

Rock or roll

Implications of maintaining QE portfolios

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Bert Lourenco

Head of Rates Research, EMEA
HSBC Bank plc
bert.lourenco@hsbcib.com
+44 20 7991 1352



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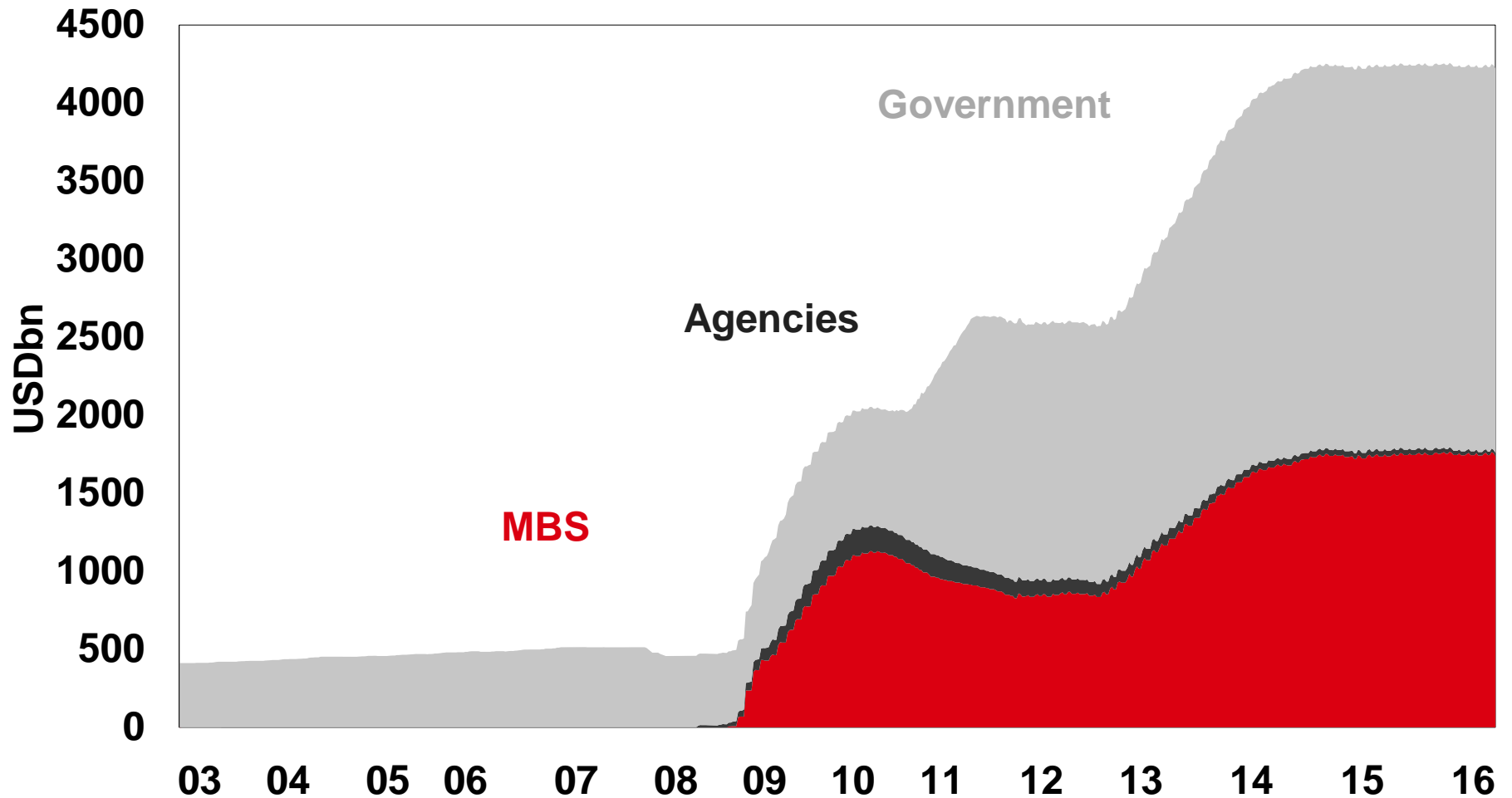
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A variety of reinvestment objectives for CBs

- **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 ^{HSBC}



Source: HSBC, NYFed

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Distribution of bond maturities a BIG problem ...

Government bond QE redemptions (All in USDbn)

	US		UK		Japan	
	Nominals	Others	Nominals	Others	Nominals	Others
Oct-16	6.53	-	-	-	15.01	-
Nov-16	24.11	-	-	-	8.55	-
Dec-16	11.70	-	-	-	56.09	2.39
Jan-17	7.36	3.10	14.92	-	20.36	-
Feb-17	20.33	-	-	-	13.34	-
Mar-17	13.56	-	-	-	60.75	2.10
Apr-17	14.00	0.51	-	-	14.58	-
May-17	32.39	-	-	-	21.43	1.55
Jun-17	12.88	-	-	-		1.82
Jul-17	11.79	1.26	-	-	20.23	1.38
Aug-17	21.85	-	6.12	-	16.89	-
Sep-17	10.95	-	4.79	-	70.74	0.89
Oct-17	8.70	-	-	-	13.05	
Nov-17	18.91	-	-	-	2.45	0.97
Dec-17	17.50	-	-	-	59.70	2.33
Jan-18	27.57	3.30	-	-	17.64	1.26
Feb-18	48.61	-	-	-	13.88	
Mar-18	31.20	-	21.08	-	73.46	2.97
Apr-18	30.36	4.21	-	-	12.57	
May-18	54.71	-	-	-	10.97	2.30

Source: HSBC estimates, BoE, BoJ, New York Fed

... for the BoJ and Fed due to operation twist

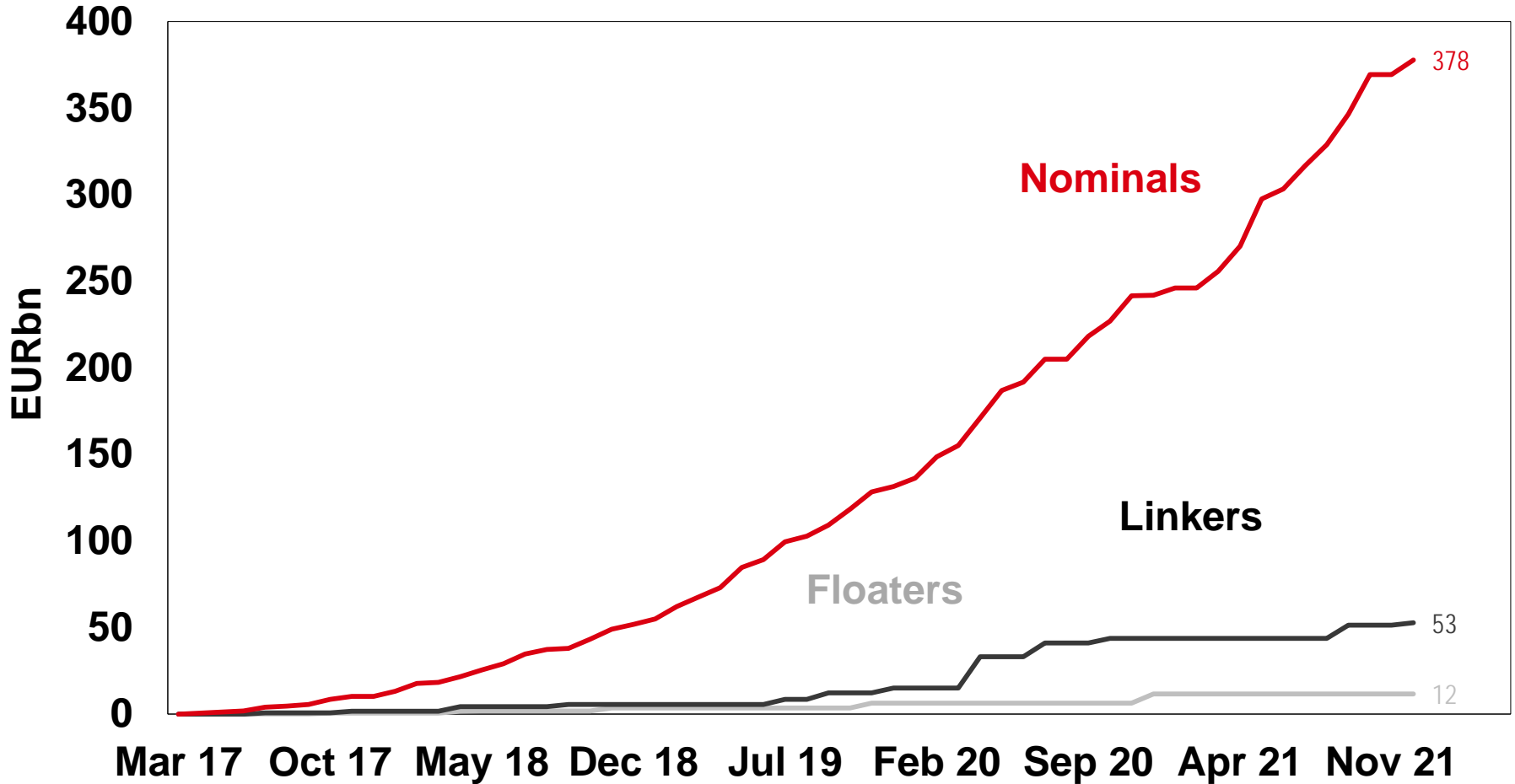
Government bond redemptions						
	US		UK		Japan	
USDbn	Nominals	Others	Nominals	Others	Nominals	Others
May-18	54.71	-	-	-	10.97	2.30
Jun-18	30.45	-	-	-	77.78	1.71
Jul-18	28.46	2.14	3.84	-	2.79	1.71
Aug-18	44.00	-	-	-	6.01	
Sep-18	17.42	-	-	-	72.55	1.77
Oct-18	21.35	-	-	-		
Nov-18	56.45	-	-	-		2.10
Dec-18	14.75	-	-	-	70.86	0.00
Total	623.18	14.51	50.75	0.00	740.60	27.25
	637.69		50.75		767.85	
% of GDP	3.55%		1.78%		18.62%	

Source: HSBC estimates, BoE, BoJ, New York Fed

General redemptions guidelines

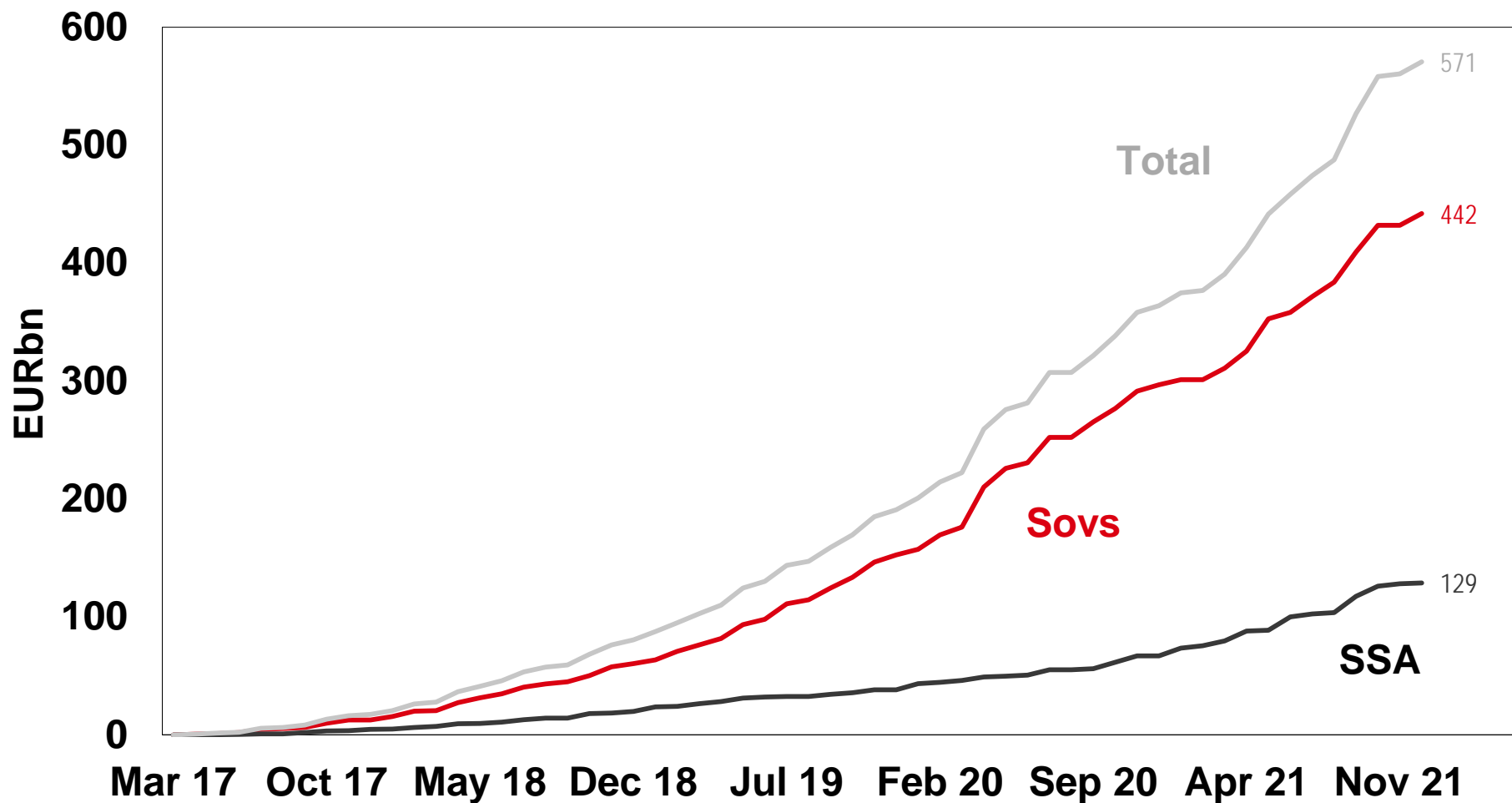
- **Avoid buying bonds within policy horizon**
 - BoE 3-years, Fed 4-years
- **Distribute reinvestment proceeds across curve segments**
 - Matching issuer duration does not negate flattening pressure
- **Try and match rollovers with supply events**
 - Supply calendar and gross issuance size key
- **Avoid 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

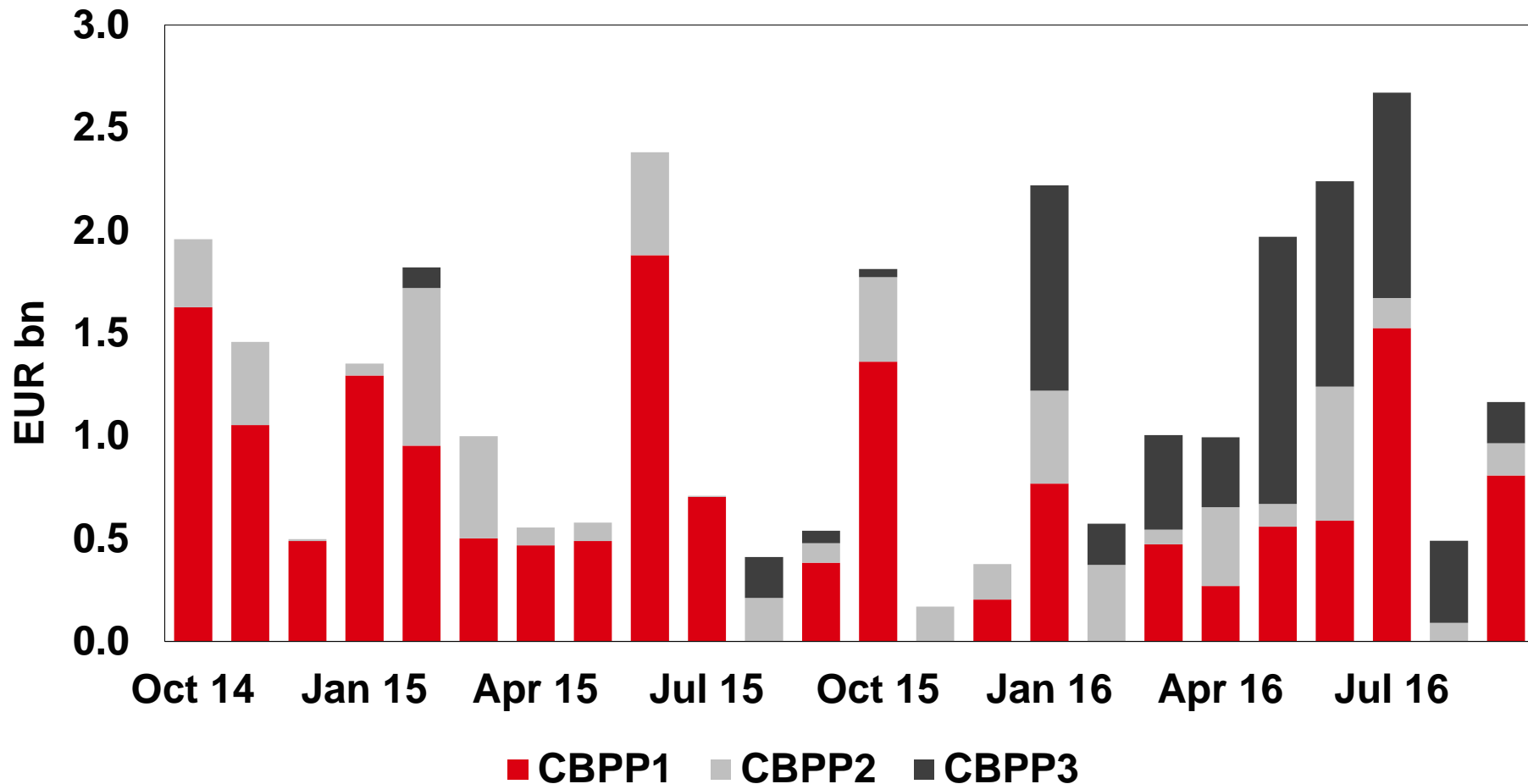


Source: HSBC estimates

- **PSPP: redemptions 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**

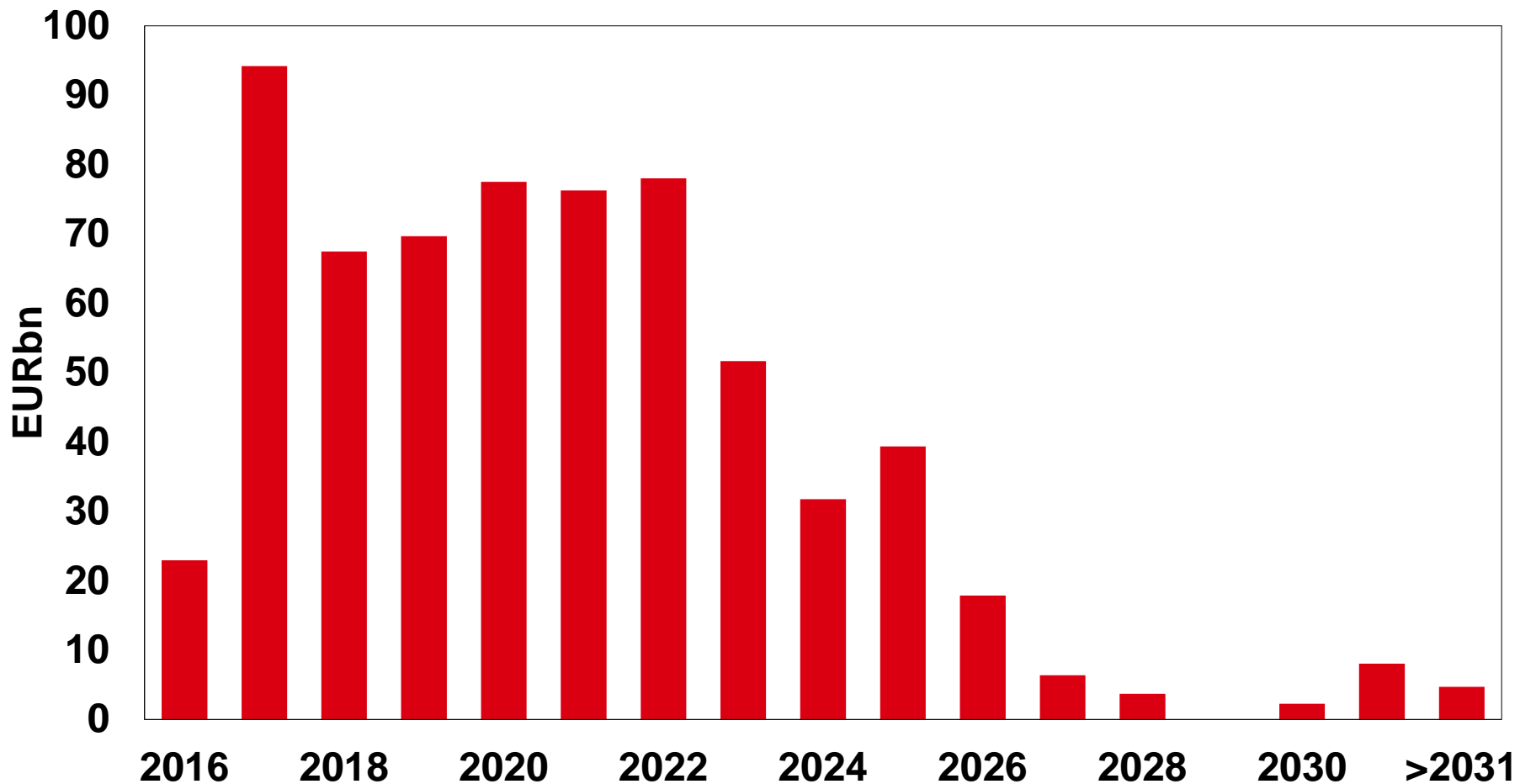
- **The intent of QE is to raise nominal GDP**
 - For the ECB, the focus is on inflation and promote credit impulse
- **Available/eligible asset impose constraints on QE programmes**
 - Money creation is temporary because bonds mature
- **Aging QE portfolios can also create obstacles**
 - Recurring competition 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

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Discussion topics

- 1. Best practices regarding reinvestment**
- 2. General issues around reinvestment and potential market impact**

Disclosure appendix

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Source: HSBC

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Issuer of report

HSBC Bank plc
8 Canada Square, London
E14 5HQ, United Kingdom
Telephone: +44 20 7991 8888
Fax: +44 20 7992 4880
Website: www.research.hsbc.com

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