The Effects of Quantitative Easing on Interest Rates: Channels and Implications for Policy

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We evaluate the effect of the Federal Reserve's purchase of long-term Treasuries and other long-term bonds ("QE1" in 2008-2009 and "QE2" in 2010-2011) on interest rates. Using an event-study methodology we reach two main conclusions. First, it is inappropriate to focus only on Treasury rates as a policy target because QE works through several channels that affect particular assets differently. We find evidence for a signaling channel, a unique demand for long-term safe assets, and an inflation channel for both QE1 and QE2, and an MBS pre-payment channel and a corporate bond default risk channel for QE1. Second, effects on particular assets depend critically on which assets are purchased. The event-study suggests that (a) mortgage-backed securities purchases in QE1 were crucial for lowering mortgage-backed security yields as well as corporate credit risk and thus corporate yields for QE1, and (b) Treasuries-only purchases in QE2 had a disproportionate effect on Treasuries and Agencies relative to mortgage-backed securities and corporates, with yields on the latter falling primarily through the market's anticipation of lower future federal funds rates.

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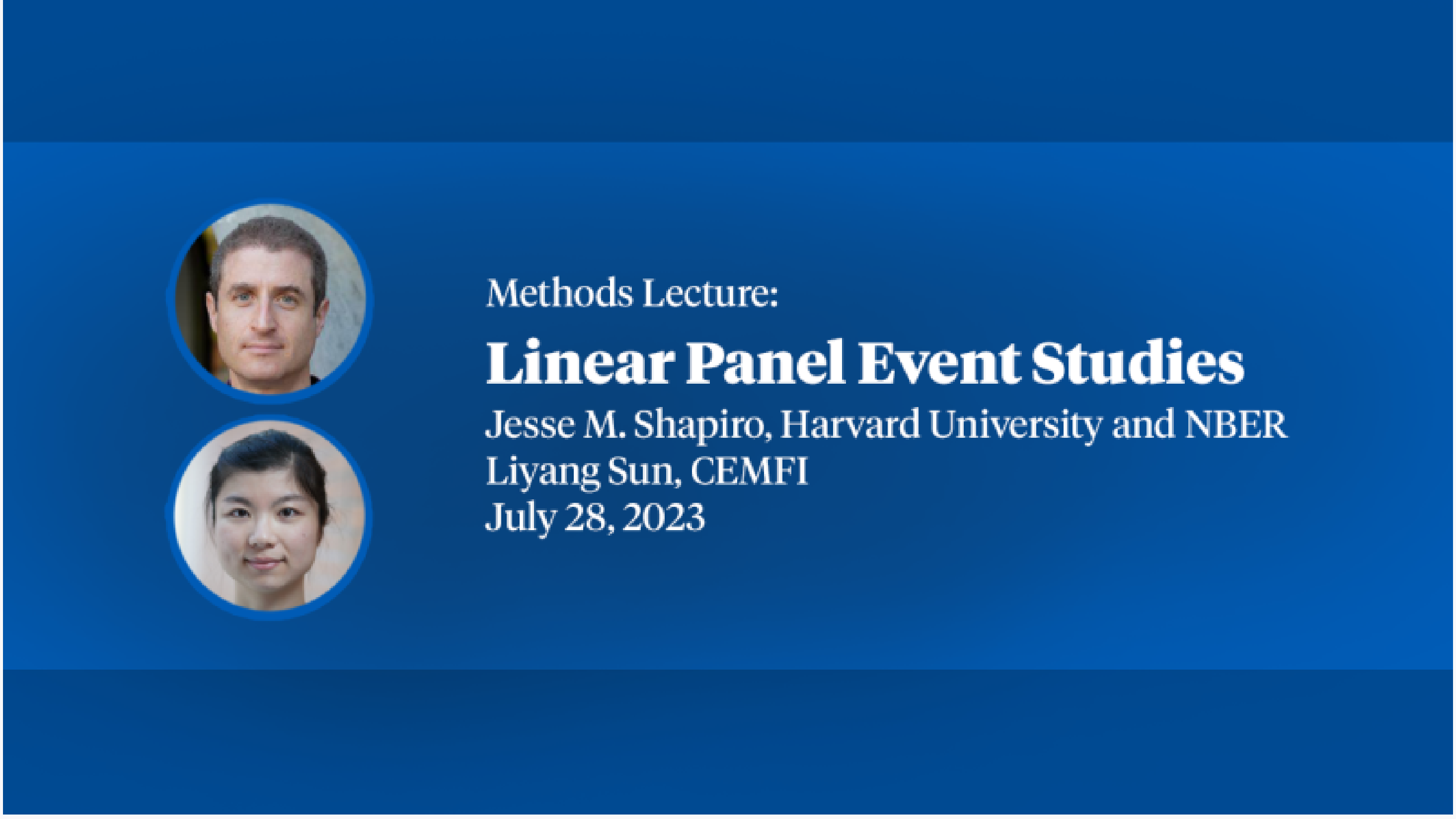

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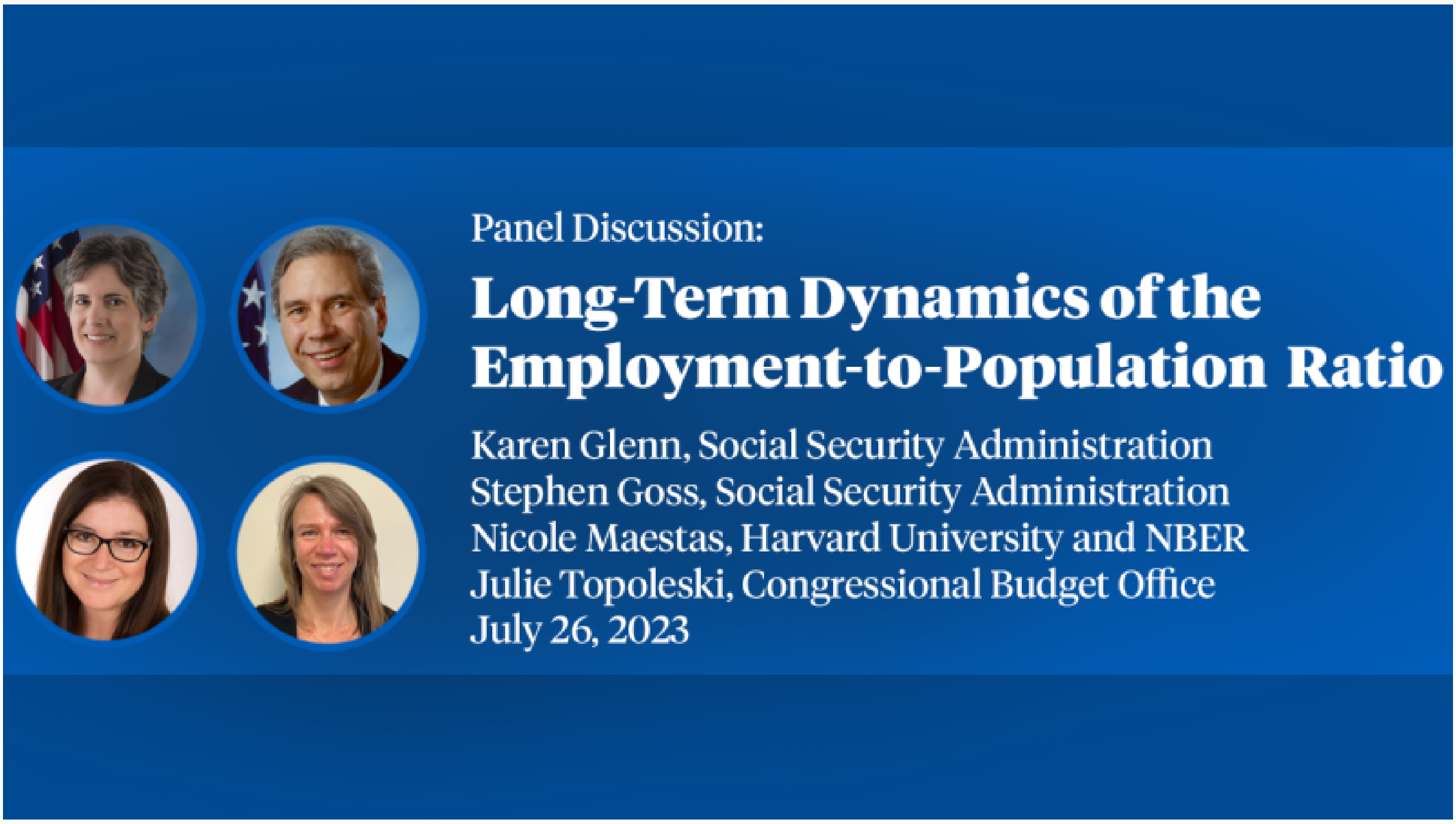

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