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Portfolio Perspectives

Debunking Conventional Wisdom

Six Reasons Why the End of Quantitative Easing May Not Lead to Higher Interest Rates

QE is ending! Oh no! Telegraphed by the Fed, the lengthy monetary expansion plan known as Quantitative Easing is scheduled to end this month as the final $15 billion of monthly purchases of Treasury notes and mortgage securities occurs.

While the incremental liquidity has certainly provided stimulus to long term asset prices over the last five plus years, I believe there are six reasons why the end to QE may not directly translate into meaningfully higher interest rates.

1. The last two times the Fed ended QE (2010 and 2011), 10 year Treasury yields fell as anticipated economic growth declined.
2. Stifled by slow economic growth, many European countries' short term rates are now negative and thus represent little threat of leading our rates higher.
3. Now at a four year high, the U.S. dollar has suppressed commodity inflation and will likely keep a lid on U.S. export growth.
4. With roughly 6% unemployment and low labor participation rates, labor markets remain balanced and wage growth subdued.
5. With a strong economy and higher tax rates, 2014's Treasury deficit should decline to just $660 billion, the lowest since 2008 – representing a small supply of debt issuance for the market to absorb.
6. Over the last five years, whenever the Fed's Five Year Forward Breakeven Inflation Rate dropped to 2.20% or below, the Fed initiated a new round of quantitative easing. At just 2.15% and dropping, Yellen and team are probably on the verge of re-upping their stimulus policies.

Taken together — low inflation, low foreign rates, slow foreign economic growth, low labor participation rates, a strong dollar and the likelihood of the Fed coming back to the party could all, in our view, support a near zero interest rate policy.

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Source: Renaissance Macro Research, LLC

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