10 Years After: Does QE Work? Are Money-Financed Fiscal Programs Inevitable?

Does quantitative easing (QE) work? It is tempting to draw analogies along the lines of, "If a nation has to ask if it is winning a foreign war 10 years after initiating hostilities…."

Stephen Williamson, economist formerly of the St. Louis Fed, argues that quantitative easing is a dud.

Regional Federal Reserve banks on three occasions (at least) have issued studies that QE is not inflationary, and but only faintly stimulative.

Certainly, present-day Japan is not a comforting example. In recent years, the Bank of Japan has bought back 45% of outstanding Japanese government bonds (that is saying something, btw), placed negative interest on some bank reserves, and holds interest rates on 10-year JGBs at zero, buying when needed to maintain the zero ceiling.

Yet on April 3 Reuters reported, "Corporate Japan expects to see only minimal inflation over the next year and barely any change looking ahead three to five years, a central bank survey showed Tuesday, highlighting yet again the difficulty the Bank of Japan faces in reaching its elusive 2 percent inflation target.

Companies surveyed by the BOJ expect consumer prices to rise 0.8 percent a year from now, unchanged from their projection three months ago."

To be sure, there has been glacial improvement in the Japanese national economy; the island has marked eight straight quarters of marginal real growth. But the yen is appreciating presently, and the BoJ's 2% inflation target is again being pushed out over the operational horizon.

In the United States, QE seemed to play a role in the recovery from 2008—yet as pointed out in this space, that recovery was epic in sluggishness, and the nation never recovered to previous trend-lines. One could state the Little Depression(which has become long) is with us to this day.

In February, the Booth School of the University of Chicago organized an all-day QE-bashing session, in general concluding QE did nothing. (One might snidely comment that the Booth School then decided QE was a success, as central banks should do nothing.)

Europe slogs along with regular European Central Bank QE, while Greece never recovered at all.

QE

Many have dismissed QE as "swapping Treasuries for bank reserves." The Fed buys Treasuries, and pays the primary dealers who deposit the money in commercial banks, creating the reserves. But the reserves are scant lent out by commercial banks—that is, lenders see no profitable loans to make, so QE is an economic wimp. Little helping matters in the US is the Federal Reserve practice of paying interest on reserves to commercial banks, a fillip for banks to stall a recovery (but make money for doing nothing).

The QE "hot potato" effect is sometimes cited. That is, sellers of Treasury bonds must put their money somewhere, and that raises asset prices while lowering interest rates, helping recovery. I suspect QE also helps boost consumption, as some bond sellers chose to spend the proceeds, but no one else has to give up consumption to buy the Treasuries. But this seems to be an extreme minority position.

Aside from the fascinating ability of a nation to pay down national debt without evident consequences, one could justifiably posit QE as rather weak tea, certainly when compared to money-financed fiscal programs.

Money-Financed Tax Cuts

US Federal Reserve Chair Ben Bernanke once advised a nation facing a deflationary recession: "Consider for example a tax cut for households and businesses that is explicitly coupled with incremental BOJ purchases of government debt—so that the tax cut is in effect financed by money creation."

Unfortunately, that nation was not the US, but Japan, and the year was 2003.

Others, including Adair Turner, former chairman of the British

Financial Services Authority and Market Monetarist David Beckworth, has assented to money-financed tax cuts as a promising monetary policy.

Conclusion

Though QE is better than nothing, there is thin evidence QE really spurs a macroeconomic recovery.

At the lower bound, or zero interest rates, the limited results of QE leave the now-conventional orthodoxy to turn to negative interest rates. Yet banks only lend when they think loans are profitable. Lending into a recession is a risky business. Besides that, savers can turn to cash if interest rates are negative (and cash in circulation is already exploding). The old saw “Cash is King” will take on enlarged meaning if negative interest rates are maintained for long.

The case for money-financed tax cuts is compelling, perhaps even inevitable. Let us hope the next recession is long off and mild.

But when it comes, why not bring the best tools to bear?