

Qualitative easing

QE impact on CEE financial markets

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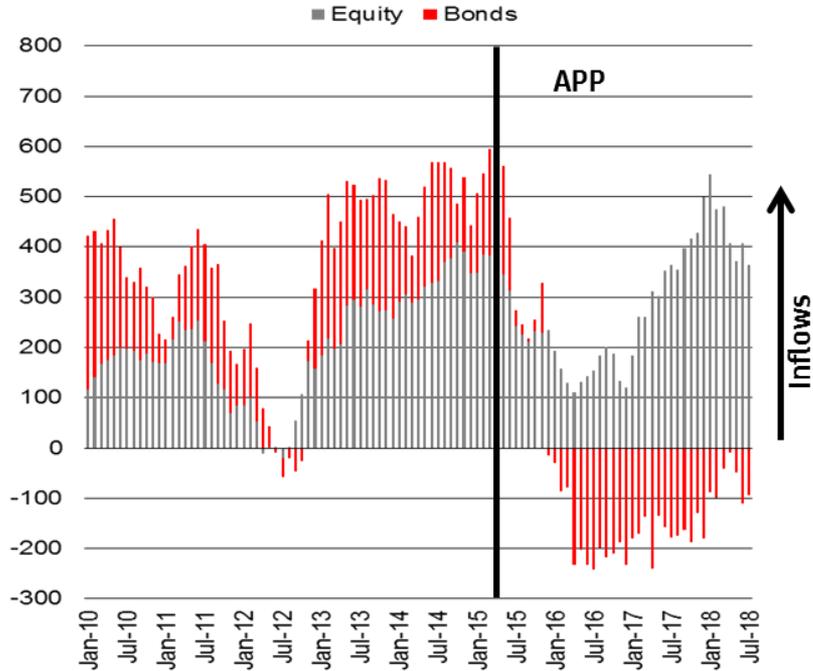
Main messages

- 1. QE-driven flows chased liquidity over returns**
- 2. QE compressed term premia for CEE bonds**
- 3. Credit spreads remain dependent on domestic policies**
- 4. Risk appetite for EM assets could weaken further, despite ECB's open-ended QE**

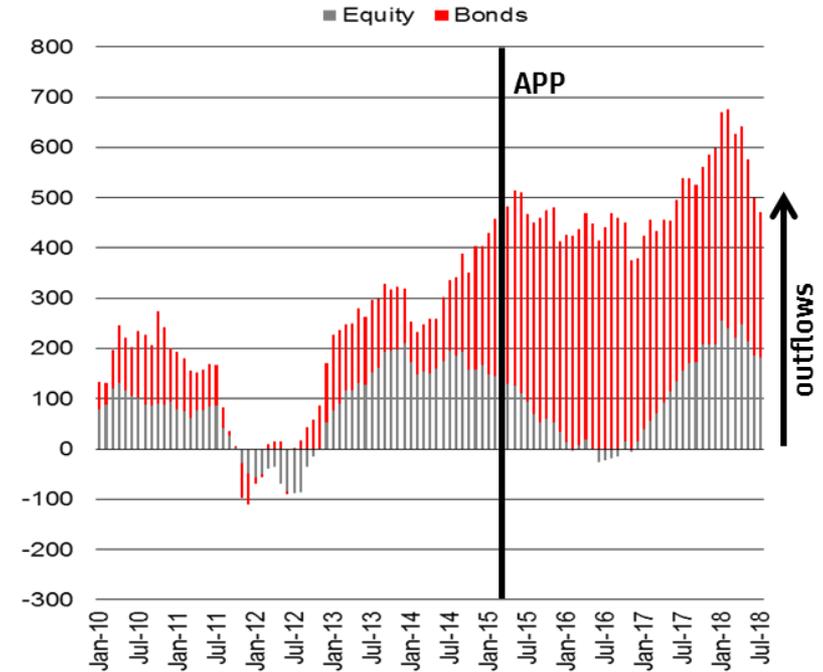


1.1. Foreign and EA investors sold EA bonds to the ECB during the APP

Foreign portfolio investment in the euro area
EUR bn, 12M rolling sum



Euro area portfolio investment abroad
EUR bn, 12M rolling sum

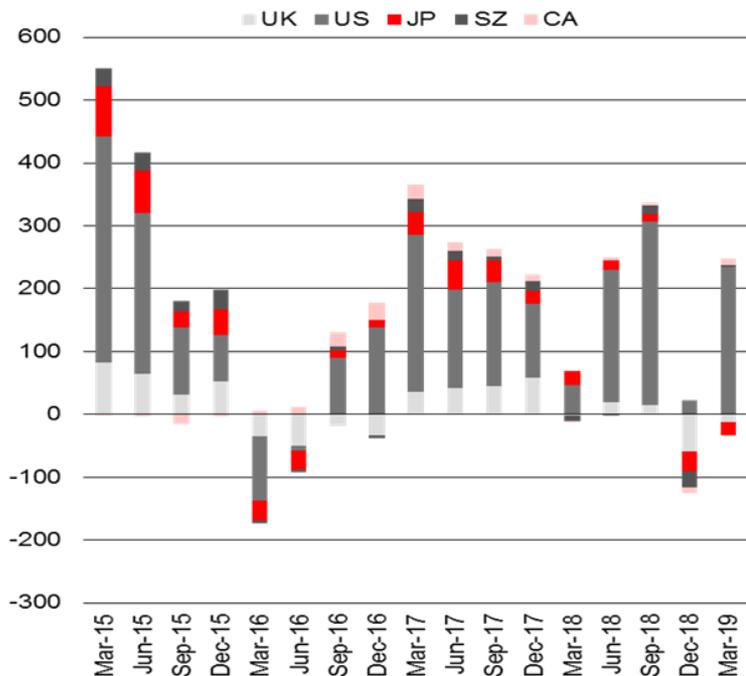


Source: Haver, UniCredit Research

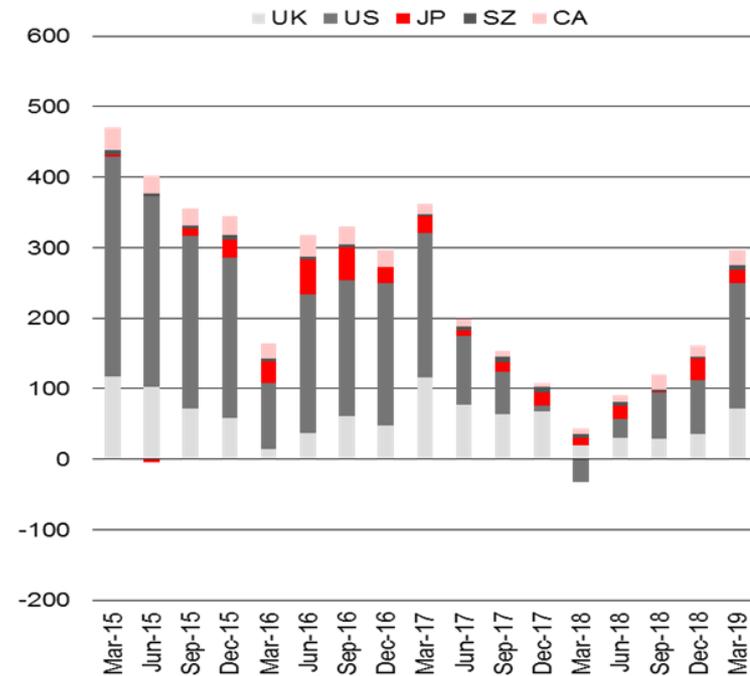


1.2. EA investors purchased bonds and equities in liquid markets...

EA investors purchased mostly US equities...
equities (EUR bn, 12M change)



... and bonds in the US, UK, Japan and Canada
bonds (EUR bn, 12M change)

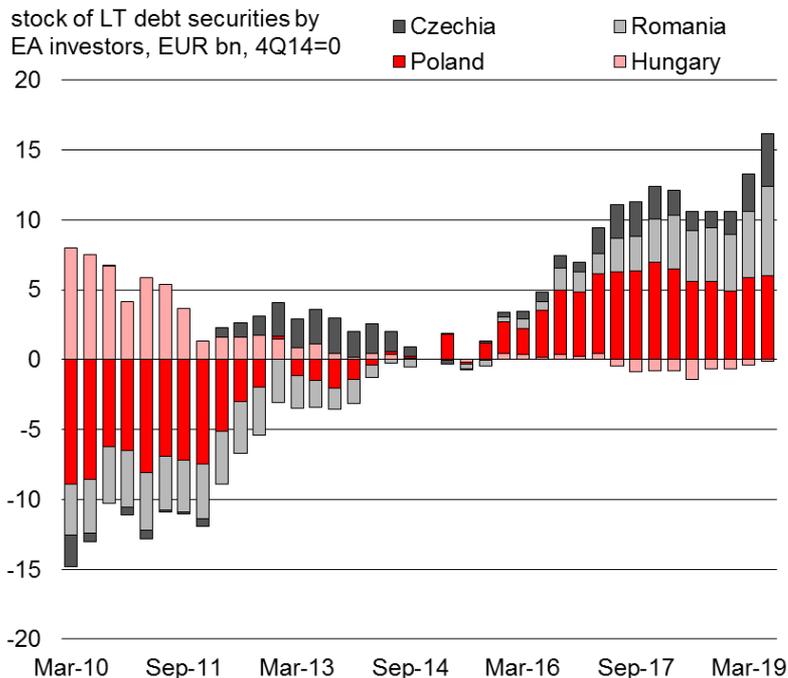


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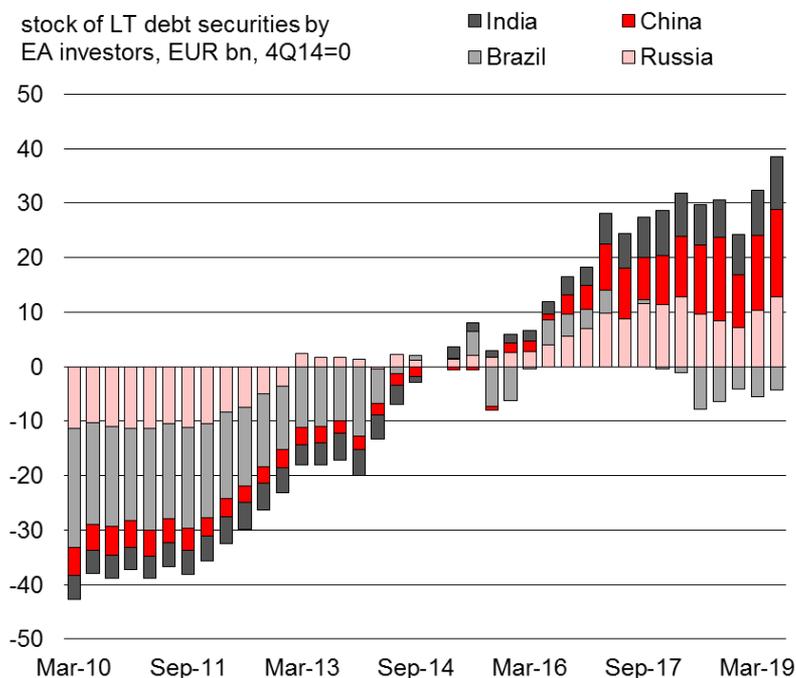


1.3. ... but showed far lower appetite for emerging market bonds

Central Europe attracted a paltry EUR 16bn in net bond inflows since the APP was launched



... and BRIC were only marginally more successful



Source: ECB, Haver, UniCredit Research



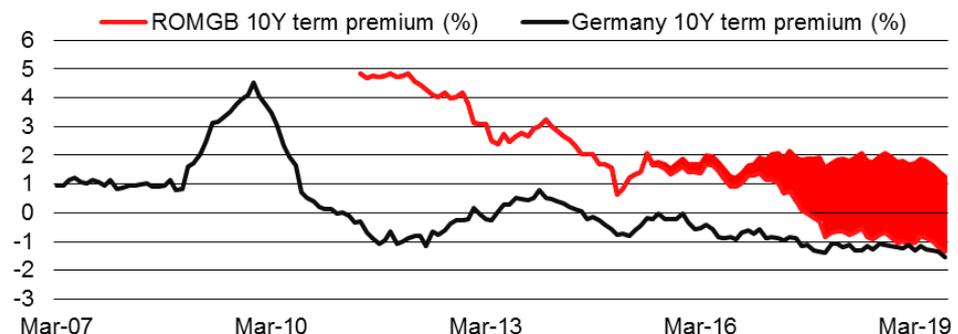
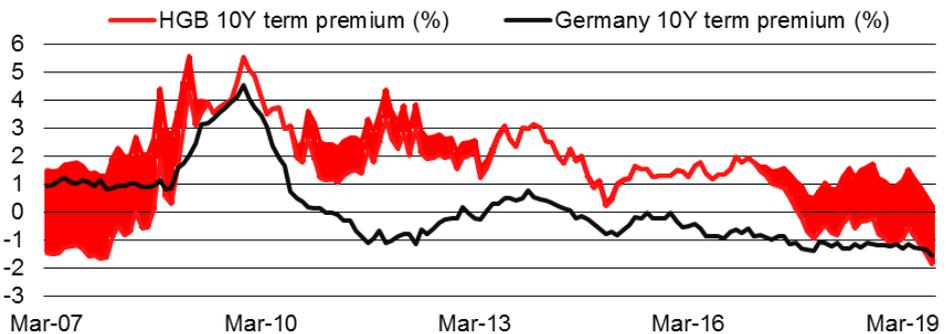
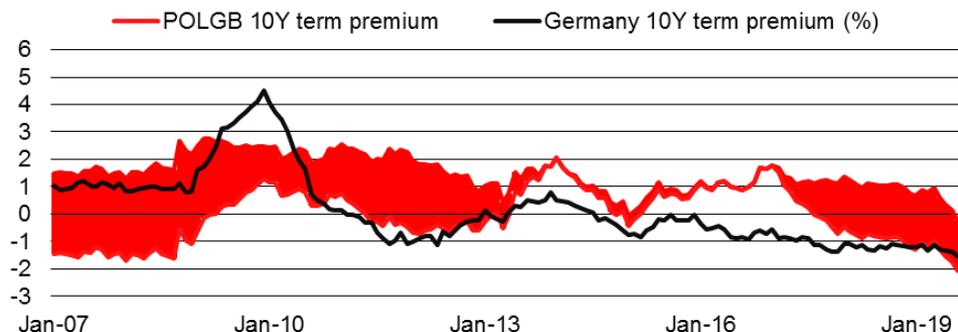
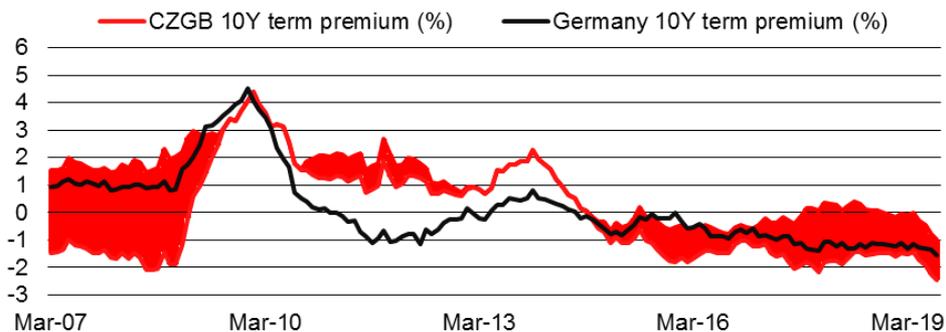
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2. **QE compressed term premia for CEE bonds**
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2.1. Term premia declined in EM in line with those for DM bonds...

In central Europe, term premia* moved with Bunds' term premia (for Poland - Jablecki et al (2016)).



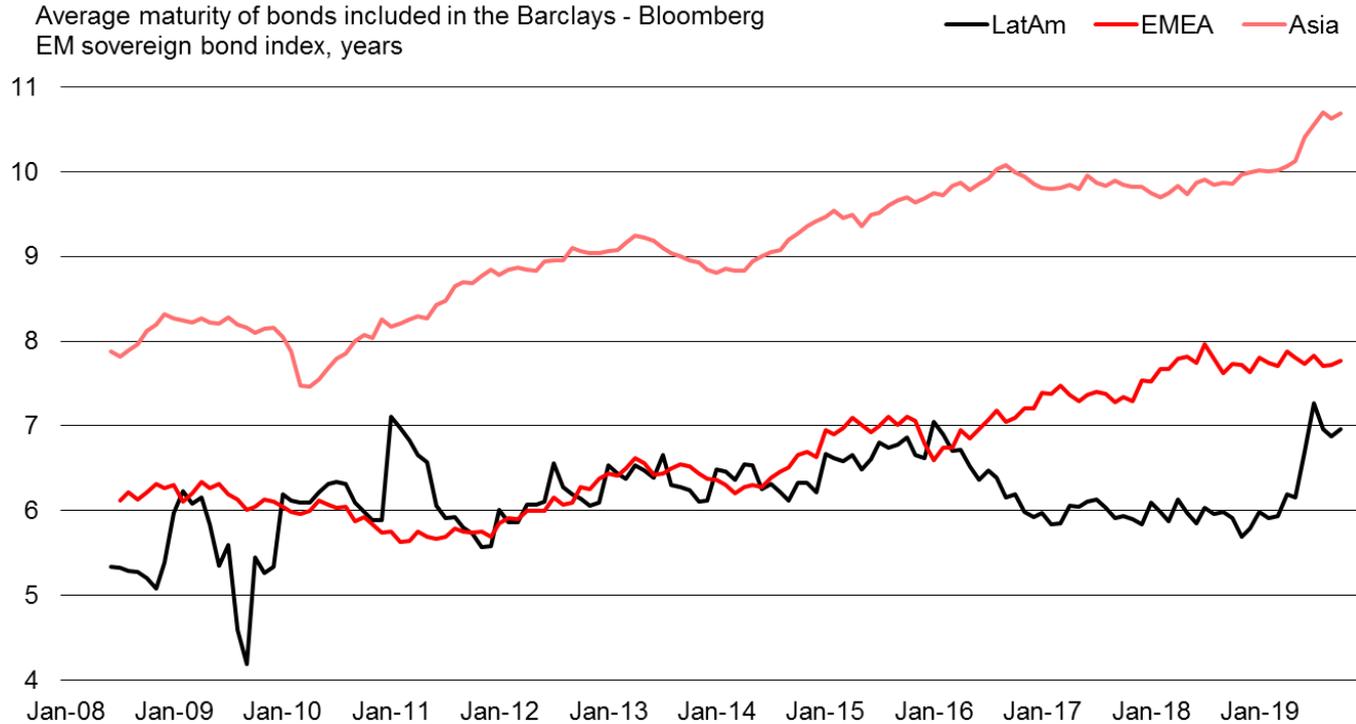
* Term premia computed using Adrian-Crump-Moench (ACM) methodology.

Jablecki, J., A. Raczko and G. Wesolowski (2016), "Negative bond term premia – a new challenge for Polish conventional monetary policy" in BIS Papers No. 89 from 15 November 2016

Source: Bloomberg, UniCredit Research



2.2. ... helping EM extend the average maturity of debt

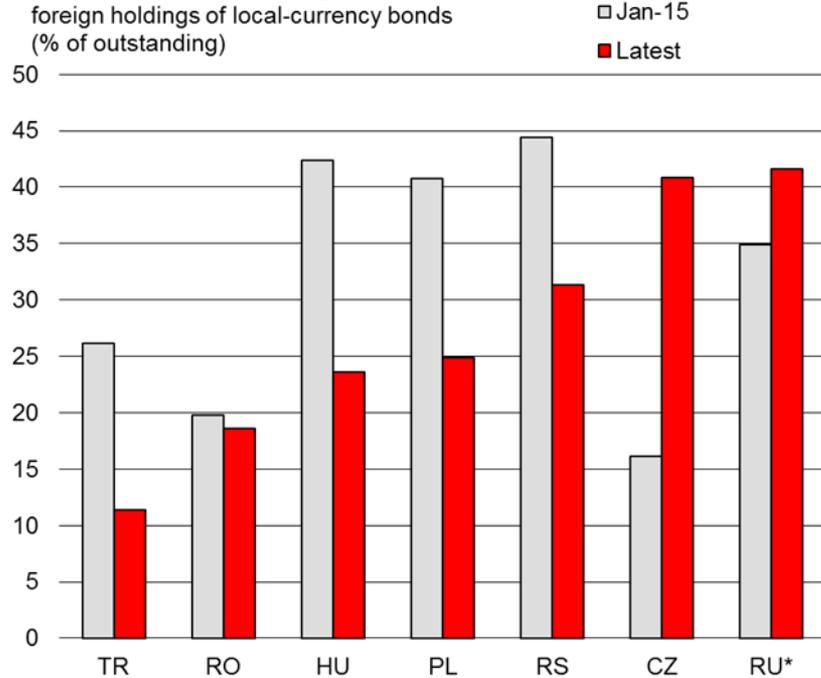


Source: Bloomberg, UniCredit Research

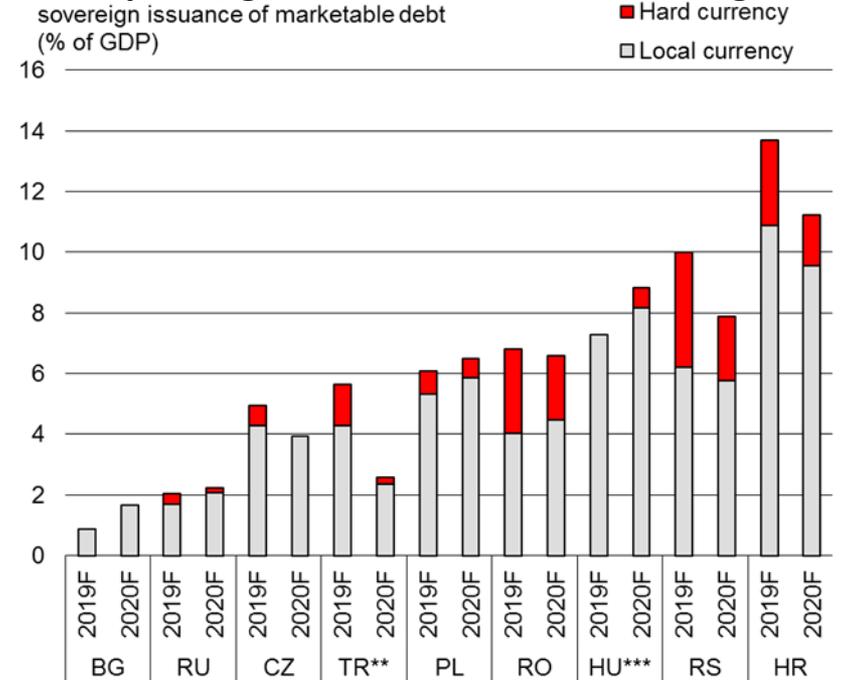


2.3. Foreign holdings of CEE bonds can rise if liquidity deepens

Lower yields in the "DM of EM" shifted the investor base to global mandates



Benchmarks should increase in size and become less frequent, given lower annual financing needs



* Percent of outstanding fixed-coupon bonds. ** Issuance for Turkey assumes an IMF loan in 2020. *** Retail bonds are excluded in Hungary.

Source: ministries of finance, Bloomberg, UniCredit Research

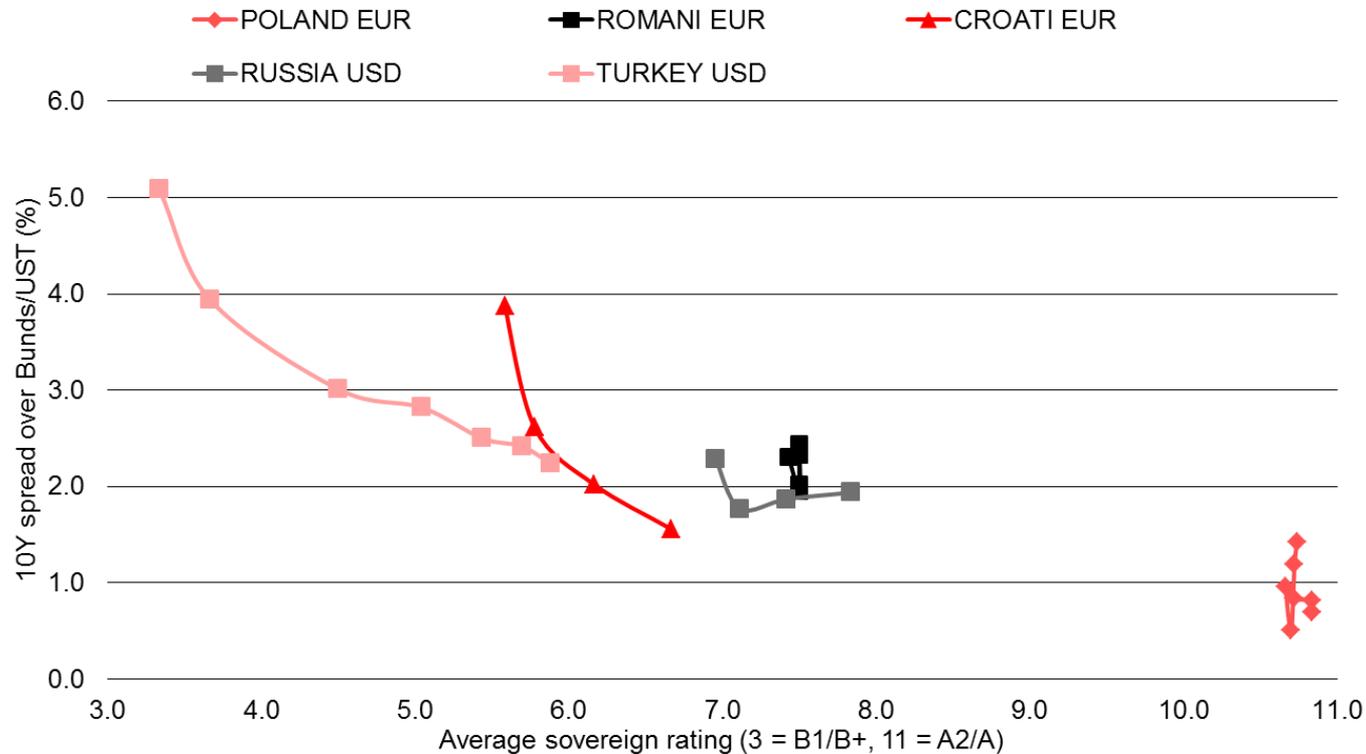


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3. Credit spreads compressed in countries where policies improved



Source: Bloomberg, UniCredit Research

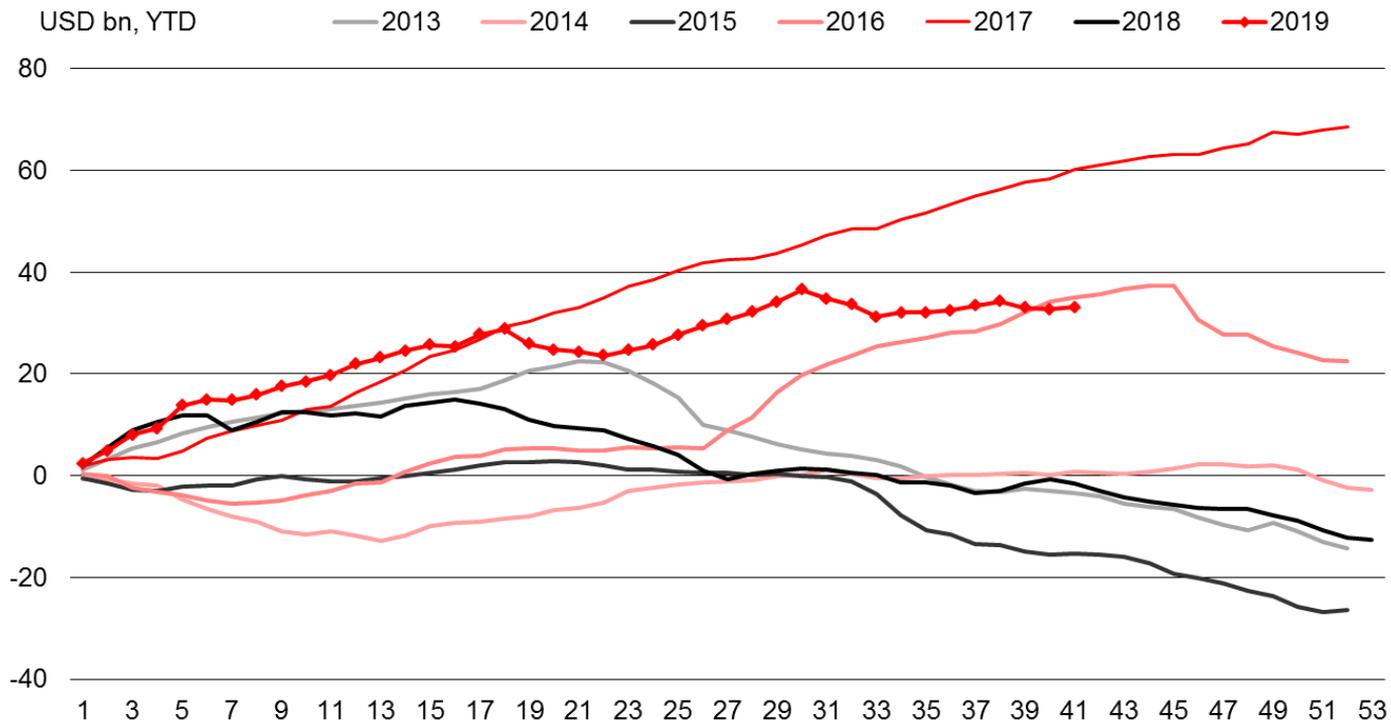


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4.1. Net flows into EM bonds stopped since end-July

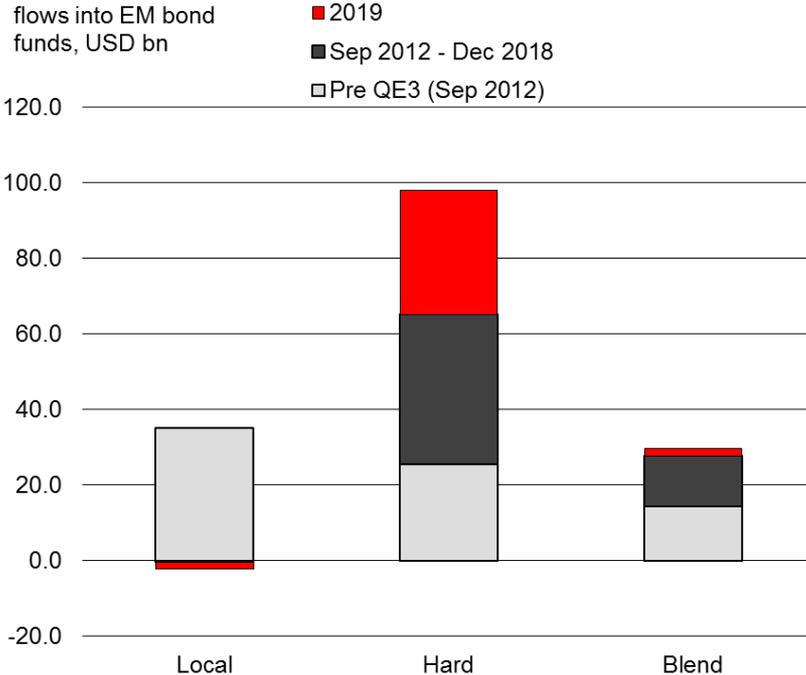


Source: EPFR, UniCredit Research

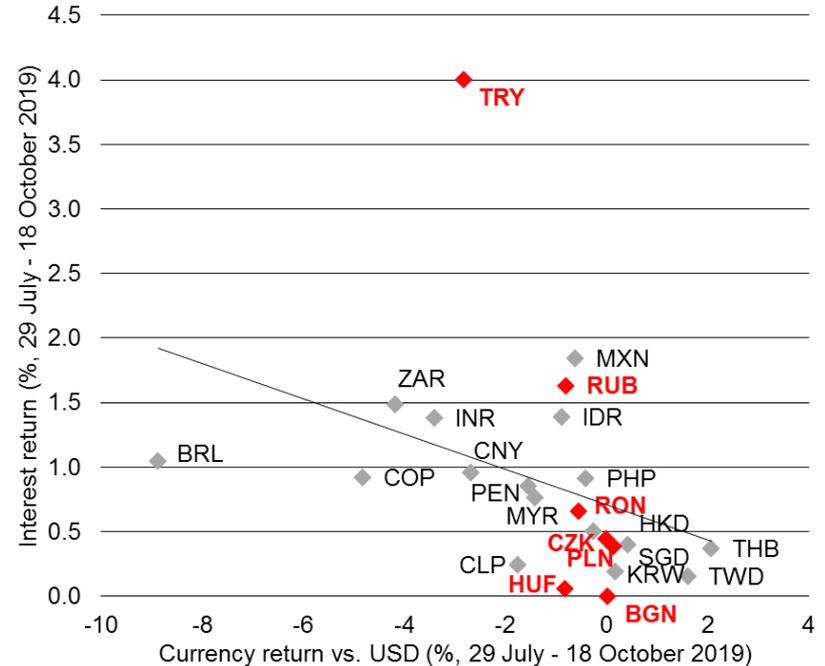


4.2. Foreign investors are avoiding exposure to EM currencies

In 2019, foreign investors bought only hard-currency EM bonds



Negative correlation between interest rates and currency performance since end-July



Source: EPFR, Bloomberg, UniCredit Research



Conclusions

1. QE-driven flows chased liquidity over returns

1. Eurozone investors preferred US equities, and US, UK and Japanese bonds
2. Flows into EM bonds were very small in comparison

2. QE compressed term premia for CEE bonds

1. EM extended the average maturity of issuance
2. Change in investor structure to global mandates that require better liquidity

3. Credit spreads remain dependent on domestic policies

1. Spread compression was driven by better fiscal policy leading to lower financing needs

4. Risk appetite for EM assets could weaken further, despite ECB's open-ended QE

1. Foreign investors did not take currency exposure to EM in 2019
2. Poor appetite for EM currencies could persist amid a strong USD and poor growth in EM



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