

"Bond anniversaire": Taper Tantrum 10 years on

Published

May 22, 2023

Length

🕒 5 minute(s) read

*In late May 2013, financial markets experienced a period of turbulence known as the "Taper Tantrum." It was a time of significant volatility and uncertainty as the Federal Reserve (the Fed) signalled its intention to reduce its bond-buying (i.e. "Quantitative Easing") Program. As we mark its 10-year anniversary, **Kevin Thozet, a member of the investment committee at Carmignac** reflects on its impact, and the implications for financial markets.*

Origins of a Crisis

The Taper Tantrum was triggered by then-Fed Chairman Ben Bernanke's remarks in May 2013, indicating that the central bank was intending to reduce its bond purchases. This surprised financial markets, which had ignored earlier hints and had become reliant on the Fed's unprecedented stimulus measures to support economic recovery in the aftermath of the global financial crisis. The prospect of reduced liquidity, potential interest rate hikes and more generally, further tightening, led to a sharp sell-off in bond markets and a surge in volatility across various asset classes.

Global Market Turmoil

The impact of the Taper Tantrum was felt globally, with emerging markets bearing the brunt of the hit. As investors withdrew capital from riskier assets, currencies and bonds of emerging economies experienced significant depreciation and rising yields. Countries with large current account deficits and high external debt levels were particularly vulnerable to the sudden capital outflows. This episode underscored the importance of strong fundamentals and prudent macroeconomic policies in navigating global financial shocks.

Lessons Learned and Policy Adjustments

The Taper Tantrum served as a valuable lesson for central banks and policymakers around the world. It highlighted the need for improved communication and clearer forward guidance to manage market expectations. Central bankers became more mindful of the potential spillover effects of their policy decisions on global financial markets and sought to adopt a more cautious and transparent approach.

Echoes and Differences with Today


The case of EM

Today, emerging markets (EM) face a much more abrupt external shock. This time, it is not only the Fed but all G10 (ex-Japan) central banks tightening policy. Central banks are not merely 'tapering' their bond purchases, they are actually reducing their holdings through passive roll off of existing bonds, a policy known as "Quantitative Tightening". They are also hiking interest rates at a pace not seen since the early 1980s. The shock was so unprecedented and unanticipated that it has even triggered a crisis among US regional banks.

In spite of this, we have had very few accidents in emerging markets. Financial stress has been concentrated in the weakest links of the "frontier markets" universe, such as Ghana, Sri Lanka or Tunisia. The largest victims of the 2013 taper tantrum, the "Fragile Five" (Brazil, India, Indonesia, Turkey, South Africa) have proved resilient thanks to much better fundamentals than 10 years ago. De facto, most of the heavyweights of the EM world spent much of 2015-2019 deleveraging their private and public sectors. Moreover, their central banks did not make the same mistakes as their G10 counterparts in 2020-2021: they started their hiking cycle much earlier. This brought inflation under control earlier than in the G10, albeit at the cost of subdued aggregate demand growth. When the Fed hikes hit, their current accounts had already adjusted towards equilibrium; their inflation was already on a clear deceleration path and interest rate curves were adequately pricing some upcoming monetary loosening. Capital outflows were minimal as EM assets were largely under-owned by foreign investors that had preferred US assets for the past 2 years.

Mind the gap between market expectations and the Fed's actions

Another parallel with 2013 is the apparent gap between the Fed's forward guidance and market expectations in terms of future monetary policy. 10 years ago, markets were ignoring the message the Fed had been sending since January and, as its intention became unequivocal on 22 May, the tantrum unfolded. Analogously, today the Fed is signalling that it is intending to maintain its current policy rates while markets are expecting those



rates to be cut by 2.5% over the coming two years.

And one can ponder on what would happen should markets shift from factoring in 250 basis points cuts over the coming 24 months to mere 150 basis points cuts. Treasury yields could indeed grind higher but emerging markets rates would sell off and we would also likely see a big washout in most expensive growth stocks.

Yet some mechanisms have since been put in place to prevent a potentially dire outcome associated with such a chasm between the Fed's intentions and markets expectations. The first is the now famous dot plot providing some guidance on the FOMC's intention two years down the line – albeit it was introduced prior to the Taper Tantrum in 2012. The second is the enhancement of surveys conducted ahead of FOMC meetings which were added in the aftermath of the Taper Tantrum. In 2014, the Survey of Primary Dealers (which looks at gaining insight into rate expectations of Primary Dealers) was complemented with a Survey of Market Participants. (which aims at gathering investors' expectations as well). They aim to allow the better monitoring of potential stability-threatening discrepancies and if need be, better adjust the Fed messaging around future path of monetary policy - and hence to lower the risk of miscommunication.

What Could Go Wrong?

While the lessons from the past suggest that the prospects of a major monetary policy mistake, and hence a renewed rates tantrum, is very much unlikely, the central scenario remains the Fed dialling back on its tightening path should a new tantrum materialize. However, it is still too early to ponder the full international ramifications of this monetary policy shock.

One ongoing development is the potential resonance of liquidity tensions with the debt ceiling drama. So far this year, the suspension of debt issuance by the Treasury has helped stabilize the bond market. And, despite banks being large holders of Treasuries, the run on regional bank deposits had a muted impact on the Treasury market. This happened thanks to a complex alchemy of financial flows. The mechanism is the following: depositors withdrew money from banks and placed them in money market funds; banks were in turn forced to sell Treasury bonds (their most liquid assets) to face these deposit redemptions. These bonds were bought back by primary dealers, who refinanced them on the repo market. The other side of these repos were money market funds that had to invest the money they received from bank depositors. The repo market is thus the bridge that enabled to re-route private savings towards the bond market despite the deposit exodus. Once the debt ceiling is raised, the Treasury will have to issue 2.2tr\$ by year-end, of which 1.4tr of T-bills. The question is how can the market absorb all this duration risk without sending shockwaves through the repo market and the entire US money market? Money market funds could choose to stick with their reverse repos with the Fed (currently 2.2tr\$) instead of buying T-bills or funding the repo market, particularly if the bond market continues to price early rate cuts. This would set the scene for a replay of the repo market crisis of September 2019. The dislocation in the short-term dollar funding market would send shockwaves through the offshore dollar market and create a harmful dollar spike against EM currencies.



Conclusion – a balancing act

As we reflect on the 10-year anniversary of the Taper Tantrum, we recognize the significant impact it had on global financial markets and the subsequent adjustments made by policymakers.

The Taper Tantrum shock guided some major improvements in the communication and forward guidance of central banks. But even the most transparent communication framework cannot shield markets from volatility when central banks commit a major policy error and need to correct course in short order. Such is our current predicament after central banks fooled themselves and the markets with their 'transitory' inflation theory in 2021. In this abrupt policy U-turn, we should remain vigilant that another pocket of vulnerability could come to the surface, as the unexpected US banking tensions illustrated this Spring.

As we move forward, Central banks and policymakers continue to navigate a complex and evolving economic landscape and the goal remains to foster sustainable economic growth while maintaining financial stability. An ever-complex balancing act.



Marketing communication. Please refer to the KID/KIID, prospectus of the fund before making any final investment decisions. This document is intended for professional clients.

This material may not be reproduced, in whole or in part, without prior authorisation from the Management Company. This material does not constitute a subscription offer, nor does it constitute investment advice. This material is not intended to provide, and should not be relied on for, accounting, legal or tax advice. This material has been provided to you for informational purposes only and may not be relied upon by you in evaluating the merits of investing in any securities or interests referred to herein or for any other purposes. The information contained in this material may be partial information and may be modified without prior notice. They are expressed as of the date of writing and are derived from proprietary and non-proprietary sources deemed by Carmignac to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by Carmignac, its officers, employees or agents.

Past performance is not necessarily indicative of future performance. Performances are net of fees (excluding possible entrance fees charged by the distributor). The return may increase or decrease as a result of currency fluctuations, for the shares which are not currency-hedged.

Reference to certain securities and financial instruments is for illustrative purposes to highlight stocks that are or have been included in the portfolios of funds in the Carmignac range. This is not intended to promote direct investment in those instruments, nor does it constitute investment advice. The Management Company is not subject to prohibition on trading in these instruments prior to issuing any communication. The portfolios of Carmignac funds may change without previous notice. The reference to a ranking or prize, is no guarantee of the future results of the UCIS or the manager.

Morningstar Rating™ : © Morningstar, Inc. All Rights Reserved. The information contained herein: is proprietary to Morningstar and/or its content providers; may not be copied or distributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

Access to the Funds may be subject to restrictions regarding certain persons or countries. This material is not directed to any person in any jurisdiction where (by reason of that person's nationality, residence or otherwise) the material or availability of this material is prohibited. Persons in respect of whom such prohibitions apply must not access this material. Taxation depends on the situation of the individual. The Funds are not registered for retail distribution in Asia, in Japan, in North America, nor are they registered in South America. Carmignac Funds are registered in Singapore as restricted foreign scheme (for professional clients only). The Funds have not been registered under the US Securities Act of 1933. The Funds may not be offered or sold, directly or indirectly, for the benefit or on behalf of a «U.S. person», according to the definition of the US Regulation S and FATCA. The risks, fees and ongoing charges are described in the KID (Key Information Document). The KID must be made available to the subscriber prior to subscription. The subscriber must read the KID. Investors may lose some or all their capital, as the capital in the funds are not guaranteed. The Funds present a risk of loss of capital.

The Funds' prospectus, KIDs, NAVs and annual reports are available at www.carmignac.com, or upon request to the Management Company. Carmignac Portfolio refers to the sub-funds of Carmignac Portfolio SICAV, an investment company under Luxembourg law, conforming to the UCITS Directive. The French investment funds (fonds communs de placement or FCP) are common funds in contractual form conforming to the UCITS or AIFM Directive under French law.

In France, Luxembourg, Sweden: The risks, fees and ongoing charges are described in the KID (Key Information Document). The KID must be made available to the subscriber prior to subscription. The subscriber must read the KID. Investors may lose some or all their capital, as the capital in the funds are not guaranteed. The Funds present a risk of loss of capital. The Funds' prospectus, KIDs, NAV and annual reports are available at www.carmignac.com, or upon request to the Management Company.

In the United Kingdom: the Funds' respective prospectuses, KIIDs and annual reports are available at www.carmignac.co.uk, or upon request to the Management Company, or for the French Funds, at the offices of the Facilities Agent at BNP PARIBAS SECURITIES SERVICES, operating through its branch in London: 55 Moorgate, London EC2R. This document was prepared by Carmignac Gestion, Carmignac Gestion Luxembourg or Carmignac UK Ltd. FP Carmignac ICVC (the "Company") is an Investment Company with variable capital incorporated in England and Wales under registered number 839620 and is authorised by the FCA with effect from 4 April 2019 and launched on 15 May 2019. FundRock Partners Limited is the Authorised Corporate Director (the "ACD") of the Company and is authorised and regulated by the FCA. Registered Office: Hamilton Centre, Rodney Way, Chelmsford, Essex, CM1 3BY, UK; Registered in England and Wales with number 4162989. Carmignac Gestion Luxembourg SA has been appointed as the Investment Manager and distributor in respect of the Company. Carmignac UK Ltd (Registered in England and Wales with number 14162894) has been appointed as a sub-Investment Manager of the Company and is authorised and regulated by the Financial Conduct Authority with FRN:984288.

In Switzerland: the prospectus, KIDs and annual report are available at www.carmignac.ch, or through our representative in Switzerland, CACEIS (Switzerland), S.A., Route de Signy 35, CH-1260 Nyon. The paying agent is CACEIS Bank, Montrouge, Nyon Branch / Switzerland, Route de Signy 35, 1260 Nyon.

The Management Company can cease promotion in your country anytime. Investors have access to a summary of their rights in English on the following links: [UK](#) ; [Switzerland](#) ; [France](#) ; [Luxembourg](#) ; [Sweden](#).

