Korean equities and US Treasury yields

STOCK MARKET

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The tapering of quantitative easing continues in the U.S. as the Federal Reserve decided to reduce its monthly asset purchases by $10 billion to $55 billion at January’s Federal Open Market Committee meeting. The size of asset purchase would not matter much to investors, be it in $55 billion or $55 billion. What matters more is that January’s tapering decision is sending a signal that QE days are numbered until the end of this year. If the Federal Reserve keeps up the pace — in other words, $10 billion monthly asset purchase reductions are implemented at each of the seven remaining FOMC meetings this year — QE will be over by the end of 2014.

The tapering of the quantitative easing continues to create some conditional market turbulence. While the Korean stock market (KOSPI) ended a volatile fourth quarter on a positive note, many market participants are concerned that the tapering of quantitative easing, i.e. the fact that historically accommodative monetary policy is being reduced in a measured and controlled fashion, may result in higher Treasury yields and a faster pace of capital outflows, which will make it more challenging for the market to maintain a positive outlook.

What is ECB going to do?

GLOBAL ECONOMY

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The European Central Bank (ECB) has some exceptional measures. There is some good news: the GDP growth in the eurozone is positive in the first quarter of 2014. The unemployment rate is declining, from 9.4% in the fourth quarter of 2013, up from 9.7% in the first quarter of 2013. The improvement could be the result of the ECB’s measures to stimulate the economy and prevent further declines in economic activity. The ECB has reduced its interest rates and has injected large amounts of liquidity into the banking system. The stimulus measures have been effective in reducing the spread between the government bond yields of Eurozone countries and the German Bund.

The ECB has cut its key interest rate to zero and has announced a new asset purchase program. The ECB’s asset purchase program involves buying government bonds and private sector debt from Eurozone countries. The ECB has also announced plans to reduce its balance sheet through the sale of government bonds.

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