Lessons for QE Policy from Research

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What have we learned from the 12 years of QE research?

1. QE works differently than conventional policy
   - Impacts are highest in the asset market targeted
   - Impacts are highest during periods of financial distress, segmentation, illiquidity

2. QE alters the quantity of bank reserves, and the post-crisis regulatory regime implies a substantially higher necessary reserves

3. These results already offer lessons for rules governing QE/QT
   - And they differ from current rules
Narrow channel evidence from U.K.

Yield Changes by Maturity from U.K. QE for U.K. Gilts and Gilt-OIS Spreads (percent)

Source: Joyce, Lasaosa, Stevens and Tong (2011)
Narrow channel evidence from MBS

• Asset prices:
  • Krishnamurthy and Vissing-Jorgensen (2011, 2013): MBS purchases moved MBS yields on current-coupon MBS particularly

• Asset quantities:
  • Rodnyansky and Darmouni (2017): If it is narrow channel, then MBS not Treasury purchases should drive lending
  • DiMaggio, Kermani and Palmer (2015): If it is narrow channel mechanism, then MBS purchases should particularly spur conforming (not jumbo) mortgage originations, because Fed purchased conforming
Many more [unconventional] narrow-channel studies

- **Eser and Schwab (2016)**: SMP announcements by ECB lowered particularly the target countries’ sovereign yields during stress periods
- **Altavilla, Giannone and Lenza (2014)**: OMT announcements by ECB particularly compressed spreads of GIIPS sovereigns to bunds
- Similar evidence in **Krishnamurthy, Nagel and Vissing-Jorgensen (2018)**

- **Grosse-Rueschkamp, Steffen, and Streitz (2019), Todorov (2020)**: ECB CSPP lowered eligible bond yields

- **Haddad, Moreira, and Muir (2020)**: Fed IG Corporate bond purchase program and IG yields
  - Similar results in **Gilchrist, Wei, Xu, Zakrajsek (2020)** for corporate bonds and **Moussawi (2022)** for municipal bonds
QE in crisis states of the world

Google Bond Yield and CDS; Fed Bond Purchase Program Announced 3/23

Source: Haddad, Moreira and Muir (2020)
Current policy

➢ Current Fed policy describes the impact of QE in terms of term premia
  ➢ “$Q \text{ bn of QE lowers 10-year term premia by 20 bps}”

➢ And then places QE on comparable footing to conventional policy
  ➢ “$X \text{ bps reduction in the policy rate lowers 10-year rate by 20bps}”

Implying $Q = X$

➢ **Tying together** conventional and unconventional is simple and communicable in terms of a policy instrument that is well understood
  ➢ Gives policy sequencing: taper asset purchases then raise policy rate
Policy rules given what we have learned (A)

➢ Since QE impacts are higher in crisis states than normal states
  ➢ Compared to conventional policy

➢ It follows that central bank should use balance sheet policy more in crisis states than normal
  ➢ Expand balance sheet in states worse than $X$
  ➢ Shrink balance sheet in states better than $X$
  ➢ $X$ determined by cost of balance sheet and macro-benefit of policy;
    Economy requires much higher reserve balances than pre-crisis

➢ In contrast, the tying-together rule favors delaying balance sheet reductions
  ➢ Policy sequencing: taper asset purchases then raise policy rate
Policy rules given what we have learned (B)

➢ Since QE impacts work through narrow channels of the asset market targeted
  ➢ Compared to conventional policy

➢ It follows that central bank should use balance sheet policy considering the mechanics of the targeted asset market
  ➢ Buy MBS if housing is central to macro dynamics

➢ In contrast, the tying-together rule has probably led to some mistakes
  ➢ Buying MBS in 2020/2021 fueled a housing boom in the U.S.
Conclusion

➢ QE works differently than conventional policy
  ➢ Impacts are most potent during periods of financial distress, segmentation, illiquidity
  ➢ Impacts are highest in the asset market targeted

➢ Differences indicate the policy rules that should govern QE and QT

➢ Economy requires much higher reserve balances than pre-crisis