Rock or roll
Implications of maintaining QE portfolios

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A variety of reinvestment objectives for CBs

- Fed wants constant balance sheet composition
  - Soma account mix and duration used as a policy tool
- BoJ has dropped portfolio duration but adopted 10Y yield target
  - Biggest reinvestment hurdle over next 2 years
- BoE aims to keep APF proceeds constant
  - Reinvests proceeds equally across curve buckets (3-7Y, 7-15Y, 15Y+)
- Riksbank unique by also reinvesting coupons
  - Like ECB, also constrained by available assets
Static portfolio size and composition since exit

Source: HSBC, NYFed
### Government bond QE redemptions (All in USDbn)

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<thead>
<tr>
<th>Month</th>
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Source: HSBC estimates, BoE, BoJ, New York Fed

Distribution of bond maturities a BIG problem ...
Government bond redemptions

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<td>50.75</td>
<td>0.00</td>
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% of GDP

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<td>637.69</td>
<td>50.75</td>
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<td>3.55%</td>
<td>1.78%</td>
<td>18.62%</td>
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Source: HSBC estimates, BoE, BoJ, New York Fed
General redemptions guidelines

- Avoid buying bonds within policy horizon
  - BoE 3-years, Fed 4-years

- Distribute reinvestment proceeds across curve segments
  - Matching issuer duration does not negate flattening pressure

- Try and match rollovers with supply events
  - Supply calendar and gross issuance size key

- Avoid being bound by composition
  - Operationally, private sector assets are a headache vs public sector
Cumulative PSPP bond redemptions – by type

Source: HSBC estimates
Cumulative PSPP bond redemptions – by issuer

Source: HSBC estimates
ECB QE redemption hurdles

- PSPP: redemption are not an issue until 2018 … meanwhile
  - Redemptions need to be factored into any QE extension
  - For core issuers, yields below Deposit Facility will push curve flatter
  - Linkers need special treatment due to dirty price/inflation uplift
  - Falling bond supply due to improving deficits remains the biggest constraint
  - Perhaps this can be offset by new supranational issuance sources

- CBPP3: Faces growing redemptions and falling net issuance
- ABSPP: Capped by lack of issuance and regulatory framework
- CSPP: 6-month eligible maturity will pose rollover risks sooner
ECB and QE

- The intent of QE is to raise nominal GDP
  - For the ECB, the focus is on inflation and promote credit impulse

- Available/eligible asset impose constraints on QE programmes
  - Money creation is temporary because bonds mature

- Aging QE portfolios can also create obstacles
  - Recurring competition with private sector for gross issuance

- Reinvestment prevents *fast* monetary and fiscal policy tightening
  - Constrains market volatility and various premia
Redemption volumes of the 3 covered bond programmes

Source: HSBC, ECB
Maturity profile of outstanding CBPP3 eligible covered bonds

Source: HSBC, Thomson Reuters Eikon

Note: The figure for 2016 are redemptions in Q4
Discussion topics

1. Best practices regarding reinvestment
2. General issues around reinvestment and potential market impact
Disclosure appendix

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Neutral: For corporate credit, the issuer's fundamental credit profile is expected to remain stable over the next six months. For covered bonds, the bonds issued in this country are expected to perform in line with those of the other countries in our coverage over the next six months.
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**Overweight:** The credits of the issuer were expected to outperform those of other issuers in the sector over the next six months.

**Neutral:** The credits of the issuer were expected to perform in line with those of other issuers in the sector over the next six months.

**Underweight:** The credits of the issuer were expected to underperform those of other issuers in the sector over the next six months.

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<th>All Covered issuers</th>
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Source: HSBC


To view a list of all the independent fundamental recommendations disseminated by HSBC during the preceding 12-month period, and the location where we publish our quarterly distribution of non-fundamental recommendations, please see the disclosure page available at www.research.hsbc.com/A/Disclosures.

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