So what does QE mean to me and my money?

As the minutes from the last Monetary Policy Committee (MPC) meeting are published - which coincidentally is the first since Mark Carney took over as the new Governor of the Bank of England, we've seen markets react with a jump in gilt yields and sterling.

But what does this mean to you and your money?

The minutes showed that the MPC voted unanimously against more Quantitative Easing (QE) in July, with all nine members (including Carney) voting against a further increase in asset purchases (another name for QE) by another £25 billion. It is also worth noting, that this is the first time this year that the MPC vote has been undivided, in fact the last vote was split 6-3 against, with previous Governor Mervyn King being one of those in favour of more QE.

So how does this effect markets? Well, if the MPC votes against increasing asset purchases, its seen as a signal to markets that one of the biggest buyers (the Bank of England) of gilts and bonds is not going to be buying as much. This perceived reduction in demand will lead to the price of these assets to fall and as the yield of an investment is merely its income divided by its value, if the price of an asset has fallen then its yield will typically rise. This is what has happened with gilt yields. As the income (coupon) on a gilt is fixed (this is why they are called 'fixed interest' securities), when the market value of the asset falls, its (interest) yield has to increase.

A slowdown in QE also has the effect of restricting the supply of money in the economy. This is because, when the Bank of England purchases assets, it is putting cash in the hands of a corporate body or individual (that it buys the asset from). This hopefully has the effect of stimulating the economy, as the seller of the asset can then use this money to spend or invest in something else. If the seller is a bank, then they can lend the money they have to someone else, who may then decide to spend or invest the money they have borrowed, which will further extend the supply of money and stimulate the economy. However, when the Bank of England decided to stop purchasing assets, this has the effect of slowing this expansion in money supply.

This should be seen as a good signal ... too much expansion in the money supply will be inflationary, and we all know that too much inflation is not a good thing. As inflation (which is a reflection of the rate at which the cost of stuff is going up) is normally the by-product of a growing economy, if the MPC is thinking about turning off the 'QE' tap, this must mean they think that the 'green shoots' look like they might be starting to sprout. And this is one of the reasons why sterling would have jumped too. Currency markets are driven by demand and supply - less supply will drive the price up. In addition, a stronger economy currency is a more secure place to invest your money and will typically earn a higher rate of interest. This is beacuse most countries will use monetary policy (the use of interest rates to control money supply) as a way of keeping inflation under control.

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As I said earlier, inflation is usually seen when an economy is growing and this typically leads to market expectations of a rise in interest rates in the future. This expectation will normally lead to more demand for that currency, which means its price will go up and we see the resultant strengthening in relation to other currencies.

So what does this mean to you and your money?

Well, if these future interest rate rises materialise as expected, it will have a direct impact on the amount you will have to pay in interest on any loans, credit cards, overdrafts or mortgages that you might have. Higher interest repayments will mean less money to spend on other things.

It also seems likely that inflation will increase in the future. Inflation erodes the spending power of your money and investors need to be compensated for this and for any restriction to access they may have on their money. So if you have money invested, it is important to ensure that it is protected against the effects of inflation. This can be done by investing in index-linked assets (ie index-linked gilts) or assets that have the potential to achieve positive 'real' returns and can outstrip inflation (ie property or shares).

If you are already invested in gilts and other sterling fixed interest securities, you may think that yields going up is a good thing, but remember this is probably because their values have gone down. Diversification into other assets can help protect you against the effects of falling markets. However, increasing yields may be good news if you are looking to purchase these assets, considering an annuity or if you are in drawdown, as increasing gilt yields should lead to higher levels of pension income being available.

A stronger pound means you'll get more (of another currency) for your money. This is good news if you're going on holiday abroad or buying foreign goods and assets, but it makes British goods (relatively) more expensive, which will make conditions for exporters more difficult.
This may also be bad news if you have money invested in non-sterling denominated investment funds, as a change in exchange rates will affect your overall returns.

As you can see, a piece of news about the minutes of an MPC meeting that many would consider to have no relevance to their lives, can have a significant effect on your money (in lots of different ways) and that's why it is so important to review your finances on a regular basis. If you feel that it's all too much to do yourself, then you should take advice from someone who knows what is going on and how these changes will affect you. They can make sure that you've got your finances organised in the best way to get the most out of your money.

So don't just hope for a better life. Plan for one.
Speak to Clayden Associates ... for the good of your wealth.

Dan Clayden – Chartered Financial Planner

Director - Clayden Associates

Information given is for general guidance only and specific advice should be taken before acting on any of the suggestions made.

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