A decade of quantitative easing

The OMFIF Foundation

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Programme

New York, Friday 28 September 2018, 8.30-14.00

Welcome and opening remarks

David Marsh, Chairman, OMFIF

Keynote address

Stanley Fischer, Vice-Chair, Board of Governors of the Federal Reserve (2014-17)

Natacha Valla, Deputy Director General for Monetary Policy, European Central Bank

Session I: A decade since the collapse of Lehman Brothers

Seth Carpenter, Chief US Economist, UBS

Stanley Fischer, Vice-Chair, Board of Governors of the Federal Reserve (2014-17)

Christopher Smart, Head, Macroeconomic and Geopolitical Research, Barings

Natacha Valla, Deputy Director General for Monetary Policy, European Central Bank

Moderator: **Mark Sobel,** US Chairman, OMFIF

Session II: government debt and central bank balance sheets

Barry Eichengreen, Professor of Economics, Berkeley School of Economics

Fabio Natalucci, Deputy Director of the Monetary and Capital Markets Department, IMF

Rasmus Rüffer, Permanent Representative in Washington, European Central Bank

Nathan Sheets, Chief Economist and Head of Global Macroeconomic Research, PGIM

Moderator: **David Marsh**, Chairman, OMFIF

Lunch

Ben Broadbent, Deputy Governor for Monetary Policy, Bank of England

Fed unafraid of unconventional policy

David Marsh
Chairman
OMFIF

AFTER the sun, the storm. The US economy is weathering an unusually buoyant period. But increasing signs that the labour market is overheating are raising the likelihood of more aggressive Federal Reserve tightening. This would increase the probability that, in the next one to three years, the US will face a new recession – inciting the Fed to restart unconventional monetary policies.

The Fed's efforts to shrink its balance sheet by $300bn-$400bn per year from the $4.5tn high are intended to create necessary leeway. The Federal Open Market Committee's 31 July-1 August meeting opened the way for future 'balance sheet actions' if and when future interest rates reach the effective lower bound.

The Committee said it was 'prepared to use its full range of tools, including altering the size and composition of its balance sheet, if future economic conditions were to warrant a more accommodative monetary policy than can be achieved solely by reducing the federal funds rate.' The FOMC recorded that 'economic researchers had not yet reached a consensus. In view of expected national and international controversy about restarting quantitative easing, that formulation appears an understatement.

Drawing lessons from QE experience

Mark Sobel
US Chairman
OMFIF

AS the zero lower bound was reached with the unfolding of the 2008 financial crisis, major central banks ushered in quantitative easing. With QE now behind the Fed and maybe soon the ECB, it is worth reflecting on lessons learned with an eye to the future.

Many argue that QE lowered the yield curve across a wide range of financial instruments, spurring investment and supporting growth, especially relative to what would have prevailed absent QE. Critics, however, point to unimpressive results and nasty side effects.

The overriding question is whether QE worked and whether it was worth it. Panellists will need to delve into the various QE transmission mechanisms and what happened. They need to answer whether QE produced big bang for the buck, and if not, was it still worthwhile. In doing so, they may focus on the debates about 'currency wars', asset bubbles, moral hazard and whether QE was good for the man on the street or simply benefitted the upper classes.

Drawing the proper lessons from QE will not be easy. The lessons are still being hotly debated. The OMFIF conference on 'A decade of quantitative easing' offers an opportunity to begin advancing the consensus.

Recurring questions on quantitative easing

ASSET purchases following the financial crisis seem to have had a significant impact on economic activity. However, one should be careful not to be precise about such estimates or how the policy works. As defined by the narrative method of economists Milton Friedman and Anna Schwartz, quantitative easing was clearly an endogenous response to the financial crisis rather than an exogenous event. Our experience of QE is also limited; the data sample is much smaller than for conventional monetary policy. And it is quite possible that the effects of QE vary according to economic conditions and what the central bank communicates about its future intentions. In this respect, it is interesting that US yields did not rise as the Federal Reserve made announcements about shrinking its balance sheet last year. It is also noteworthy that yield curves in the UK and US have remained relatively flat despite a significant lengthening in debt issuance by treasuries, one that outweighs the impact of QE on the average maturity of public sector liabilities held by the private sector. This suggests that, at least when markets are functioning normally, the 'portfolio balance' and 'liquidity' channels by which QE works may be less important than the 'signalling' channel.

Ben Broadbent
Deputy Governor for
Monetary Policy, Bank of England

Q1 Theory v. reality – How and through which channels has QE worked?

During the 1991 Gulf War, the Pentagon briefer on a heavy bombing of a relatively small target was asked by a reporter if it was similar to killing a fly with a sledgehammer. 'My own personal opinion,' Lieutenant General Thomas Kelly replied, 'is that's a delightful way to kill a fly.' In some ways, quantitative easing was the blunt and overwhelming tool required to address a problem that was much more menacing than a fly. QE's longer-term consequences will only be fully appreciated when it has been unwound. But when the financial world was staring into the abyss, it was comforting to know that the theory worked so effectively in practice.

Christopher Smart
Head of Macroeconomic and Geopolitical Research, Barings

Quantitative easing was meant to work through three channels. First, it was meant to trigger portfolio rebalancing. By purchasing longer-term securities with short-term reserves, the central bank reduces the duration risk borne by private investors, which in turn compresses term premiums. Downward pressure is exerted across the entire yield curve as a result. The resulting scarcity in specific market segments was also meant to raise bond prices. Second, the expansion of central banks' balance sheets signalled a 'loose for long' policy stance – thus inducing downward revisions to interest rate expectations. Finally, QE was meant to work directly by loosening private sector credit conditions. Purchases of such assets as covered bonds or asset-backed securities were meant that way, in the hope that banks would increase their loans supply accordingly. Overall, those expected effects were vindicated by the facts.

Natacha Valla
Deputy Director General for Monetary Policy, European Central Bank

Q2 Can we expect to resort to QE more regularly in the future?

MY answer to this question is a definite maybe. The case for 'more regularly' rests on two things. One, that the equilibrium real rate of interest (R*) is now permanently lower, so there will be less scope for cutting rates. The jury is out on the permanence of R*'s decline. Two, that instruments other than monetary policy will again be largely unavailable in future downturns. In particular, that fiscal policy will be unavailable, either because debts and deficits are already too high, or because there is insurmountable ideological opposition to raising them. The answer depends on when and where you're talking about.'

Barry Eichengreen
Professor of Economics,
Berkeley School of Economics

UNCONVENTIONAL monetary policies helped restore market confidence during the financial crisis and fostered the subsequent global economic recovery. Asset purchases and forward guidance have become part of the macroeconomic stabilisation arsenal, and some policy-makers have suggested these tools could address financial stability risks. The prospect of diminished potential growth and a lower neutral policy rate raises the odds that the nominal lower bound may bind again in the future. Unconventional monetary policies may become more routine, especially with limited scope for fiscal policy. Even so, questions remain about their future effectiveness and possible consequences given the size of central bank balance sheets and related political economy considerations.

Fabio Natalucci
Deputy Director of the Monetary and Capital Markets Department,
IMF

THE major global central banks have gained experience with quantitative easing in the context of the 2008 financial crisis and its aftermath. While implementation details as well as the empirical evidence and its reading differ, it seems safe to say that QE is a useful monetary policy tool to provide accommodation, notably at the effective lower bound. The experience of the European Central Bank shows that QE also works in a monetary union, may usefully include private sector assets, can be particularly effective if combined with negative policy rates, and can strengthen forward guidance on interest rates. QE can therefore be considered a useful instrument in central bankers' toolbox.

Rasmus Rüffer,
Permanent Representative in Washington, European Central Bank

OVER the past decade, we have learned two important lessons about quantitative easing policies. The first is that they are powerful; central banks are never entirely out of ammunition. But second, QE policies are less powerful — and have more unintended consequences — than conventional measures. Life at the effective lower bound is painful.

Steering clear of the effective lower bound to the extent possible will be a key challenge for central banks. Nevertheless, with growth and inflation markedly lower than a generation ago, episodes at the effective lower bound are likely to be more frequent than in the past, despite the best efforts of central banks. When such episodes do emerge, QE will be the standard response.

Nathan Sheets,
Chief Economist and Head of Global Macroeconomic Research, PGIM

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