Macroeconomic and Fiscal Consequences of Quantitative Easing

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Discussants: Mark Gertler, Marco Del Negro

Alisdair McKay opened the discussion by noting that one practical challenge of QE is that policymakers are reluctant to adjust it quickly, for fear of destabilizing financial markets. He asked how rapidly QE responds to shocks in the authors' stochastic simulations, and whether the framework could incorporate an adjustment cost to capture this reluctance.

Frederic Mishkin then turned to the ample-reserves regime. He recalled that when central banks first expanded their balance sheets, the resulting increase in reserves was thought to be largely innocuous for interest rates. In practice, however, during QT, as the balance sheet was being reduced, the demand for reserves proved far higher than anticipated—largely because of post-crisis regulation—producing an unexpected spike in short-term rates. He asked how this fits into the authors' framework, since it implies that the balance sheet may not be able to shrink below a certain level without the economy hitting the flat portion of the reserve demand curve.

Picking up on a point raised in Marco Del Negro's discussion, Mark Gertler considered the possibility of an economy moving toward (near-)zero currency, in which the central bank would lose a major source of revenue. He argued that the central bank cannot simply be left constrained, because to act as a lender of last resort it must be able to issue riskless liabilities. Something would therefore have to give, and the most natural arrangement, he suggested, would be some form of Treasury backing of the central bank.

Valerie Ramey asked the authors to discuss any connection between their work and the "What About Japan?" paper presented earlier in the session.

Marcin Kolasa began the response by addressing Gertler's discussion. He agreed that there is substantial uncertainty about how QE operates depending on circumstances and stressed that the authors deliberately calibrate the effects of QE very conservatively—both the response of the term premium to QE and the pass-through to economic activity. He clarified that the paper's intent is not to portray QE as a fiscal windfall that treasuries might seek to exploit. Rather the authors aim to counter the common perception that QE merely exposed central banks to losses. That view, he argued, neglects that QE stimulated the economy during the downturn and thereby raised tax revenue, so that on net the fiscal position was better off even under conservative assumptions. In this sense, the exercise serves to vindicate what central banks did rather than to hand the treasury a tool to exploit. Turning to Del Negro's points, he agreed they were valuable but noted that addressing them properly would require more granular modeling of central bank balance sheets—not just currency, but also items such as FX reserves and gold that matter for other countries. Finally, responding to McKay, he explained that in the paper QE is implemented once and then gradually wound down, and that even in the stochastic simulations QE is not allowed to respond endogenously to shocks. The purpose of those simulations, he emphasized, is precisely to show how unfavorable the outcome could be for central bank profits, balance sheets, and the consolidated government debt under a given distribution of shocks. He added that allowing QE to respond is an additional layer the authors have examined but chose not to include in the paper.

Jesper Lindé continued by addressing when a central bank should turn to QE. He distinguished credit easing in response to financial stress—which he agreed the central bank should undertake—from QE as a tool of macroeconomic stimulus. For the latter, he described a natural ordering of instruments: first exhaust the short-term policy rate down to the effective lower bound, potentially including negative rates; next use forward guidance to align market expectations with the central bank's outlook, as in early 2009 when markets priced a far more severe recession than the Fed anticipated; and only if long-term inflation expectations continue to drift down amid persistent slack should QE be deployed. On this basis he argued that QE should be retained as a viable instrument for monetary stimulus, distinct from financial-stress interventions and without precluding complementary measures such as fiscal expansion. Returning to the theme of uncertainty, he reiterated that the authors took conservative stances on both relevant elasticities so as not to oversell QE, yet still obtained fairly favorable effects.

Responding to Gertler's discussion of debt maturity, he noted that the duration of newly issued U.S. debt remained essentially flat once the Fed began QE—aside from a brief initial period—whereas in some European countries debt duration lengthened following the ECB's programs, working against the central bank; this offsetting behavior does not appear in the U.S. data.

On McKay's question about the speed of response, he argued that acting quickly is not especially important, since a central bank that waits a few quarters and observes continued deterioration can still deploy QE later. Finally, addressing Ramey's question, he suggested that the model's "banana-shaped" Phillips curve makes it well suited to analyzing economies with dormant inflation, sticky inflation expectations, and inflation close to zero—rather than outright deep deflation—and can be used to explore viable options for escaping such a trap.