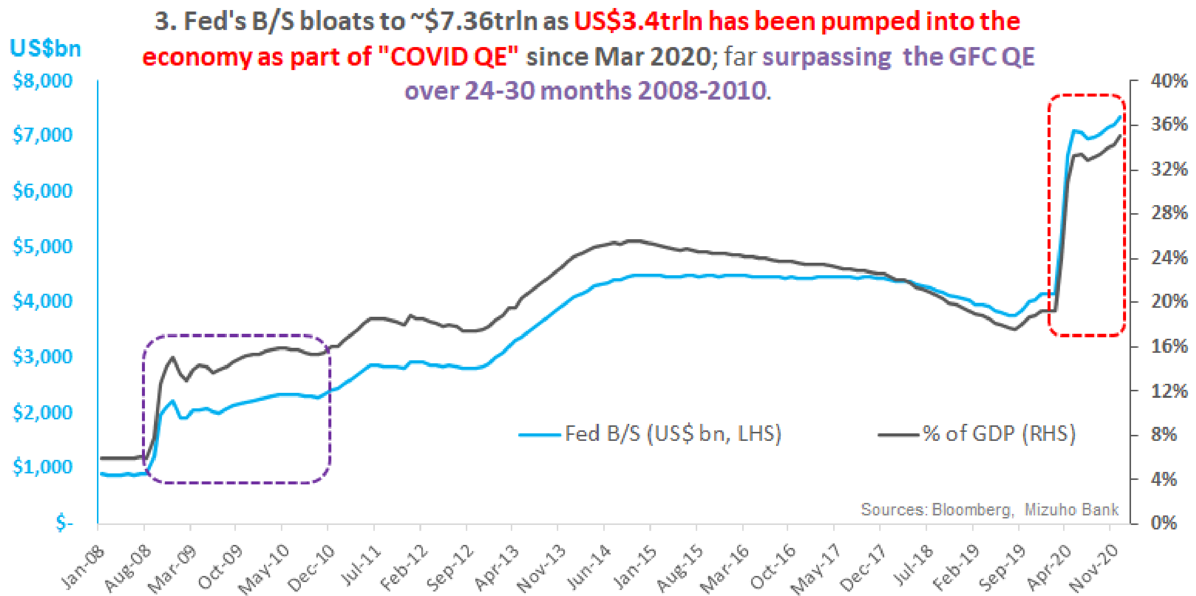



### No QE-Vaccine Contraindications

**Even with COVID vaccination** starting to take off, **central banks will probably not hasten to pull back on exceptional accommodation.** Not only due to the reality of phased vaccinations and a consequently bumpy recovery but also due to an abundance of caution regarding real economic/demand recovery lagging as confidence remain fragile for longer. Meanwhile, fading fiscal support alongside higher debt also dampening the recovery.

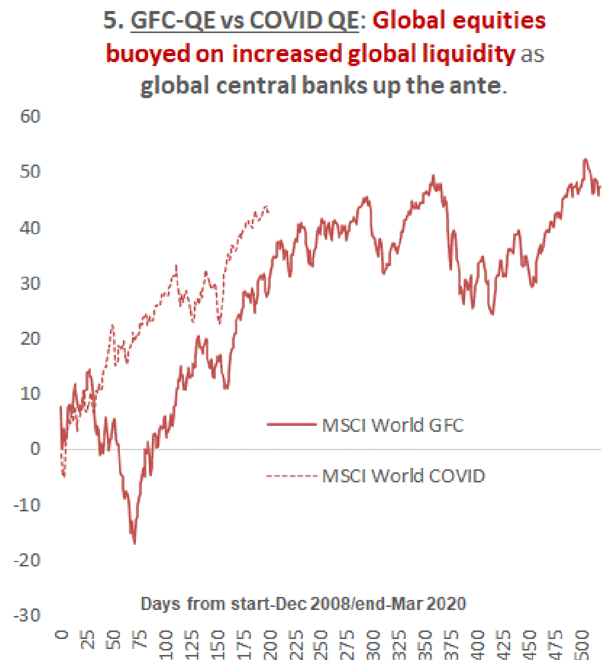
Simply put, there are **no contraindications between the vaccine and QE**; and the **latter will persist at least through 2021 if not through 2022**, reinforced by the Fed's exceptional accommodation; with far-reaching impact on global financial markets.

**Show Me the Money!**



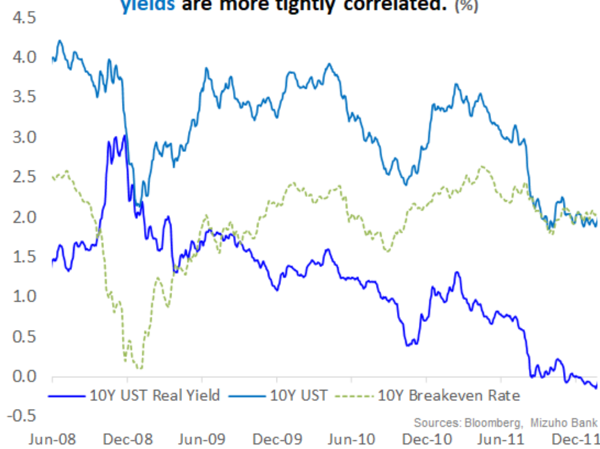

As such, **global asset markets are poised for unprecedented QE liquidity**. By way of comparison **24-months out from (GFC) QE** being initiated in November 2008, the **Fed had pumped out $240bn** (increased sizably to ***$1.5trln*** over a ***30-month period; mid-2008 to end-2010***) compared to a **staggering $3.4trln in COVID QE in the nine months to end-2020**; with **another $1.44trln on the tap for 2021** at a committed $120bn/mth QE pace.

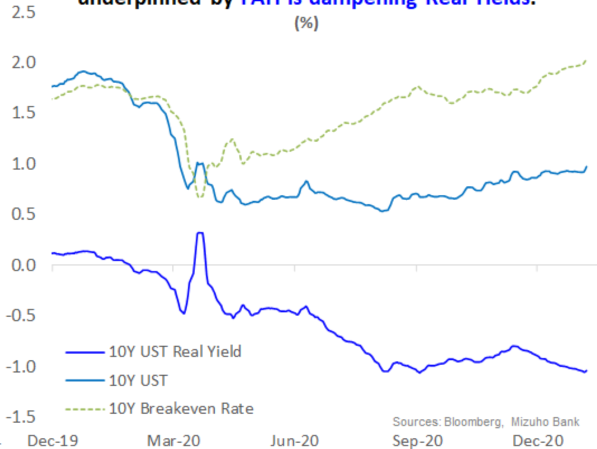
## Equity Market Bulls Seduced by Liquidity




While QE-equity market relationship is not one-to-one, continued infusion of liquidity in a low interest-rate and aggressively yield-seeking environment is **likely to lift US and global equities further**. Albeit subject to air pockets amid headline risks in a stubbornly uncertain global climate. Already **US and global equities, boosted by COVID QE, in the nine months to end-2020 were up almost as much as post-GFC rallies till end-2010**.

## FAIT Drives Real-Nominal Yield Wedge …



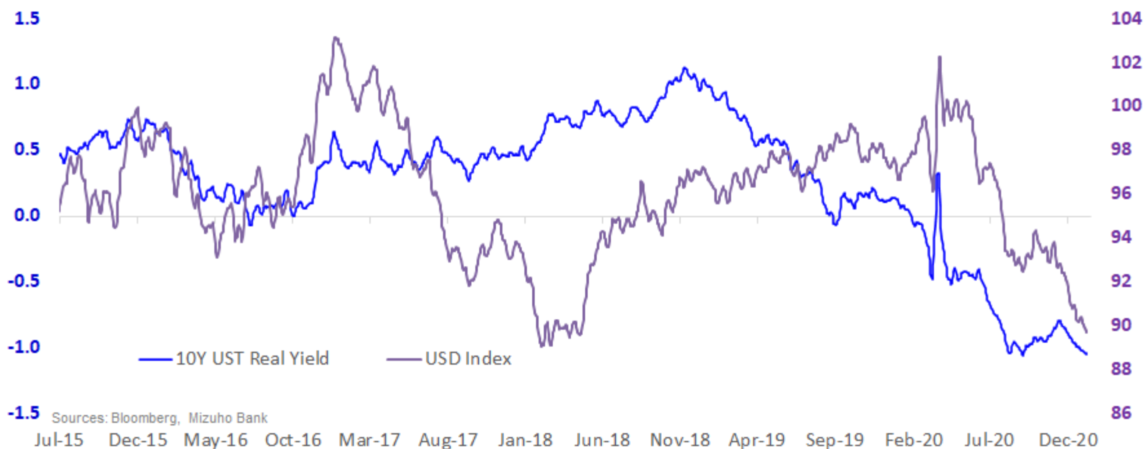




By and large, **QE aimed at buying bonds will help to lower yield**; which became more apparent with "Operation Twist" (longer end UST purchases) as in 2011. But with **UST yields already exceptionally low**, and vaccine **optimism driving demand recovery hopes**, continuation of **COVID QE** in 2021is **unlikely to significantly and sustainably reverse** a bias for slightly **firmer (nominal) UST yields**.

Nonetheless, the **Fed's paradigm shift to flexible average inflation targeting** (FAIT*) in policy mandate to deliberately allow the economy (both inflation and the job market) to run hot for a period of time to compensate for prior undershoot, a **wedge between inflation expectations** (represented by 10Y breakeven/BE) **and UST yields** may be expected.

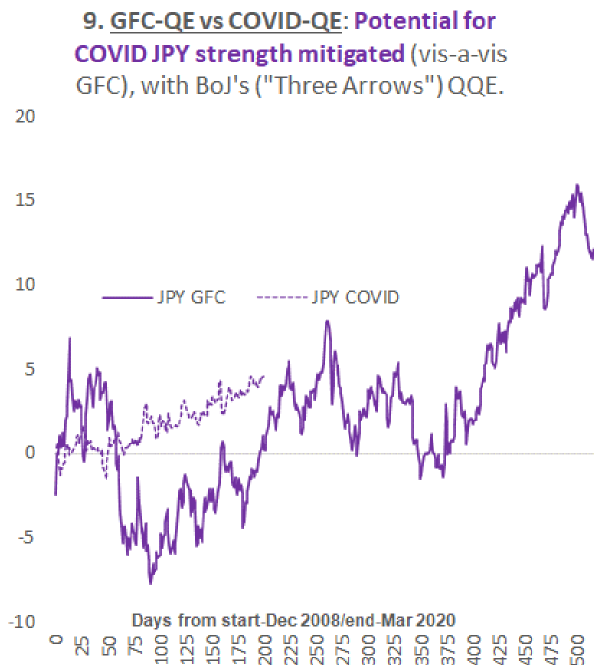
Specifically, **UST yields are likely to be better anchored** on exceptional and deliberately extended policy accommodation (by mandate) whereas **inflation expectations more susceptible to being lifted by re-flation expectations** (driven by vaccine-driven demand recovery hopes, US fiscal support/infrastructure boost amid 'Blue Wave' and/or other cost-push factors). The resulting phenomenon of **buoyant, if not upwardly biased** (nominal) **UST yields, but fairly well-suppressed real yields**.

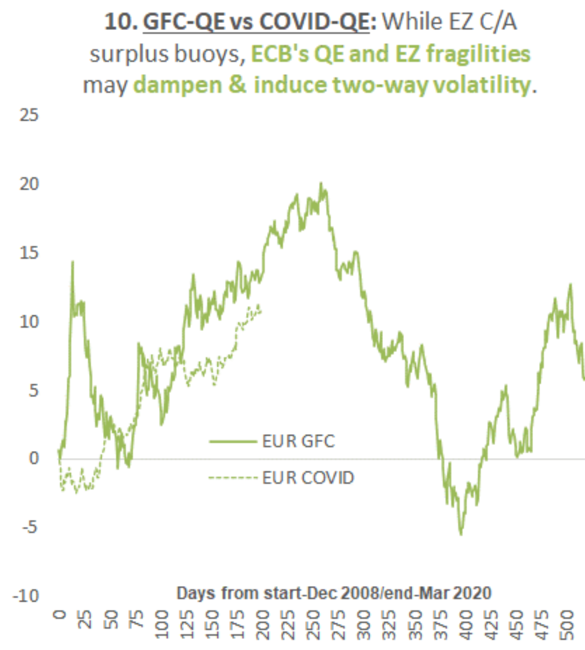
## Dampening the USD




**Soft, if not softening, real US yields** in turn set the stage for **entrenched bearish USD trend**; which has been **supported by the COVID 'USD Smile'** dynamics (consistent with a weaker USD as economic conditions turn less negative, thereby **reducing safe-haven USD demand**, ***yet*** at the same time **sustaining the Fed's exceptional accommodation** on an abundance of caution).

And this bearish USD may **potentially be accentuated against "COVID JPY" as incentives for, if not coercion of, aggressive yield-seeking intensifies** in an ultra-low/negative rates world being continually flushed with cheap money. That is to say, the **USD mounts a serious challenge for dominance as the main funding currency**. What's more, **EUR and JPY buoyancy** already derived **from C/A surplus positions** are further **sharpened by widening US "twin deficit"**.

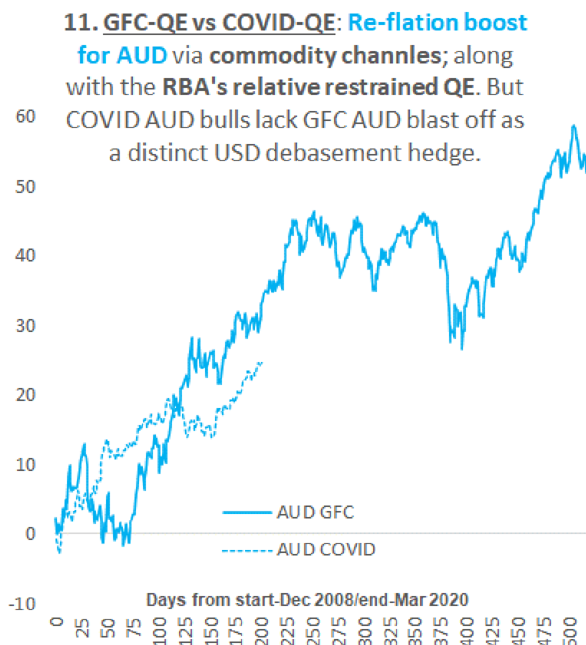


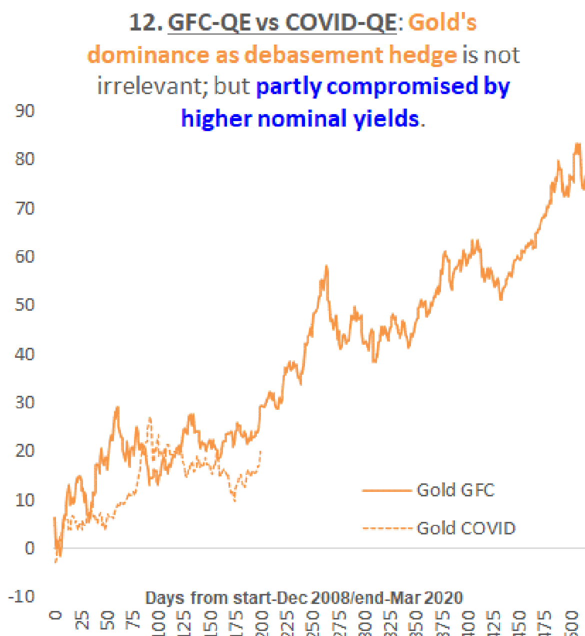




But it is an oversimplification to pin EUR and JPY upside bias on one-dimensional factors. Fact is, **fragile Euro-zone conditions and stretched short USD bets will amplify latent volatility in EUR markets**. Especially given the ECB's concerted asset purchases in the context of its discomfort with extended EUR strength.

Similarly, the **BoJ's apprehensions about excessive JPY strength** (notably USD/JPY falling below the psychological 100 level) **backed by more active asset purchase (QQE)** mean that **while JPY may be under upward pressures, it may not quite surge as much as it did during GFC**; especially on the combination of "Three Arrows" revival, BOJ activism and wider UST-JGB spreads.

## Debasement & Reflation



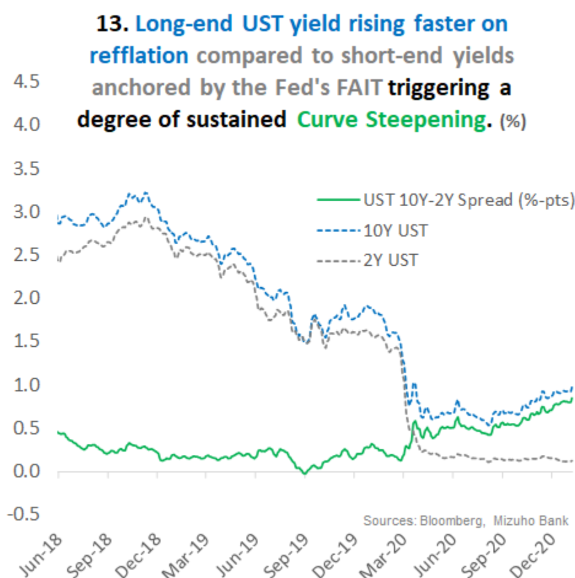
The **most prominent feature of QE** though is the **deluge of USD liquidity created** and the **attendant risks of USD debasement**. But unlike the GFC experience this round of USD debasement risks are **complicated, and partly mitigated, by** the confluence of; i) wider adoption of QE by global central banks resulting in a **broader fiat debasement concern**, and; ii) **coincident reflation expectations** being driven by vaccine optimism (resulting in rising nominal yields and commodity prices). Which is to say, **room to run on COVID QE** for debasement hedge assets such as **Gold and AUD may fall short of GFC-QE gains**.

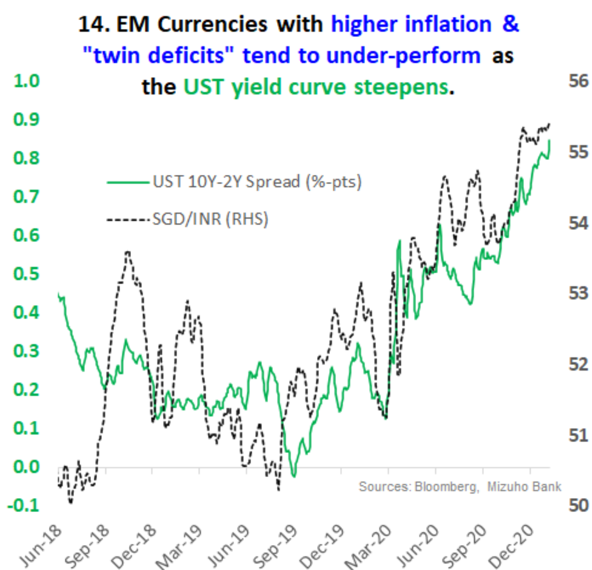
**Higher nominal UST yields conspiring with** in a world with **more prevalent global QE** (amongst Major as well as EM central banks) **diminishes** the **case to hedge for narrow USD debasement risks with other fiat currencies**. In other words, **unmitigated USD sell-off from (COVID) QE is now subject to checks**.

Accordingly, **AUD's COVID QE allure, while underpinned by reflation-commodity channels, may not be as stark as that during GFC QE**, **given its attraction as an emphatic proxy for USD debasement hedge is softened by the RBA QE** (though to be sure, this is pales relative to the Fed's QE).

**Gold bulls too** may have cause to be relatively **more restrained**. To be sure, **Gold's advantage as a hedge against wider fiat currency hedge is undisputed**. In addition, Gold also arguably hedges against reflation (although this is just the other side of the fiat hedge). However, what is often overlooked by reflation arguments is that **being a zero-yielding asset, Gold's allure may be eroded by rising UST yields**. **Especially as** vaccine-driven **demand recovery hopes catalyze reallocation away from Gold into industrial metals**.

## Steeper Curve & Sharper Differentiation




With USD sell-off premised on debasement risks (from the Fed's QE) being tempered by the notion of relative QE elsewhere (including EM economies), then a **steeper UST yield curve**, **resulting from** the **tension between reflation** (pulling long-end yields higher) **and FAIT anchoring short-end yield even more forcefully**, could **instigate even sharper differentiation in currency performance** against the USD.

And **most pronounced for EM currencies**. Generally, **EM currencies** (including EM Asia FX) **tend to under-perform as the UST yield curve steepens**; as the threshold for assuming "riskier" positions in EM assets raised by the ability to earn higher returns on long-end "safe asset" such as USTs.

Specifically, this under-performance will be **more pronounced for EM currencies exposed to higher inflation** (as real yield differentials are even less compelling) and those **with "twin deficits"**, given increased currency vulnerabilities to sudden reversal of capital flows.

## EM Asia FX: Softer USD Support Subject to Risks

As such, in EM Asia, **steepening UST yield curve** against a **backdrop of "twin deficit" risks amplified by rising oil prices**, may start to **compromise the performance of INR, IDR and PHP**; ***despite in a soft USD climate***.

And **if India's inconveniently elevated inflation does not subside**, **rupee may be the distinct under-performer**. In contrast, SGD may be well-positioned amid low inflation and oil sector gains; especially given Singapore's large ***financial sector that stands to benefit from a steeper yield curve alongside post-COVID demand recovery*** (although prolonged MAS hold will rein in excess volatility).

As such, on the whole, our **EM Asia FX views**, **while predominantly still driven by the narrative of a softer USD from on-going QE reinforced by firmer CNY**, remains cognisant of, and **subject to; i) risks from abruptly higher UST yields**, ***especially*** if sustained reflation optimism triggers a ***catch-up in real yields***; **ii) re-ordering of C/A advantages post-COVID** amid rising oil/commodity prices and restoration of pre-COVID import patterns; **iii) policy strains** (both monetary and fiscal) impacting recovery momentum as well as macro-stability, **and; iv) political risks** accentuated by the economic/social stress endured during the COVID pandemic.

| FX Forecasts | Mar 21 | Jun 21 | Sep 21 | Dec 21 | Mar 22 | Jun 22 |
|---|---|---|---|---|---|---|
| USD/CNY | 6.13 - 6.67 (6.35) | 6.20 - 6.60 (6.42) | 6.20 - 6.58 (6.40) | 6.15 - 6.53 (6.35) | 6.10 - 6.50 (6.30) | 6.12 - 6.48 (6.32) |
| USD/INR | 69.8 - 75.9 (72.8) | 71.7 - 76.7 (74.8) | 71.6 - 76.3 (74.0) | 69.7 - 75.2 (73.0) | 69.2 - 74.9 (72.5) | 68.8 - 75.0 (72.0) |
| USD/KRW | 1040 - 1120 (1076) | 1060 - 1130 (1100) | 1030 - 1090 (1060) | 1030 - 1100 (1070) | 1010 - 1090 (1050) | 1010 - 1100 (1050) |
| USD/SGD | 1.27 - 1.34 (1.30) | 1.28 - 1.36 (1.32) | 1.28 - 1.35 (1.31) | 1.26 - 1.33 (1.30) | 1.25 - 1.32 (1.28) | 1.26 - 1.33 (1.29) |
| USD/IDR | 13390 - 14500 (13800) | 13640 - 14760 (14050) | 13480 - 14610 (13800) | 13210 - 14320 (13650) | 13310 - 14460 (13750) | 13410 - 14690 (13850) |
| USD/MYR | 3.75 - 4.16 (3.98) | 3.90 - 4.17 (4.06) | 3.90 - 4.17 (4.02) | 3.80 - 4.08 (3.96) | 3.74 - 4.07 (3.90) | 3.78 - 4.11 (3.94) |
| USD/PHP | 46.0 - 49.9 (47.9) | 46.6 - 49.8 (48.5) | 46.2 - 49.1 (47.6) | 46.2 - 49.7 (48.2) | 45.8 - 49.4 (47.8) | 45.5 - 49.5 (47.5) |
| USD/THB | 28.9 - 30.8 (29.7) | 29.3 - 31.4 (30.1) | 28.4 - 30.4 (29.6) | 27.4 - 30.0 (29.2) | 28.6 - 30.3 (29.4) | 28.8 - 30.7 (29.6) |
| USD/VND | 22500 - 23700 (23120) | 22600 - 23500 (23170) | 22500 - 23400 (23000) | 22500 - 23500 (23100) | 22400 - 23500 (23000) | 22300 - 23500 (22950) |
| USD/MMK | 1290 - 1360 (1320) | 1320 - 1390 (1350) | 1310 - 1370 (1340) | 1290 - 1350 (1330) | 1280 - 1350 (1320) | 1280 - 1350 (1315) |
| AUD/USD | 0.738 - 0.830 (0.790) | 0.728 - 0.815 (0.765) | 0.715 - 0.824 (0.788) | 0.759 - 0.843 (0.800) | 0.768 - 0.843 (0.805) | 0.768 - 0.851 (0.810) |

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