

Fear Not QE Tapering

Do not fear QE tapering. Its a good thing.

1. Its a sign of strength, that the economy is able to tolerate tighter monetary conditions.
2. US treasury issuance is falling as a result of improving economic growth and thus tax receipts. If the Fed maintains its purchases as a proportion of issuance, it would have to slow its rate of purchases.
3. By operating QE, the Fed is removing from the market the most ubiquitous, important, and highest quality collateral used in repo agreements. The Fed does not rehypothecate its assets on a large scale ongoing basis, although it has been contemplating a reverse repo facility in its last FOMC meeting. QE therefore reduces the liquidity in the collateralized lending market. Given that LIBOR markets have thinned, since 2008 and then the LIBOR scandal, the repo market is extremely important to global credit and liquidity. QE tapering is positive for repo liquidity. Because collateralized lending, particularly on such short tenures has a highly advantageous risk weighted treatment under Basel 3 capital rules, it is an important source of credit in the current environment.