The Rational Behind QE in EMEs

Gianluca Benigno, Federal Reserve Bank of New York

The views here are of the presenter and do not necessarily represent those of the Federal Reserve Bank of New York or Federal Reserve System.
QE in EMEs

- Focus on EMEs that have adopted QE in the aftermath of the Covid-19 shock;
  - What do we observe?
  - What is the rationale behind this policy choice?
  - Under which circumstances is it possible for EMEs to engage with QE?
  - Is this a tool inflationary?

Amidst the COVID-19 outbreak, an unprecedented number of developed and emerging market central banks engaged in new long-term asset purchase programs (QE)

- Canada, Australia, and New Zealand intervened for the first time, along with a few old timers: Fed, ECB, BoJ, and BoE, SNB, and Riksbank. Monetary policy 3.0 version (monetary-financing).
- Several emerging market central banks also adopted this form of intervention for the first time, most of them before reaching the ZLB
### QE in EMEs: Event study from Rebucci et al. (2021)

<table>
<thead>
<tr>
<th>Country</th>
<th>Central Bank</th>
<th>Date</th>
<th>Size</th>
<th>Other Purchases</th>
<th>Rate Cut</th>
</tr>
</thead>
<tbody>
<tr>
<td>Israel</td>
<td>Bank of Israel</td>
<td>3/16/2020</td>
<td>Unspecified amount</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>Israel</td>
<td>Bank of Israel</td>
<td>3/23/2020</td>
<td>50 billion ILS</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>Korea</td>
<td>Bank of Korea</td>
<td>3/26/2020</td>
<td>Unlimited for 3 months</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>Colombia</td>
<td>Banco de la República</td>
<td>3/24/2020</td>
<td>2 trillion COP</td>
<td>Sovereign, Bank Assets</td>
<td>No</td>
</tr>
<tr>
<td>South Africa</td>
<td>South Africa Reserve Bank</td>
<td>3/25/2020</td>
<td>Unspecified amount</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>Poland</td>
<td>Narodowy Bank Polski</td>
<td>3/17/2020</td>
<td>Unspecified amount</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>Poland</td>
<td>Narodowy Bank Polski</td>
<td>4/8/2020</td>
<td>Unspecified amount</td>
<td>Sovereign, State-Guaranteed Bonds</td>
<td>Yes</td>
</tr>
<tr>
<td>Romania</td>
<td>Banca Națională a României</td>
<td>3/20/2020</td>
<td>Unspecified amount</td>
<td>Repos, Local Government Bonds</td>
<td>Yes</td>
</tr>
<tr>
<td>Hungary</td>
<td>Magyar Nemzeti Bank</td>
<td>4/7/2020</td>
<td>Unspecified amount</td>
<td>Sovereign, MBS</td>
<td>No</td>
</tr>
<tr>
<td>Hungary</td>
<td>Magyar Nemzeti Bank</td>
<td>4/28/2020</td>
<td>1 trillion HUF</td>
<td>Sovereign, MBS</td>
<td>No</td>
</tr>
<tr>
<td>Croatia</td>
<td>Hrvatska narodna banka</td>
<td>3/13/2020</td>
<td>Unspecified amount</td>
<td>Sovereign, Corporate Bonds</td>
<td>Yes</td>
</tr>
<tr>
<td>Philippines</td>
<td>Bangko Sentral ng Pilipinas</td>
<td>3/23/2020</td>
<td>300 billion PHP</td>
<td>Sovereign, MBS</td>
<td>No</td>
</tr>
<tr>
<td>Philippines</td>
<td>Bangko Sentral ng Pilipinas</td>
<td>4/13/2020</td>
<td>Unspecified amount</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>Mexico</td>
<td>Banco de México</td>
<td>4/21/2020</td>
<td>100 billion MXN</td>
<td>Sovereign, Corporate Bonds</td>
<td>Yes</td>
</tr>
<tr>
<td>Turkey</td>
<td>Central Bank of the of Turkey</td>
<td>3/31/2020</td>
<td>Unspecified amount</td>
<td>Sovereign, Corporate Bonds</td>
<td>Yes</td>
</tr>
<tr>
<td>Turkey</td>
<td>Central Bank of the of Turkey</td>
<td>4/17/2020</td>
<td>5% To 10% of total assets</td>
<td>Sovereign, Corporate Bonds</td>
<td>Yes</td>
</tr>
<tr>
<td>India</td>
<td>Reserve Bank of India</td>
<td>3/18/2020</td>
<td>100 billion INR</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>India</td>
<td>Reserve Bank of India</td>
<td>3/20/2020</td>
<td>300 billion INR</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>India</td>
<td>Reserve Bank of India</td>
<td>4/23/2020</td>
<td>100 billion INR (twist)</td>
<td>Sovereign</td>
<td>No</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Bank Indonesia</td>
<td>4/1/2020</td>
<td>Unspecified amount</td>
<td>Sovereign</td>
<td>No</td>
</tr>
</tbody>
</table>
QE in EMEs: Findings (Rebucci et al. (2021))

- On average, impact of QE on EM yields larger and more persistent than in DMs.
- QE associated with larger depreciation in advanced economies than in emerging markets;
- Policy interventions enacted before reaching the zero-lower bound;
- Impacts are heterogeneous across countries;
- Several exchange rates appreciated.
QE in EMEs: Rationales

- Improve bond market functioning ("Original Sin Redux" Carsten and Shin (2020))
- Provide additional monetary stimulus (macroeconomic stabilization)
- Ease government financing pressure in the face of the pandemic (financing fiscal authority)
QE in EMEs: Framework

- Critical Features:
  - Local currency borrowing at the Sovereign Level;
  - Flexible Exchange Rate;
  - Sound Institutional Framework.
QE in EMEs: Local Currency Borrowing

Many Countries Have High Debt Ratios

Debt to GDP Ratio (percent)

Local Currency Share of Government Debt (percent)

Source: Institute of International Finance
QE in EMEs: Risks

- Risks:
  - Excessive depreciation and de-anchoring of inflation expectations
  - Dabrowski and Dominguez-Jimenez (2020) point out at differences between core and peripheral currencies.

- IMF (2020) (Drakapoulous, Goel, Natalucci and Papageorgiou)
  - Communication to limit risks to credibility
  - Purchases should be conducted in secondary market (limit fiscal dominance)
QE in EMEs: is it inflationary?

- Functioning of quantitative easing: is QE inflationary?
  
  - Quantitative easing merely involves the central bank buying bonds (or other bank assets) in exchange for deposits made by the central bank in the commercial banking system – that is, crediting their reserve accounts. The aim is to create excess reserves which will then be loaned to chase a positive rate of return.
  
  - Quantitative easing is an accounting adjustment in the various accounts to reflect the asset exchange. The commercial banks get a new deposit (central bank funds) and they reduce their holdings of the asset they sell.
QE in EMEs: is it inflationary?

- Functioning of quantitative easing: is QE inflationary?
  - The net financial assets in the private sector are unchanged although the portfolio composition of those assets is altered (maturity substitution) which changes yields and returns.
  - In terms of changing portfolio compositions, quantitative easing increases central bank demand for “long maturity” assets held in the private sector which reduces interest rates at the longer end of the yield curve. This might increase aggregate demand given the cost of investment funds is likely to drop.
  - QE not inflationary to the extent to which it indirectly influences aggregate demand and exchange rate does not depreciate (CPI).
QE in EMEs: is it inflationary?

- QE and monetary-financing
  - The use of QE in the context of expansionary fiscal policy creates net financial assets in the private sector.
  - Expansion in aggregate demand can be inflationary if there is no slack in economic activity.
  - Crucial to be in policy framework in which sovereign borrows in local currency with floating exchange rate.
QE in EMEs: is it inflationary?

- Monetary and Fiscal Policy Interaction

- The starting point is to think about the consolidated balance sheet of the Treasury and the Central Bank (recently Rogoff (March, 2021, House of Lords, London) indeed stated that “...a point that a lot of people do not understand is that the Central Bank is a 100% subsidiary of the Government” and that “you really have to look at them integratively”).

- Benigno and Nistico’ (2021) in which the role of the Central Bank in backing the liabilities of the Treasury is considered explicitly and focuses on the economics of helicopter money.
Conclusions

- EMEs have adopted QE during pandemic
  - Effective in addressing tension in local currency bond markets.
  - Scope for adding it as additional policy tool and expands its role depend on policy framework.
  - Importance to understand monetary and fiscal policy interaction for both DM and EMEs.