Fiscal Aspects of Normalizing Central Banks’ Balance Sheets

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Normalizing Central Banks’ Balance Sheets: What is the New Normal?
The ZLB and fiscal aspects of QE

- The ZLB and QE: Fed, ECB, BoJ.
- Fiscal aspects of normalization for the Fed.
The ZLB: Overnight interest rates
Quantitative Easing at the ZLB: The tale of three central banks

- BoJ: Reluctance from 2000s, decisive QE since 2013.
Index, August 2008 = 100.
What can QE achieve?

- QE can restore growth and raise inflation towards CB objective.

- QE can improve debt dynamics.

- Effectiveness depends on decisiveness, implementation.
  - Fed: Effective overall.
  - BoJ: Effective with costly delay.
  - ECB: Effective for “strong” states, not effective for “weak” states.
Ten-year government bond yields

The chart shows the ten-year government bond yields for the United States, Germany, Italy, and Japan from 2001 to 2017. The y-axis represents the percent yield, ranging from -7 to 7 percent. The x-axis represents the years from 2001 to 2017. The line colors and styles are as follows:

- United States: Blue line
- Germany: Black line
- Italy: Green line
- Japan: Red line

The yields for each country are depicted with their respective lines, allowing for a comparison over time.
- Reluctance in adopting QE has kept inflation notably below ECB price stability objective and led to deterioration of debt dynamics in many states.
- Implementation of QE has resulted in distributional effects inside euro area—implicit subsidy for “strong” states and tax for “weak” states.
- Two issues with implementation:
  - Deviation from loss-sharing associated with single monetary policy.
  - Reliance on credit rating agencies for eligibility.
ECB QE: Government bond yields vs OIS

Two-year maturity

Ten-year maturity
“The Bank will apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank.”

“The Bank will purchase Japanese government bonds (JGBs) so that 10-year JGB yields will remain more or less at the current level (around zero percent). … an annual pace of increase in the amount outstanding of its JGB holdings at about 80 trillion yen …”

“The Bank will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds the price stability target of 2 percent and stays above the target in a stable manner.”

(Bank of Japan, 21 September 2016)
Japan’s debt: The power of the BoJ balance sheet

Decisive QE with unknown multiplier: Adapted when initial amounts proved insufficient.

Distributional effects favoring housing sector through purchases of MBS—effectively a combination of monetary policy and fiscal policy.

Issues with normalization:
- Should Fed keep subsidizing housing sector?
- Should the Fed reduce holdings of Treasuries?
- Is projected balance sheet “too large”??
Fed QE: Treasury debt vs MBS

Size of Fed balance sheet, in trillion dollars.
Balance sheet level. Index, August 2008 = 100.
Balance-sheet-to-GDP ratio. Projection assumes the level of the Fed’s balance sheet remains unchanged and nominal GDP grows as projected by IMF until 2022.
Projection assumes the level of the Fed’s balance sheet remains unchanged and nominal GDP grows as projected by IMF until 2022 and 4% per year thereafter.
Keeping the Treasuries, phasing out the MBS

Balance-sheet-to-GDP ratio. Compares unchanged size of balance sheet with phasing out MBS, starting in 2018 ending in 2022 (about 350 billion per year).