Snapshot

2012 September 14

Markets rally after Fed launches QE3

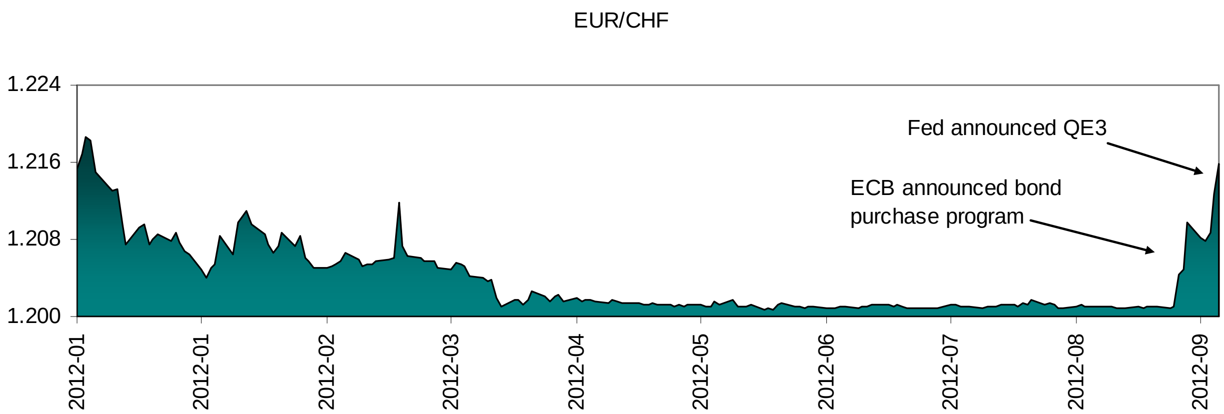
The Federal Reserve Bank announced its third round of quantitative easing yesterday. Fed didn't set any limits to the duration of the program or amount of papers that it would buy. As Fed major goal is labor market improvement, Bernanke stated that they are "trying to meet maximum employment mandate, so that's the objective". This gives them a chance to be very aggressive:

- First the Fed has extended central policy rate guidance at 0-0.25% at least through mid-2015 (compared to previous end-2014).
- Second, the Fed provided a more upbeat assessment of the US labour market and the economic growth outlook in 2013 and 2014 after taking into consideration the upcoming QE3 stimulus.
- Third, Federal Open Market Committee (FOMC) will begin purchasing mortgage-backed securities (MBS) at a pace of 40bn USD per month. The FOMC will also continue its 667bn USD "Operation Twist" through the end of 2012. This is done in order to extend the average maturity of its holdings of Treasury securities as announced in June and to maintain its existing policy of reinvesting principal payments from the Federal Reserve's holdings back into agency MBS. These actions will increase the Committee's holdings of longer-term securities by about 85bn USD each month through the end of the year. This should put downward pressure on longer-term interest rates, support mortgage markets and help to make broader financial conditions more accommodative.

As expected, QE3 has been partially priced-in to asset prices already. Nevertheless, risk appetite did increase today:

- The dollar slid to $1.3034 per euro. The weakest since May 8;
- Gold and oil climbed to a six and four month high respectively;
- U.S. stocks surged, sending the Standard & Poor's 500 Index to its highest level since 2007 as investors started to jump on board by picking up equities ahead of the news;
- Even EUR/CHF moved up by 1.23% after staying on the Swiss central bank set floor for 5 months. This shows greatly increased global risk aversion. (Graph below)

We believe that risk appetite will improve in the upcoming months as it looks that there is enough motivation among policy makers in China and Europe to stimulate. European policy makers have announced their bond purchase program and China's top planning agency approved plans to build rail, roads and urban infrastructure.



Source: Bloomberg, DNB Markets

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