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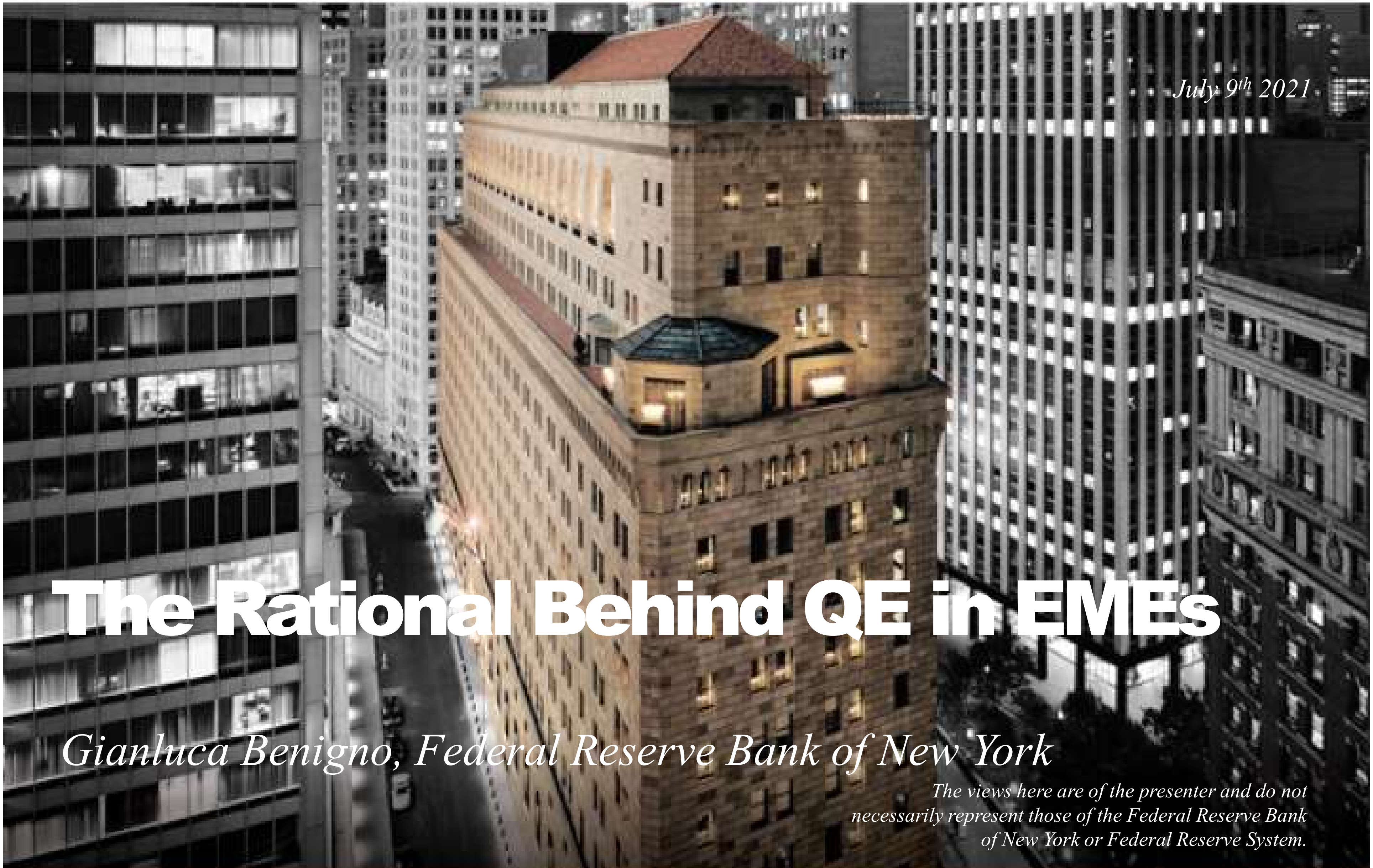

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The Rational Behind QE in EMEs

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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?

Based on “Should Credible Emerging Market Embrace Quantitative Easing during the Pandemic” (https://libertystreeteconomics.newyorkfed.org/2020/10/should-emerging-economies-embrace-quantitative-easing-during-the-pandemic.html)

QE in EMEs: Background

- 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)

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

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.

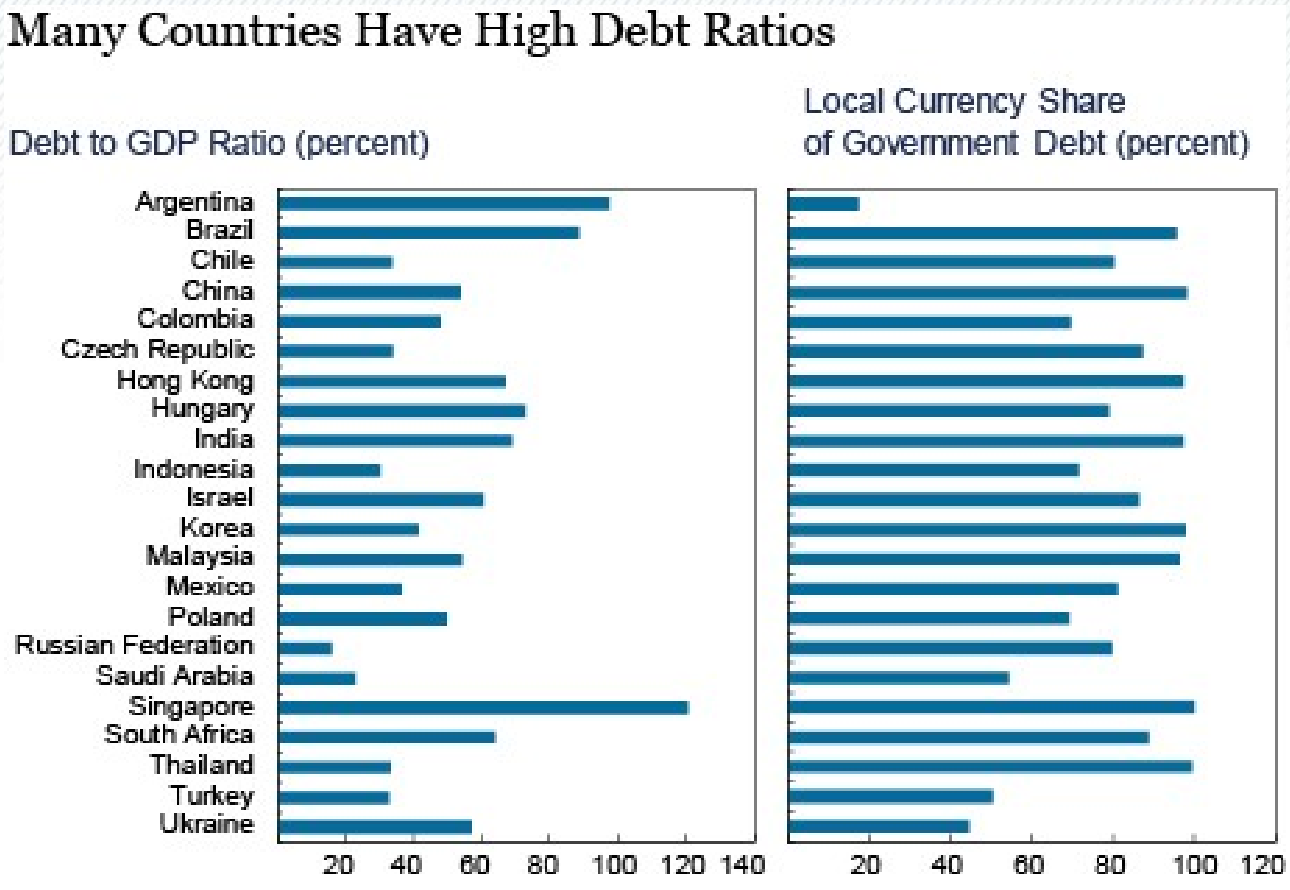
QE in EMEs: Rationales

- 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



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 is 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 Governmen*t" 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.