ANDBANK RESEARCH

Global Economics & Markets

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USD Fixed Income - Four reasons to believe that it is more appropriate to think of lengthening duration than to cut it

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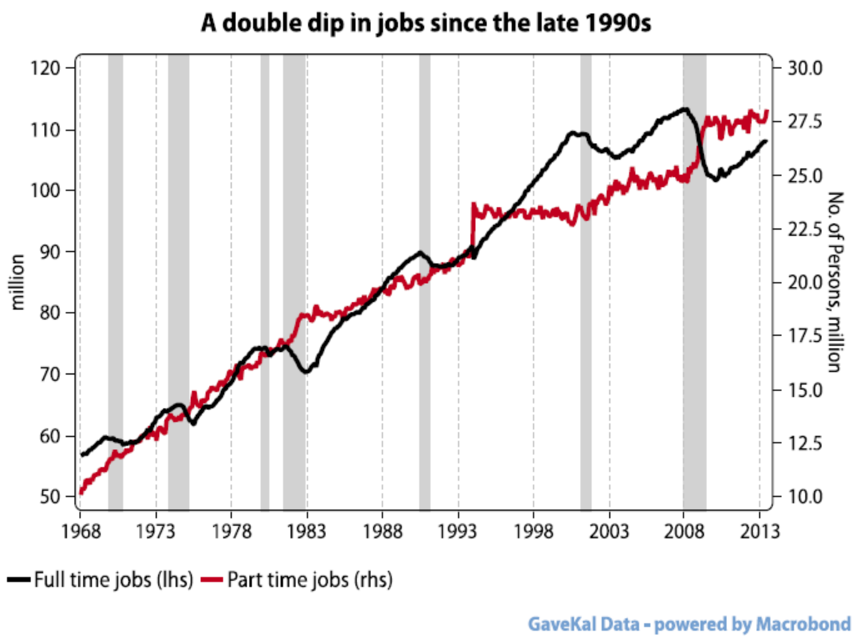
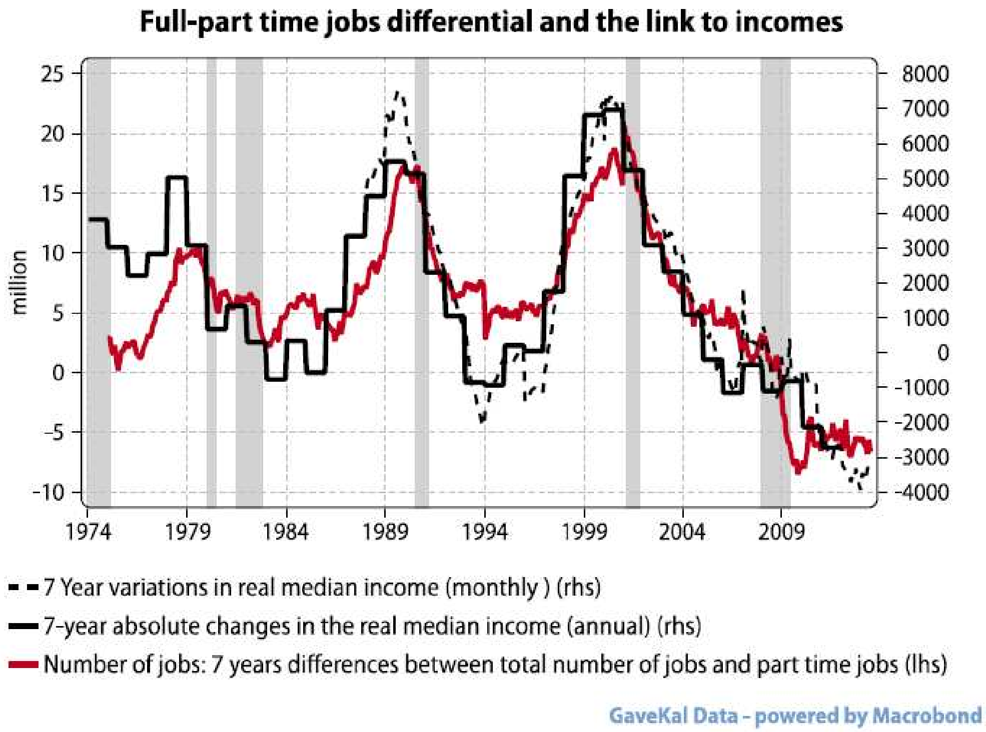
1st. Because of the quantity & quality of jobs being created in the US

- Charles Gave defines perfectly this as one of its biggest worries about the medium term outlook for the US economy.

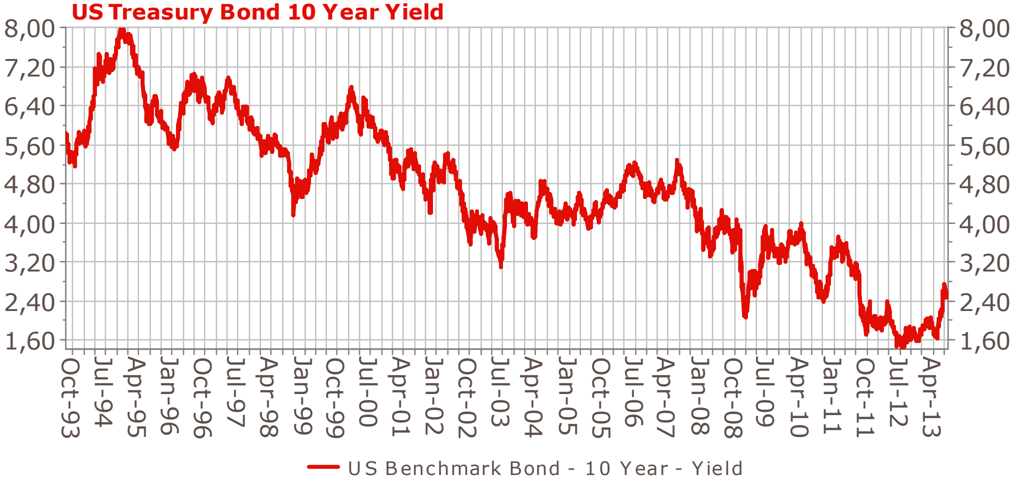


… and this poor process of job creation in the US, has prompted structural changes in the median income level

- Charles Gave demonstrates this by measuring first the difference in job growth for part time vs full time workers (red line).
- As this gap widens in favor of part time employment, it is legitimate to think that a greater share of the US labor force earn now lower wages.
- This can be clearly seen in the sharp decline in the real median income in the last 7 years.
- Put simply (in words of Mr Gave), "Median income has slumped"
- **And we, in Andbank, strongly believe that this process requires a long time to be reverted…**
- **… causing demand factors to exceed supply factors …**
- **… which leaves us with our long held central scenario of disinflationary pressures.**



2nd. Why to think that this secular trend could now revert?



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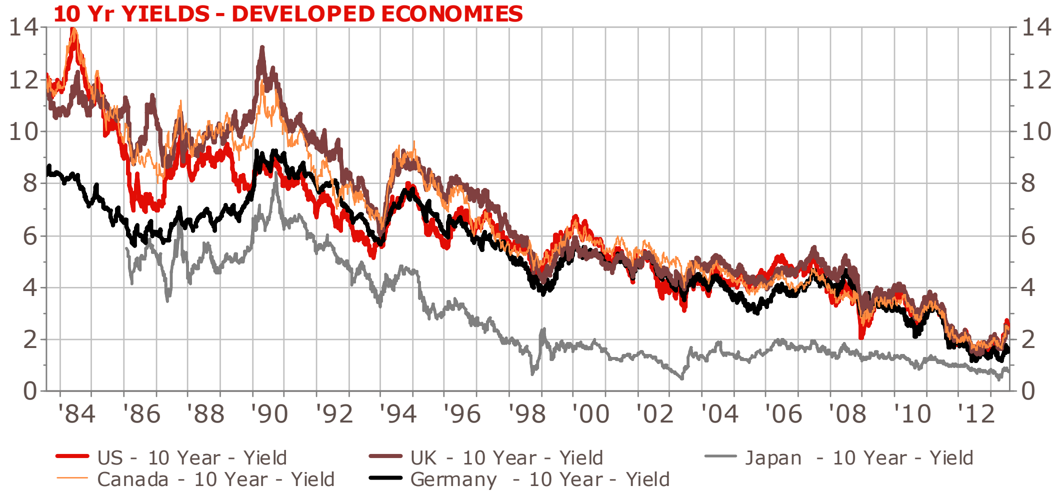
The only explanation at all convincing to justify a change as decisive, should be based on: (1) The hypothesis of a structural change in the process of global disinflation. (2) or the hypothesis of a dramatic decrease in the globalization process itself, so that developed economies stop importing such deflation.

Lords. That is simply not going to happen!



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3rd. Because this adjustment within the secular trend could have been completed.

1. Tapering of QE does not mean, in any way, an increase in interest rates (as it was in 1994).
2. However, long term yields has increased by the same amount (as in 1994), and tripled that shift in relative terms
3. Tapering does not mean that the Fed is going to sell its Treasuries.
4. In fact, we project a three-steps "exit strategy"
    - i. One year of diminishing marginal expansion in Fed's balance sheet (until 2Q 14).
    - ii. One year of "stability" in the total size of monetary base (until 2Q 15).
    - iii. A normalization of balance sheet's size at the pace of Fed's assets amortization (until 2Q 17)
    - iv. Interest rates rise (conditioned on the activity pace approaches the potential rate)

4th. Swap spread in the US remain at historical lows and this should normalize towards the 40-50 bps. Meaning that, with no inflationary pressures at sight that bring the swap curve upwards ..., this can only be materialized through a decline in UST yields.

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