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EM Rates and Credit

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QE in emerging markets

Unconventional risks

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Doing QE the EM way

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Central banks typically engage in bond buying as a last resort – when the official rate has hit zero. Not in emerging markets. Here, some central banks have dived into QE programs with rates well above zero. The dominant rationale centres on a desire to stabilise markets as fiscal pressures build, typically pandemic-related. In many cases it is sterilised, or mopped up through bills issuance, but not always. In the end, additional money is being printed through central banks bond buying. We survey the risks. There are some. Some central banks have quite large programs, others are engaging in QE from an already vulnerable state. Then again others are small and reversable. One thing is sure; they need monitoring.

Below are our estimates of what EM central banks are doing in terms of QE size (Fig 1).

Fig 1 Quantitative Easing programs ongoing in Emerging Markets

% GDP	Poland	Croatia	Chile	Hungary	Turkey	S Africa	Romania	Indonesia	Colombia	Philippines
QE done	4.5	4.0	2.6	0.5	1.2	0.6	0.3	0.9	1.1	0.3
QE target	9.5	8.0	4.0	3.0	2.0	2.0	1.5	1.5	1.1	0.4

Source: ING estimates

QE is the equivalent of printing currency. Printing more currency increases its supply, and should therefore lower its price. The US and other core central banks have managed to execute QE without a material adverse effect on FX, partly as their underlying currencies are underpinned by a muscle memory of relative macro stability.

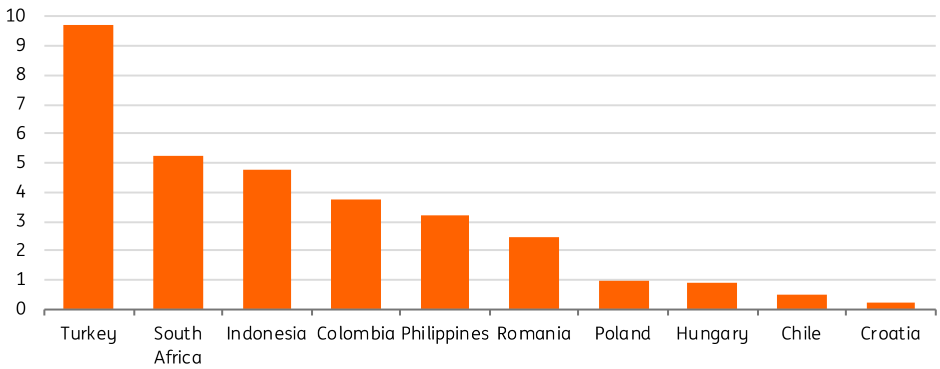
The USD is of importance here. It is the global reserve currency, and we find during times of crisis that there is excess demand for it. That's a luxury position from which to execute QE. The likes of the EUR and the JPY tend to trade as a stationary series around the USD on their respective crosses – big swings, but typically mean-reverting. And since they are all at QE there isn't much for them to depreciate against.

But emerging markets are different. Here FX rates are trending, typically reflecting wider inflation differentials, on top of the tendency for capital flight when policy wobbles, which in turn produces echoes and overshoots. Now throw in a dose of QE and you have a further excuse for vulnerability. The question is, to what extent are risks being run.

Jumping in at the deep end

For emerging markets (EM), the Quantitative Easing (QE) button has been pushed with rates well above zero in many cases (Figure 2). None of the central banks in question went in to QE with rates actually at zero, although Croatia and Chile were practically there, and Poland has gotten there belatedly.

Fig 2 Policy rate that obtained when QE was enacted (%)

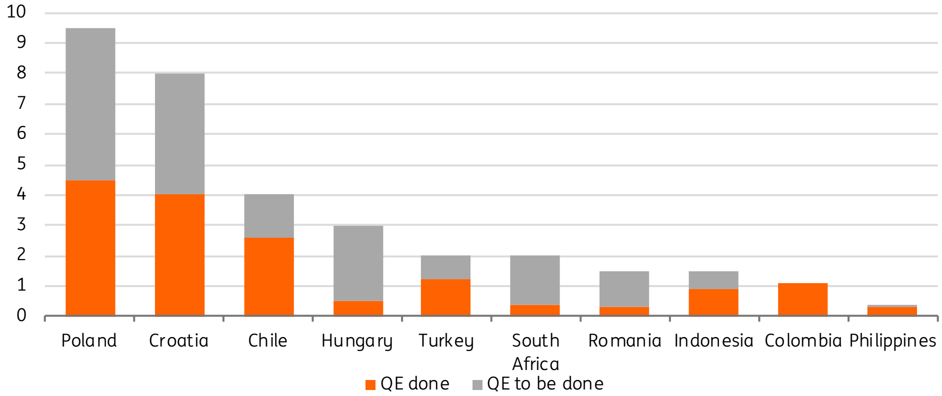


Source: ING estimates

QE impact partly depends on the starting point

Emerging market central banks that have kicked off QE are a real mixture of players. Many of the central banks are not telling us how much they are doing, or indeed intend to do. Below is a combination of what is known plus estimates (Figure 3).

Fig 3 Size of EM programs in EM (% GDP)



Source: ING estimates

At one extreme of the credit spectrum is **Poland**, and probably Israel. These central banks are buying government bonds and are unlikely to cause too much consternation for their markets, provided macro stability is maintained. That said, Poland in particular is not invulnerable by any means. It runs risk by virtue that it is running the biggest QE program in EM space, potentially posing FX risks at some point in the future.

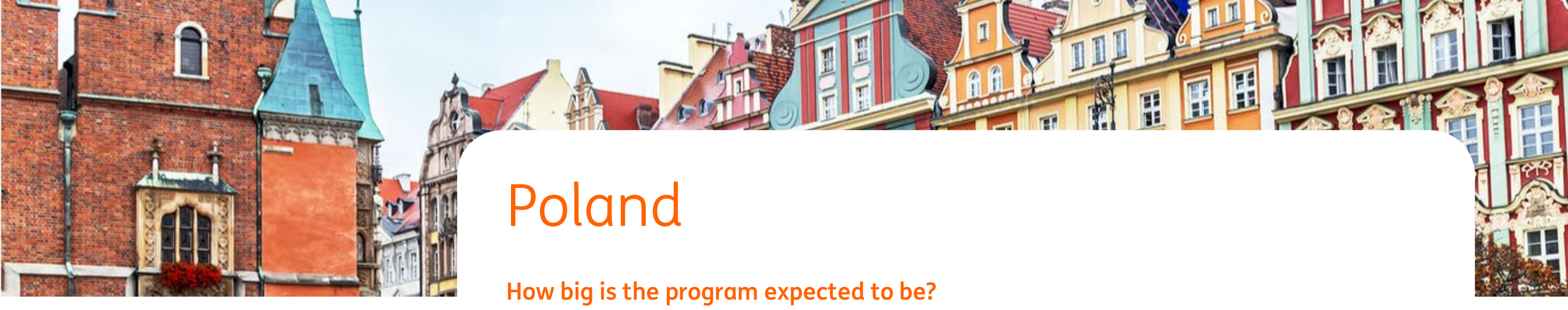
Hungary comes after that. Here policy here is aimed at financial market stability with a dose of yield curve control to aim fiscal management. A central goal is to be able to control the long-end of the yield curve, providing cheaper, less volatile funding for the Hungarian budget. It is not significant in size, but also far from insignificant.

Then comes **Chile**, which is largely providing bank support through loans; theoretically equivalent to bank bond buying, but baby steps in QE terms. And **Colombia** which is buying corporate bonds (but just out to 3 years). Meanwhile **Brazil** is paving the way to make QE possible, but there is no certainty they would employ it. It is tempting now as market rates have fallen, but more tempting should conditions re-deteriorate.

Then we have the likes of **Philippines, Indonesia** and **South Africa.** They are all buying government bonds. The sizes here range from small to unspecified, with the largest vulnerability attached to the latter. The likes of South Africa buying bonds right along the yield curve for unspecified sizes is great for the short term as there is a big buyer in play but poses risks from a medium-term perspective. At the other end of the scale the Philippines is only buying out to 6 months in maturity, just toe-dipping.

That said, even where QE is short dated or small in size, it is also a starting point to potentially expand from. For more grandiose QE projects, statements are being made. **Romania** is one of those names that has re-established credibility in the past decade, and has been rewarded with a return to investment grade. But it is now in a vulnerable phase, where there is a rating threat.

Apparent ability to control the currency helps, but a step too far into the temptation of QE runs risks. Should QE go on for a period of time without an FX reaction, that does not mean there will not be one. Reaction can still come in an exaggerated way at a moment of future vulnerability. The fact that this has not happened so far does not mean it won't happen; stuff like this tends to build until it gets to a "sit up and notice" moment.



Poland

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How big is the program expected to be?

The Polish fiscal response to Covid-19 is the largest in Europe (direct fiscal spending of 6.5% of GDP, excluding loans and guarantees). Globally only Australia, Japan, and the US announced bigger packages. With a cyclical shortfall in revenues and doubtful one-off proceeds budgeted for 2020, it is set push the deficit to 11% of GDP, and public debt to 59% of GDP in 2020.

Is there an official size?

We expect the core of the funding for the fiscal stimulus to come (indirectly) from NBP asset purchases (QE). We estimate the program at 8.5-10% of GDP in 2020, although there is no official target. We estimate it to cover the residual amount of the net public borrowing needs, which cannot be absorbed by local banks.

What is the central bank buying exactly?

So far the NBP has spent some 4% of GDP on QE, buying government bonds (POLGBs), BGK (state controlled bank) & PFR (Polish Development Fund) bonds. NBP purchases cover all years from 1yr-10yr maturities. Of the PLN85.4bn bought so far, maturities of 5yr or longer constituted 85%.

Is it all on secondary, or is there a primary market element?

The NBP is not allowed legally to participate in the primary market. All transactions are conducted on the secondary market. But both the new T-bonds or T-guaranteed bonds purchased are freshly issued. The placements would not be so smooth without the NBP commitment to play an active role on the secondary FI market.

Is QE legal?

The central bank cannot monetize fiscal deficit. The central bank sterilizes the majority of liquidity QE creates through bill issuance. They present QE as open market operations which streamline the monetary policy transmission mechanism: by ensuring liquidity in secondary markets for the purchased securities and enhancing the impact of NBP interest rate cuts on the economy.

Does the central bank need to do QE?

Poland could probably fare relatively well during the crisis without a QE program, but the government launched a very aggressive and large fiscal program so QE assures the smooth and fast implementation of the funding for stimulus. In particular, the so-called Financial Shield of the PFR is implemented very quickly.

Is it helping the fiscal response?

The policy mix response (huge fiscal stimulus and plus QE) should prevent tensions or the bankruptcies of many businesses. Without QE, the fiscal response would be much smaller. That said, the efficiency of QE in igniting credit to the economy is limited.

Is it impactful for the real economy?

It means that so far, NBP is largely self-sterilizing its QE-driven liquidity given that credit demand from corporates and households is low and banks tightened their credit conditions due to the pandemic. To sum up, QE is certainly aiding the budget and it affects the real economy via fiscal programs it is funding. In the majority these are transfers with a fiscal multiplier below 1. They should preserve employment and make a recovery in 2020 smoother (less bankruptcies and lower spike of unemployment), but the investment component is limited.

Hungary

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How is the central bank conducting QE?

The National Bank of Hungary decided in April 2020 to launch a two-fold asset purchase program: government securities, and also mortgage bonds. Under the government securities purchase program (GSPP), the NBH purchases forint denominated fixed-rate government securities in the form of prompt securities sale and purchase transactions in the secondary market.

Why did the central bank start a QE program?

The Monetary Council decided to launch GSPP to restore the stable liquidity position of the government securities market, and to relaunch its mortgage bond purchase program to improve the long-term supply of funding to the banking sector. A central goal of the GSPP is to be able to control the long-end of the yield curve, providing cheaper, less volatile funding for the Hungarian budget.

Which securities and are there any rules of engagement?

The NBH is buying HUF-denominated fixed-rate government securities with at least 3yrs maturity. The volume of individual government securities series owned by the NBH may not exceed 33% of the nominal value of the outstanding security series. They also buy HUF-denominated fixed-rate mortgage bonds publicly issued by issuers in the territory of Hungary. Mortgage bond collateral coverage should be at least 80%. The original maturity of the mortgage bond is at least 3yrs.

Is there any primary market involvement?

The GSPP only buys on the secondary market, using both a weekly auction and ad-hoc transactions. With respect to the mortgage bond program, NBH makes offers on the primary market as well as purchasing on the secondary market.

Is there an official size to the program?

The NBH did not set a total amount of purchases for either program. The central bank will perform a technical revision when stock increases reach HUF 1,000 billion (~2% of GDP) in government securities and HUF 300 billion (~0.6% of GDP) in mortgage bonds while continuously monitoring the implementation of the asset purchase programmes.

Is the QE program sterilised? (eg, by issuing more bills to soak up liquidity)

The NBH set clear goals and the programs are quite transparent. The only question mark is the overall size, especially after the NBH only set technical revision-related milestones. The tricky part is the impact on HUF, but we can say it is a quasi-sterilized program as the liquidity pushed into the system in the long-end is sucked out in the short-end via the new 1-week deposit facility.

Is it working? Is it worth it?

As the Hungarian debt-to-GDP is the highest in the region and it is still well above the “BBB”-rated peers’ median, it is good to have control on the cost of debt financing; as deficit financing will be higher by around 5% of GDP compared to last year. And taking into consideration the collapse of the retail bond market, a measure which can control the HGB yield curve could become handy. It has not been necessary to enact this program, but it has its clear benefits.

Romania

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What was the backdrop from which QE was conceived?

Romania could be seen as one of those cases where QE wasn't only improbable but even unconceivable. Why? Well, it currently has relatively large twin deficits with a poor track record of fiscal discipline, a tight managed floating currency rate with a propensity for depreciation, relatively high nominal interest rates and was already on a downward trend in rating reviews. Historically being one of its few strong indicators, the debt/GDP ratio is set to broadly reach its peers rated average this year.

Why did the central bank in the end opt for QE?

We believe that in the case of Romania the QE decision was not taken with the same goals in mind as in Hungary or Poland (where it was needed and seen more as an additional support measure for the large fiscal stimulus packages). The fiscal stimulus in Romania is relatively limited (c.3.2% of GDP including guarantees) so it was not the additional spending needs stemming from this package which triggered the QE decision. In our view, it was the rather urgent need to unfreeze the fixed income market and – by extension – to keep public finances up and running.

What have been the main effect from QE?

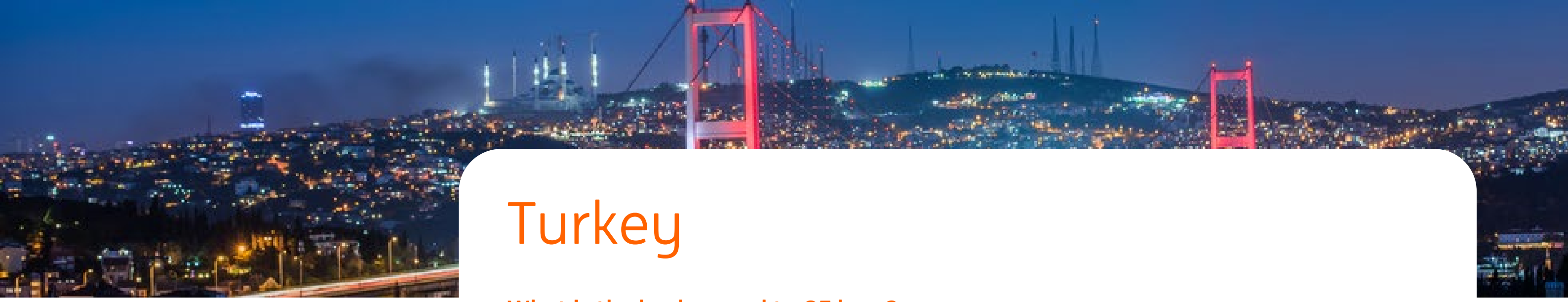
Yields shot 200-300bp higher in early March, with little-to-no trading activity and demand for ROMGBs, putting the Finance Ministry in a position where it had to reject several auctions. We believe that without the NBR's decision to start QE, the public finances functionality would have been seriously jeopardized, near the point of a complete jam.

Which maturities are in focus?

Having these objectives in mind, the NBR's QE will likely be limited in size, or at least this was the probable intention. The fact that these are the objectives (and not, say – the yield curve control) can be deduced from the fact that so far the NBR's focus was on the short and belly part of the curve.

And what is expected next year?

Nevertheless, we estimate that the central bank will need to buy the equivalent of at least 1.5% of GDP this year in order to achieve these goals. In the short term this will probably do the job (say, ensuring that this year's funding needs are met) but for the next year we believe that tougher measures on the fiscal side will be needed and we foresee at least a VAT increase.



Turkey

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What is the background to QE here?

In its monetary and exchange rate policy paper for 2020 released at the end of last year, the CBT initially set "the securities portfolio for open market operations" at a maximum of 5% of its analytical balance sheet total assets (up from TRY18.9bn nominal for 2019). At that time, this translated into TRY32-33bn at the end of 2020, a c.70%

Has Covid-19 impacted the policy?

In its measures against the economic and financial impacts of Covid-19, the CBT announced at end-March that purchases conducted under the limits of the 2020 policy paper will be carried out in a front-loaded manner. Later, on 17 April, the limit was revised up to 10%.

Is there a financial stability aspect?

So as to support financial stability by containing the likely impacts of the liquidity need of the Unemployment Insurance Fund (UIF) on market functioning, the CBT has also allowed primary dealers to (temporarily) sell the government securities that they have bought from the UIF. These purchases are not under the limit set for the open market operations portfolio.

Is there official data on QE?

The CBT does not announce the UIF bonds contribution to the ongoing increase in its portfolio. But, before the decision, as of February, the UIF had TRY131.6bn, of which about 93.1% (around TRY122.5bn) was invested in government bonds, while 6.93% was in deposits. The latest data, as of end-April, show that total assets stood at TRY133.2bn and the composition changed in favour of deposits with a 23.42% share vs 76.58% in government bonds.

What numbers do we know about?

According to the CBT balance sheet, total securities portfolio is TRY67.3bn (9.1% of the balance sheet, roughly 1.5% of GDP, 7.2% of domestic debt stock). Since policy shifts with the pandemic, the CBT has been quite transparent about bond purchases and despite a significant increase in the last two months, the current size is (a) well below the levels of the early 2000s as a legacy of the 2001 financial crisis and (b) relatively small compared to QEs currently being conducted by other EM central banks.

Croatia and Czech Republic

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Why did the Croatia central bank kick off QE?

Appearance on the QE map was probably less surprising, as its monetary policy was already ultra-loose for a number of years. The stated purpose of its decision was to maintain stability of the fixed income market. The standard policy kit was heavily employed as well, through a mix of FX interventions and liquidity injections. The most important one, a 5Y structural operation at 0.25% injected HRK3.8bn (€500m+) into the banking system. A swap line with the ECB has been established.

How much is the Croatia central bank buying?

On the QE side, the central bank expanded the eligibility of participants to pension funds, insurance companies and investment funds. By the end of April, the HNB purchased almost €1.9bn of government bonds. That is probably close to 4.0% of 2020 GDP. Given that the budget deficit could reach over 8% of GDP this year, we see the HNB measures as adequate.

Is the QE discussion in the Czech Republic hot right now?

Though very close to the zero-lower bound, the CNB board did not specify a preferred option for delivering further monetary easing if rates hit zero. CNB Board member Tomas Holub mentioned possible tools for delivering monetary easing when the zero-lower bound is hit, including the 2013-2017 FX-floor regime style, QE, the yield-curve control or some funding for lending scheme. Even negative rates were mentioned, though this is not the preferred option. According to Holub, however, the CNB board has not reached a consensus yet.

Could Covid-19 accelerate a Czech decision to go on QE?

Though getting to a technical zero level in the second half of the year looks as a likely scenario now, potential unconventional tools would be in the pipeline only if the Czech economy enters a protracted recession with mounting deflationary pressures, much worse than the current CNB baseline expecting a GDP contraction of 8% this year. A V-shaped recovery is less likely as the severity of Covid-19 outbreak will damage economic growth for a longer time, but strong deflation prospects are not visible.

Bottom line: do we see Czech QE as a runner?

Though the act on CNB buying was approved in Parliament and the CNB could possibly embark on broad bond-buying (though this legal change applies only until the end of 2021), the CNB repeatedly mentioned that it would only have a financial stability focus, as providing massive liquidity does not seem necessary. The situation would need to deteriorate materially vs the CNB baseline to push the CNB to extraordinary measures. Out of the three key non-standard measures (negative rates, QE and FX floor) we see the FX floor as the most likely, however.

Colombia, Chile and Brazil

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How do we read QE enactment in Colombia when rates are not near zero?

In Colombia, the reference rate (now at 2.75%) remains higher than the "technical minimum", so there's still enough scope to implement monetary stimulus through rate cuts. But a bond buying program has been enacted. It seemed thematic at the time, as risk aversion was peaking late in March, to go that route.

How big and in what securities is the Colombia QE program in?

Late in March, Colombia's Banrep announced that the central bank would buy about US$2.4bn (0.8% of GDP) of private debt instruments due in three years or less, as well as purchase government peso bonds, known as TES, totalling about US$1bn.

Why did Chile go down the QE route?

Chile has followed the more traditional path towards unconventional monetary stimulus initiatives, ie, the BCCh reduced its reference rate to its technical minimum (0.5%), and then it moved into "unconventional" territory. The bank's measures have been primarily focused on ensuring that, despite the spike in risk aversion, local credit markets remain fully functional.

What is the purpose and how big will it get?

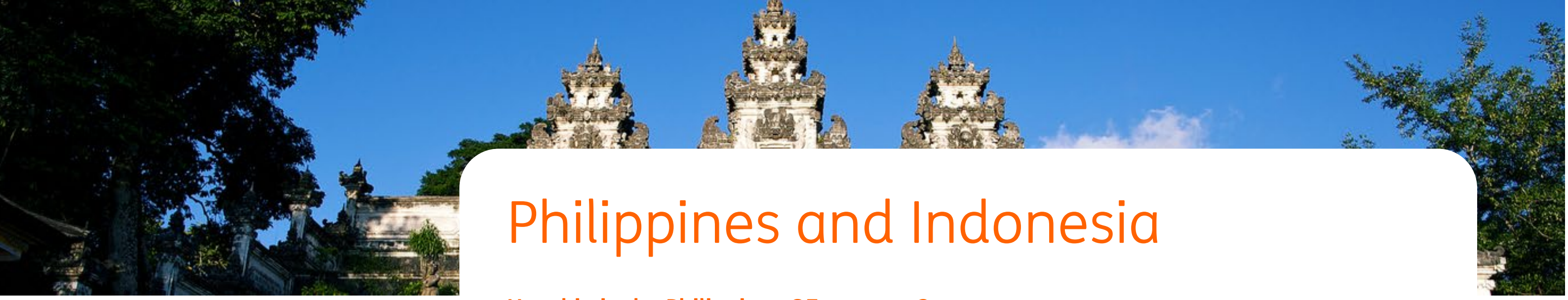
As BCCh recently stated, the focus is to ensure that monetary policy transmission through the credit channel remains open and continues to support the local economy. They are doing this by providing direct funding to local banks and creating incentive structures for banks to continue to lend. While theoretically the same thing as buying bank bonds, the Chilean approach seems to us closer to baby steps in the direction of QE, which generally characterizes the extent of QE in LATAM.

Is Brazil considering QE too?

In Brazil, the central bank has received the legislative approval and should have a fully-implemented regulatory framework to purchase public and private debt instruments imminently. But it's unclear to what extent the central bank will make use of this instrument. The bank's crucial challenge going forward should be help flatten the local yield curve, which may be achieved if the market rally seen in recent weeks maintains the current momentum. In practice, this may have reduced the need for any type of QE.

Are there good reasons for Brazil to resist doing QE?

Given the controversies any private-sector bond-buying could generate, central bank officials may consider this a last-resort initiative. Given Brazil's recent history, any central bank action on this front is likely to be highly scrutinized by local analysts and media alike, with officials likely acting with extreme caution to avoid creating the suspicion of corruption. Moreover, given that there is still some room on the rate-cutting front, with another 75bp rate cut to 2.25% likely taking place later this month, perhaps authorities should opt not to rush into a bond-buying spree. Recent debate among central bankers suggest that 2.25% may be considered the "technical minimum" for the SELIC rate. In that case, with the door practically closed for further rate cuts, should local financial market conditions deteriorate in the coming months, the arguments in favour of a bond-buying program should strengthen materially.



Philippines and Indonesia

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How big is the Philippines QE program?

BSP has adopted small scale quantitative easing, conducting outright purchases of government securities in the secondary market. The total amount is negligible (roughly PHP38bn versus PHP4.9tr outstanding) and was implemented at the height of the risk-off episode in March to help stabilize the market.

Would the BSP be described as an active player?

BSP maintains its presence in the secondary market but is not an active player. There was much talk about the PHP300bn repurchase agreement with the Bureau of Treasury (up to PHP600 bn) but QE in the true sense of the word for BSP was negligible.

What size QE has Indonesia been engaged in?

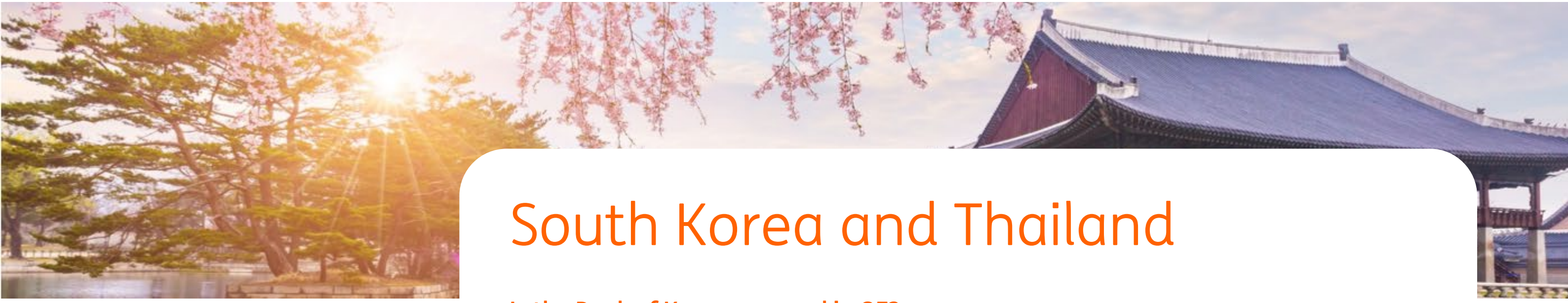
Although BI Govenor Warjiyo has reported quantitative easing of up to IDR504tr in Indonesia, nearly IDR137tr are repurchase agreements while outright purchases of government bonds total IDR166.2tr in the secondary market and IDR6.9tr in the primary market (total bonds outstanding IDR3,050tr).

Is there a primary aspect too?

BI has been active in bond purchases, initially in the secondary market but now also in the primary market after a Presidential regulation that allows them to participate at primary auctions. Thus, Indonesia has conducted quantitative easing to the tune of IDR173.2tr to date with bond purchases in both the primary and secondary market.

Why has Indonesia done QE in the first place?

Bank Indonesia has maintained its presence in the bond market as part of its “triple intervention”, with bond purchases helping limit the rise in yields, with foreign investors selling up to IDR135tr worth of bonds in 2020.



South Korea and Thailand

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Is the Bank of Korea engaged in QE?

If the definition of QE is an expansion of the central bank balance sheet through outright purchases of securities via expanded cash liabilities (printed money), then the Bank of Korea is probably not undertaking QE. Governor Lee has recently indicated that the BoK has bought government bonds in the secondary market, and mentioned a figure of KRW1.5tr in one press conference, (US$1.2bn), but this seems to have been a short-lived market-smoothing intervention, rather than any concerted attempt at yield control.

Can we describe repos as QE lite?

The BoK has been variously described as conducting QE-lite, or "Korean-style" QE since 26 March when it unveiled its new policy measures. It is undertaking uncapped repo at fixed interest rates with an expanded set of institutions and an expanded set of securities. But since these are not outright purchases, but repos, they can't be described as QE, and the adoption of the terms QE-lite and so on are probably deliberate to try to maximize the sticker shock of what is in fact a big liquidity operation.

Could we expect more explicit QE in the future?

The Korean government is looking into changing BoK law to enable the central bank to accept other non-public or quasi-public securities, and they may pave the way for some actual QE in time. Governor Lee has also expressed some interest in moving in this direction too. At the latest BoK meeting, Governor Lee indicated that rates had reached the effective lower bound. While some see this as an indication of QE (he has implied no move to negative rates), it still feels as if purchases of bonds in the secondary market will be market-volatility driven, and not part of a longer term support strategy. As of now, Korea cannot be accurately described as undertaking QE.

Is the Bank of Thailand considering QE?

With Bank of Thailand's interest rate policy almost reaching its limits (currently 0.5%) and the government going on a borrowing spree to fund huge fiscal stimulus, the idea of the Bank of Thailand moving to a QE path has been gaining some traction. In April, Don Nakornthab, Senior Director for the economic and policy department of the central bank, told newswires that the central bank had studied unconventional options of large-scale asset purchases and yield control as a last resort option. Nothing further has been heard about this policy study since. We don't see the BoT adopting QE anytime soon.

South Africa

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What kind of asset purchases is the central bank engaged in?

On 25 March, the SARB announced government bond purchases in the secondary market aimed at stabilising the market, together with other measures including daily repo auctions, an extension of main repo facilities up to 12 months (usually 7 days) and an adjustment in the lending and borrowing rates on standing facilities. Regarding bond purchases, the SARB has reiterated this shouldn't be considered as QE as the policy rate (currently 3.75%) and short-term interest rates are well above zero but rather as technical intervention to ensure the smooth functioning of markets. Program specifications are vague (no targets for size and duration).

What kind of volumes are we talking about?

The SARB bought ZAR1bn of government bonds in March but has since stepped up purchases with ZAR11.4bn in April and ZAR10.2bn in May, bringing total government bond holdings to ZAR30.8bn (US$1.8bn) or c.0.6% of GDP.

What have been the effects of the SARB's measures?

The bond purchases have helped to restore a functioning market as South Africa faced a financial shock due to the virus outbreak and Moody's downgrade (27 March) which led to exclusion from the WGBI index (the share of foreign holdings in SAGBs have fallen from 36.9% in February to 31.5% in May). In combination with 150bp in cumulative rate cuts since April, the yield on local currency bonds has fallen below pre-crisis levels (currently 7.2% for SAGB 10.5% 26s).

Is there any element of primary buying involved?

According to the SARB, the legal framework doesn't allow for direct government lending. However, there have been calls for the central bank to do so, including Deputy FinMin Masondo who suggested that the SARB should buy one-off "special bonds" by the government to combat the crisis. The SARB is aware of the contentious nature of debate, with Deputy Governor Naidoo reiterating that directly financing the government wouldn't be prudent and in Finance Minister Mboweni (who ran the SARB as a governor between 1999-2009) they have a strong ally in defending central bank independence.

What are the risks for South Africa from bond purchases?

For now, the SARB's credibility and the small purchase size imply limited risks but there are nonetheless substantial medium-term risks to credibility: In line with calls from parts of the ANC for a change of the central bank's mandate to also include economic growth in recent years, we expect the lively debate about the central bank role, including fiscal monetization, to continue. We believe that the SARB will drag its feet and stop short of going to the extreme, but the huge fiscal deficit (Bloomberg consensus for 13% of GDP) means that the SARB will have to play a role, possibly through larger bond purchases. This will be a balancing act given the toxic mix of the rand's volatile nature, low FX reserves as well as fiscal and structural rigidities. South African risk assets would remain among the most vulnerable in a renewed downturn.

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