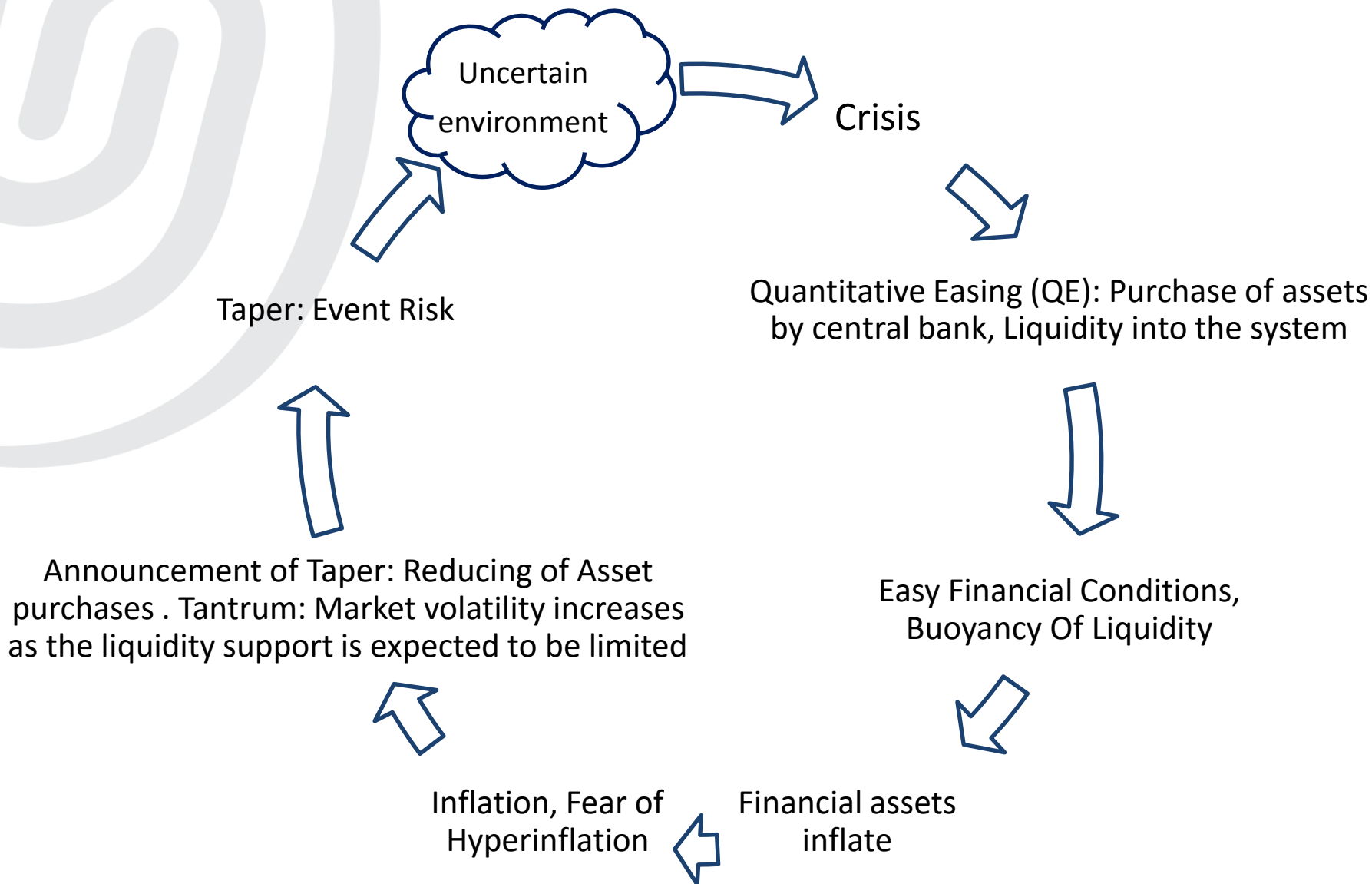




Food for Thought (Fixed Income)

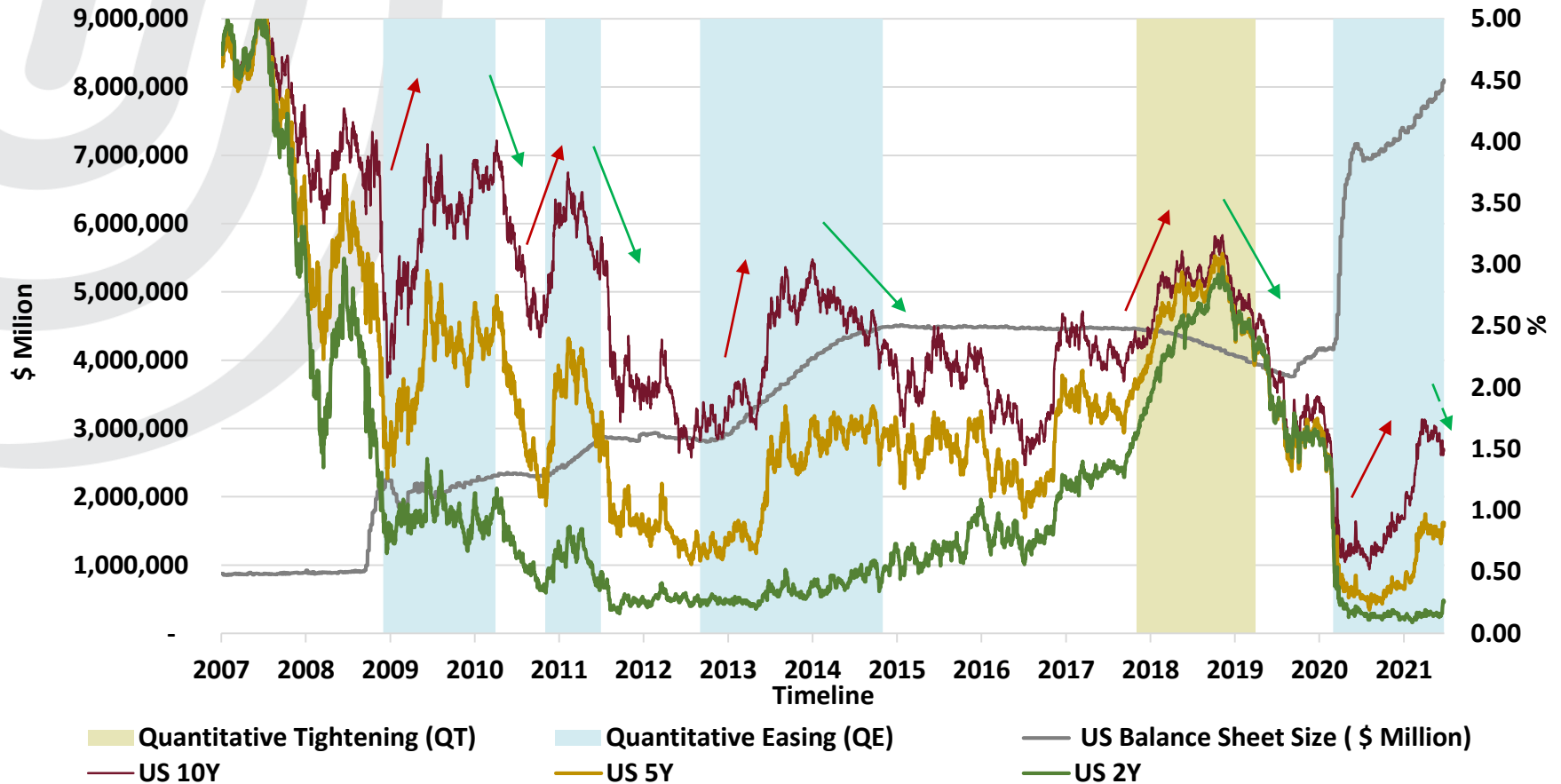


10 Year Rates- US and India



- Variation in US Interest Rates matter to all asset classes across markets and geographies
- Co- movement in Indian and US rates are significant and material.
Monthly change in IN 10 Y = 0.96 + 0.81 (Monthly change in US 10 Y); R square = 0.8

Source: Fred, St. Louisfed

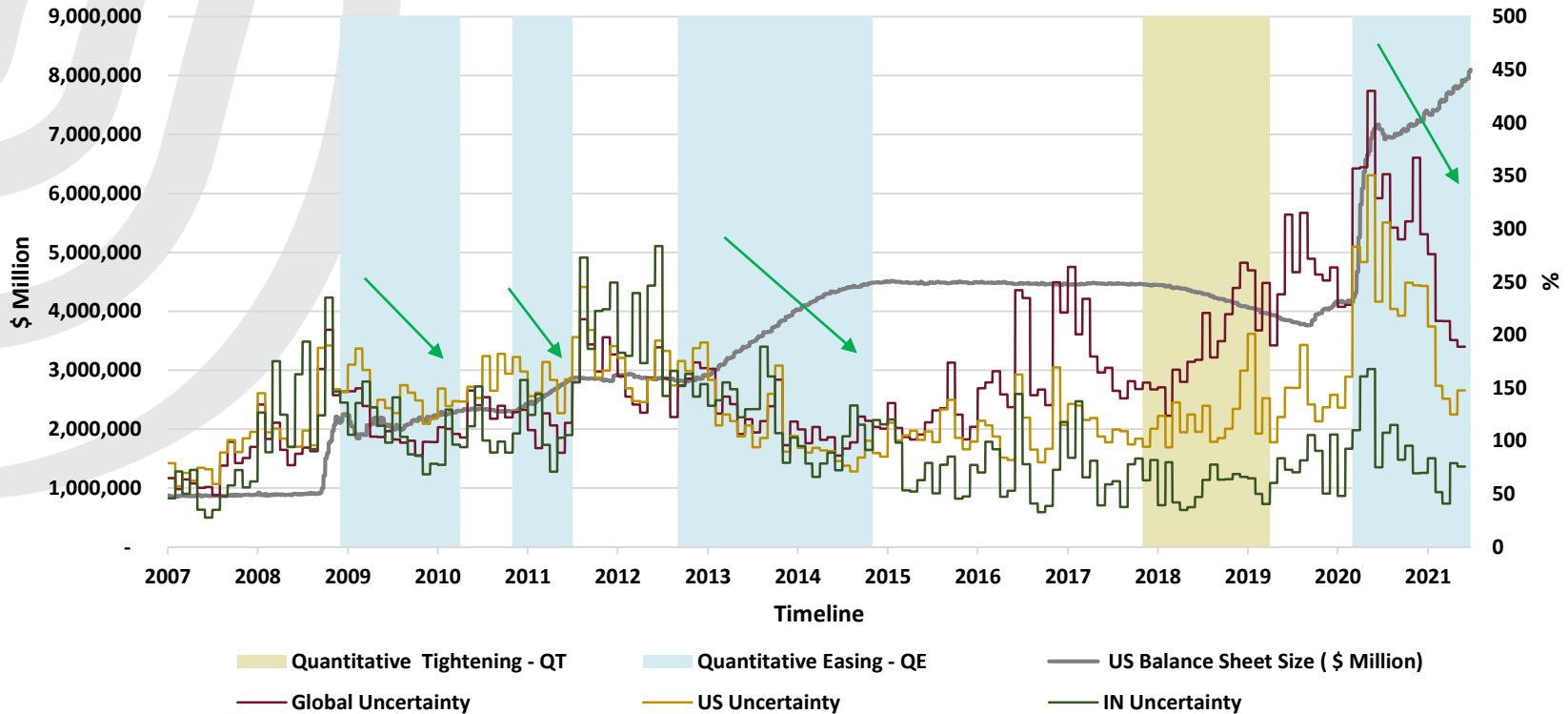


- US rates fall precipitously once QE is announced and keeps rising as the QE progresses
- Peaks out within the QE and falls sharply as the QE is pared down.
- The pattern is consistent through QE1, QE2, QE3 ,QT...
- Has the current upward move in US 10Y peaked out? Probably yes

Source: Fred, St. Louisfed



- Term spreads increases as QE progresses, peaks out within QE
- Falls sharply as QE is pared down and during Quantitative tightening (QT) . Pattern is consistent throughout the time period.
- Long term inflationary expectations (market determined 5Y forward) exhibits a similar pattern.
- Has the current long term inflationary expectation topped out as the taper nears ? Probably yes



- Economic Policy Uncertainty Index (EPU): Policy uncertainty may refer to uncertainty about monetary or fiscal policy(refer glossary slide for detailed info)
- EPU falls consistently through the QE and hits the trough as it is pared down.
- EPU has fallen sharply from the peak in the current cycle and continues to fall.

Source: Fred St. Louisfed, policyuncertainty.com

- Volatility around inflation, taper timeline, pace and quantum are expected to continue.
- Economic Policy Uncertainty (EPU) is falling sharply. Still higher than averages.
- EPU may trough out as the Quantitative Easing ends.
- In the current cycle, United States interest rates, term spreads, 5 year forward inflationary expectations so far have shown confirmation to the historic patterns.
- Data indicates US 10 yr might have peaked out for current QE.
- Taper and tantrums around QE are event risks and sources of volatility.
- As per historical trends, interest rates tend to move upwards as QE progresses as expectations of taper increase. However, data suggests that eventually, rates move downward thereon as observed during all previous QEs. Are we in that period? Going by historical trends, data indicates a downward trend in interest rates ahead.

- **EPUI** – Refers to Economic Policy Uncertainty Index. Policy uncertainty may refer to uncertainty about monetary or fiscal policy. Policyuncertainty.com measures policy-related economic uncertainty by forming an index from three types of underlying components. One component quantifies newspaper coverage of policy-related economic uncertainty. A second component reflects the number of federal tax code provisions set to expire in future years. The third component uses disagreement among economic forecasters as a proxy for uncertainty.
- **QE**- Quantitative easing (QE) is a form of monetary policy used by central banks as a method of quickly increasing the domestic money supply and spurring economic activity. The central bank infuses a pre-determined quantity of money into the economy by buying financial assets from commercial banks and private entities. This leads to an increase in banks' balance sheet size.
- **QT** - Quantitative tightening (QT) is a contractionary monetary policy applied by a central bank to decrease the amount of liquidity within the economy. The policy is the reverse of quantitative easing (QE).The main goal of QT is to normalize (i.e. raise) interest rates in order to avoid increasing inflation, by increasing the cost of accessing money and reducing demand for goods and services in the economy.

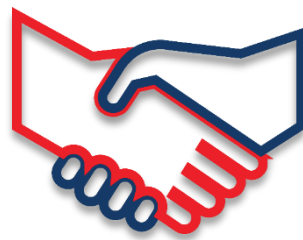
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