# BLONDEMONEY – WRITTEN EVIDENCE (QEI0012)

# QUANTITATIVE EASING INQUIRY

**1. Has the expansion of the Bank of England's Quantitative Easing programme undermined the independence of the Bank, or the perception of its independence? What are the implications of this?**

Perception is reality when it comes to the independence of a central bank. Independence might be set out in statute but as with all rules it is how they are interpreted that determines how the statute works in practice. It is incumbent upon the central bank to make the argument for their interpretation such that onlookers are convinced they remain independent. If the argument fails to be credible, then independence has been lost.

The Bank of England is currently losing the argument. This is largely because they have been buying Gilts almost exactly in line with the speed of Treasury issuance, leaving themselves open to the charge of monetisation.

The long-term implication of this would be that the Bank loses control of inflation, interest rates, and ultimately its own institutional credibility.

**2. How well has the Bank of England communicated its decisions on Quantitative Easing? Is the programme transparent enough?**

The communication has been poor. What is the programme designed for? It has done many things:

- Market-maker of Last Resort
- Lowering interest rates in order to stimulate Aggregate Demand in the economy
- Holding up prices in order to avoid fund failures due to a fire sale

Speeches by Dave Ramsden (17th February 2021)[1] and Andrew Hauser (7th January 2021)[2] admit that QE has been used for any and all of these purposes. The very fact that Ramsden had to make such a speech almost a year after the programme began suggests a recognition that communication needs to be improved.

It would help if the Bank were able to provide a quantitative model that broke down the impact of its QE programme. Such a model is only as good as its assumptions, but if we were able to see that x amount of purchases led to an increase in inflation or demand of y, and an improvement in market bid-offer

[1] https://www.bankofengland.co.uk/-/media/boe/files/speech/2021/february/qe-as-an-economic-policy-tool-what-does-it-do-and-how-should-we-use-it-speech-by-dave-ramsden.pdf?la=en&hash=AE99573FFBBA2E2E3C37FB95BC7403E98DC08166
[2] https://www.bankofengland.co.uk/-/media/boe/files/speech/2021/january/why-central-banks-need-new-tools-for-dealing-with-market-dysfunction-speech-by-andrew-hauser.pdf?la=en&hash=A02A833632782A87D97A1F9EFEB26205B4E8DF13

spreads of z, then that would be useful for transparency. We would recommend that they create such a ready reckoner that they can update as they gain more information.

In Dave Ramsden's speech he only referred to a "stylised" QE transmission mechanism. This is too abstract.

### 3. Should the Bank of England's mandate be altered?

No. It has already been adjusted in the wake of the financial crisis such that it now has to achieve potentially conflicting aims. One target is much clearer to communicate and thus retain credibility.

### 4. How should Quantitative Easing be defined?

Quantitative Easing is the provision of monetary stimulus by increasing the money supply through purchases of securities from the market. It allows the central bank to affect the quantity of money as well as the price of money.

It is not the same as the central bank undertaking its role as a market-maker of last resort even though the mechanics might be very similar.

### 5. What were the original objectives of Quantitative Easing and have they changed?

Even in 2009, it wasn't clear whether QE would even achieve its desired result. The Q2 Monetary Policy Report notes[3]:

*'With Bank Rate close to zero, asset purchases should provide an additional stimulus to nominal spending and so help meet the inflation target. This should come about through their impact on asset prices, expectations and the availability of credit. However, there is considerable uncertainty about the strength and pace with which these effects will feed through'*

But it's evident that the main goal was to boost spending in the economy. The reasons for the reactivation of the QE programme in March 2020 were much less clear. The Minutes of the 19th March meeting[4] merely state that "*the MPC judged that a further package of measures was warranted to meet its statutory objectives*". There was a nod to market dysfunction as they conclude '*The purchases announced today will be completed as soon as is operationally possible, consistent with improved market functioning*'.

The original objective of meeting the inflation target has morphed into a much wider goal that is not yet fully understood.

---

[3] https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2009/quantitative-easing.pdf
[4] https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/monetary-policy-summary-for-the-special-monetary-policy-committee-meeting-on-19-march-2020

## 6. Has Quantitative Easing been successful and how should success be measured?

Success should always be measured in terms of meeting a goal. For the Bank of England, this would be achieving its mandated target(s). Regarding inflation, price stability around 2% has been difficult to achieve since QE began. This is not just because of BOE activity however, as inflation has been prey to downward structural forces such as demographics, as well as idiosyncratic events such as a depreciating currency in the wake of the Brexit vote and concomitant uncertainty.

Success of a method of monetary easing can also be measured in terms of whether it operated as it should. In this regard, QE has had some success in keeping longer-term Gilt yields relatively low.

The National Bureau of Economic Research has produced a paper on various attempts made to judge the success of QE[5] which cautions that '*central bank papers find QE to be more effective than academic papers do. Central bank papers report larger effects of QE on output and inflation*'.

With central banks marking their own homework, the jury is still out on the success of QE.

## 7. What trade-offs does the Bank of England's Quantitative Easing programme entail? What effect might it have on inflation?

Any QE programme runs the risk of distorting the market without achieving its goals of stimulating demand and inflation. It is very difficult to calibrate its impact on inflation because we don't have the counterfactual.

## 8. What have been its distributional effects?

It's clear that QE has been accompanied by a rise in asset prices. It is not just lower-for-longer interest rates that reduce the risk premium and therefore boost assets such as equities. The presence of the central bank in the market also minimises risk by being a price-insensitive purchaser. This creates lower volatility than would otherwise be the case. That changes the price of risk and incentivizes risk taking behaviour.

By creating a backstop for risk-taking, this can benefit businesses that would otherwise have gone bust, rewarding the profligate. By boosting asset prices, this benefits those who hold assets versus those who don't.

## 9. How does the Bank of England's Quantitative Easing programme compare to other programmes internationally?

The latest round of QE has been similar in the US, UK and Europe, both in terms of scale and impact on market yields. All have struggled to communicate why

[5] https://www.nber.org/papers/w27849

they have done what they've done and what targets they hope to achieve. All run the risk of finding themselves the architects of moral hazard: unable to exit without destabilising the market.

## 10. Could the expansion of Quantitative Easing in the UK create the possibility of economic stability being undermined in the future? If so, how?

Manipulating a market will always result in unintended consequences. Like squeezing a balloon, at some point it will pop.

There are two issues we are monitoring:

1. Excess liquidity creating a positive feedback loop in rising asset prices that then reverses into a vicious downward spiral.
    - If the market always expects the BOE to step in, then the moment that they don't, the bottom falls out of the market. This creates moral hazard whereby the central bank creates a rod for their own back and becomes unable ever to exit from their asset purchases.
2. Loss of control over inflation due to loss of institutional credibility.
    - A central bank can make a credible argument that distortion is required in order to achieve a certain target (such as 2% inflation). But if the target is achieved and the distortion remains, then credibility leaches away. Once gone, it is lost forever and it becomes impossible to regain the target.

A market crash or higher inflation would both undermine economic stability, even if short-lived.

## 11. What evidence is there for any upper limits to the Bank of England's Quantitative Easing programme?

Evidence from Japan suggests that once the central bank owns a significant proportion of the government bond market, then the market itself ceases to function. On Tuesday 31st March 2018, no Japanese Government Bond traded at all[6]. Since then, the Bank of Japan has engaged in even more QE, to the point where they are now talking about loosening up on their policy of Yield Curve Control. Governor Kuroda said in January 2021 that "*our review won't just focus on addressing the side-effects of our policy. We need to make it more effective and agile*"[7].

12. Will Quantitative Easing be unwound in full, and if so how? Is it likely that the Bank of England's balance sheet will be permanently, and structurally, larger going forwards?

All of the evidence from the major central banks that have engaged in QE is that it is almost never unwound. Balance sheets remain permanently higher. Central

[6] https://www.wsj.com/articles/nobodys-trading-10-year-japanese-government-bonds-1521113501
[7] https://www.reuters.com/article/us-japan-economy-boj-idUSKBN29Q09U

banks find it hard to find the moment at which it can be done without destabilising either the economy or the market, and if they wait too long, another crisis emerges to which the answer becomes even more QE.

**In Conclusion**

- Quantitative Easing can be a useful tool that has had some success in boosting stimulus into the real economy
- It also depresses the cost of risk and therefore mandates asset price booms, creating a distributional wealth effect by benefitting the asset rich at the expense of the asset poor
- It has been used in recent times for a multiplicity of reasons, including market-maker of last resort, which risks confusion over its communication
- This lack of transparency could be improved by quantitative indications of how the one tool of QE delivers on the several targets it's designed to achieve, such as a reduction in market spreads as well as inflation and growth

**Who We Are**

BlondeMoney is an independent macroeconomic research consultancy. We analyse the unpriced risks in financial markets and how to navigate them. We focus on three areas: Macro, Politics, and Liquidity. Our clients range from financial institutions to business owners. All come to us for sensible market commentary that cuts through the noise to get to the core of what is happening in the world.

Our team of six is based in Oxford and London. Our founder, Helen Thomas, has twenty years' of experience in both Westminster and the City, having worked as an adviser to former Chancellor George Osborne as well as a fund manager at State Street Global Advisers. She is a Board Member of CFA UK and a Freeman of the City of London. Her full bio can be found here. Our COO, Richard Brownlees, spent thirty years working on the trading floors of investment banks advising fund managers on currency risks. His full bio can be found here.

*26 February 2021*