Ultra-Easy Money: Digging the Hole Deeper?

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Aims and scope →

is not inadequate liquidity but excessive debt and possible insolvencies. The policy stakes are now very high.

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Notes

1. For a record of these changes, which have affected all aspects of the conduct of monetary policy, see White [2013].

2. This was the term used by Ken Rogoff in his Adam Smith presentation to NABE in 2011. See Rogoff [2011].

to essentially “unsustainable” levels in many countries.

7. There was a vigorous debate about such supply side issues in the pre-War period. See Selgin [1997].

8. Careful historical analysis indicates that the Great Depression was essentially unique in there being an association between falling prices (CPI) and a shrinking economy. See Atkeson and Kehoe [2004] and Borio and others [2015].

9. There is now a huge literature documenting earlier crises in which both the real and financial sectors have been affected. Common themes are some early piece of good news that justifies optimism, associated financial innovation, and

13. A large part of this is due to weak prices for commodities, energy in particular. However, other measures of inflation and inflationary expectations have also been weak.

14. Core inflation in the US is not much below 2 percent, and most estimates indicate the output gap is now quite small. Nevertheless, both market and survey based measures of inflationary expectations continue to decline.

15. For a fuller description of the various ways in which ultra-easy monetary policy might actually decrease consumption and investment, see White [2012].

20. Borio and others[2015] provide estimates of the magnitude of these effects. They are not trivial, amounting to one-quarter of a percentage point off growth (annually) in the upturn and double that in the subsequent downturn.

21. For example, see Hoffman [2013]. Also the extensive discussion of these issues in Eurofi [2016]. Of particular note, to the extent that low interest rates push up the deficits of corporate pension funds with defined benefits, the corporation must fill the gap. This will be a direct charge on cash flow and profits. It is hard to avoid the conclusion that this will discourage investment.

22. The return on equity for institutions designated as Systemically Important Financial Institutions (SIFIs) has fallen dramatically in recent years. The

balance sheet liabilities, foreigners are finding that dollar financing has become increasingly difficult. Moreover, with strong pressure from the Japanese government on Japanese financial institutions to raise returns by investing abroad, and the incentive provided by negative risk-free rates in Japan, this problem can only get worse. Other anomalies are the growing gap between corporate bond spreads in the Eurozone and CDS spreads, and the relative performance of the Nikkei and Topix in Japan. Both clearly reflect central bank asset purchases.

26. At the end of July, the Bank of Japan announced an expansion of its US dollar funding facility for Japanese banks, allowing them to roll over dollar loans for as long as four years. Presumably this was done in recognition of potential dollar funding problems and with the agreement of the Federal Reserve.

30. Recall the "taper tantrum" of June 2013 when Chairman Bernanke merely hinted at the possibility of a "tapering" of QE purchases in September.

31. From 2009 to 2015 Q3, U.S. dollar denominated debt owed by non-bank borrowers outside the U.S. rose about 50 percent to $9.8 trillion. It doubled to non-bank borrowers in EMEs to $3.3 trillion. See Bank for International Settlements [2016, pp. 12–13].

32. In August of 2016, the IMF's Article 4 review of China gave a stark warning about the quality of credit in China. See also Blundell-Wignal and Roulet [2014] who note that much of the EME borrowing has arisen in industrial sectors where the rate of return on capital has been falling in recent years.

FOMC's decision in September 2015 not to raise the policy rate. However, members of the FOMC at the time emphasized that this was not done in China's interests, but due to the associated knock on effects (perhaps aggravated by associated slowdowns elsewhere) on the United States itself. International concerns seemed off the table when the FOMC raised the policy rate in December, but seemed to return around the time of the Brexit vote in June of this year.

38. Central banks are part of government. Therefore, when central banks buy longer-term government debt with central bank liabilities, they are essentially replacing the government's longer-term, fixed rate obligations with short-term debt which tends to have a much lower rate of interest. Indeed, in some countries that rate is now negative. Accordingly, exit from QE will increase government deficits. So too will raising policy rates.

42. In both Japan and the Eurozone, massive increases in the base money provided by central banks have not led to significant increases in broad money. This is because the central bank purchases of debt have largely come out of the portfolios of banks. A “tipping point” for expectations could possibly arise when nonbanks begin to sell bonds in exchange for central bank money and measures of broad money do finally begin to increase.

43. When the Fed raised rates in December, long rates did not rise but fell. This is more consistent with Risk-Off behavior and market anticipations of slower growth not faster growth. Similarly, when the BOJ introduced negative policy rates in January of this year, the Yen rose (Risk Off) rather than fall. As a further sign of decreasing confidence, in only one week in August, the Financial Times had three major op ed pieces by respected observers (Amar Bhidé, Bill Gross and Eric Lonergan) all expressing views similar to those

800 general elections. They argue in their Abstract that “Our key finding is that policy uncertainty rises strongly after financial crises as government majorities shrink and polarization rises. After a crisis, voters seem to be particularly attracted to the political rhetoric of the extreme right, which often attributes blame to minorities or foreigners.” Normal business cycle downturns do not have the same political consequences.

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