



QE2: impacts and limits

Overview

The Mid-term elections in the US will not have significant economic impact as the stimulus is about to be completed. As wished by Republicans, austerity will come, but in a much less aggressive manner in comparison with the Euro zone. Only the Fed can now veritably support the economy via a possible new wave of QE. The problem with such a policy is if it will exacerbate global imbalances and exchange rate disruptions. This uncooperative approach of the US will probably complicate the discussions of the coming G20 summit in Seoul in November.

Focus: QE2: impacts and limits

Confronted with a deceleration of activity due to the tightening of fiscal policies, the central banks of Western economies are currently maintaining their securities purchase programs and discussing the option of renewing and reinforcing their QE (Quantitative Easing) policy. The Fed is the most advanced for considering the case of a QE2. QE2 is very likely to be announced in the next FOMC meeting (November 2-3). We expect the size of the program will be between USD 500 bn-USD 1tn, the implementation to be progressive, bonds and possibly MBS to be the assets purchased, and the impact to be limited.

Indeed, given the divisive thoughts of FOMC members including whether a new QE is needed, whether QE is really effective, and whether alternatives exist, the limited size of the program will produce limited effects. Moreover, the purchase amount is likely to be small, as in our view, GDP growth will be stronger than expected in coming months. QE2 is unlikely to have a major economic impact after announcement, as the market has already factored in the QE2 expectation. As a result of this, we do not expect the US dollar to be weakened further. The impact on commodity prices depends on how progressive the QE2 is and how much assets will be purchased ultimately. The commodity price is likely to accelerate but to move within a mild band under our current scenario.

The limits of these new QE policies are visible in the long-term. They put the mandate of central banks to keep the control of inflation and their independency at risk, are powerless in the context of deleveraging, increase the risk exposure of central banks in relation to possible large fluctuations of government bond prices, reduce the incentive of governments to decrease their deficit urgently as they could finance it more easily and less costly, contribute to the instability of foreign exchange market.

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	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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