

Quantitative Easing

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Times of crisis spell the obvious crises in the financial markets as they become more obvious in a way that distresses and creates uncertainty. This later recoils into the economy and affects its dynamics. Restoring this trend to its former state requires the input of commercial banks that step in and help the situation. Central banks always guide their monetary policies by manipulating their short term nominal interest rates. Nevertheless, in times of global crises where the short rates are almost the zero lower bound, there is a greater need for more tools for economic recovery and stimulation.

Banks put up quantitative measures to ease and absorb shocks. These measures are also known as unconventional measures and they boost the stability of the economy. Quantitative easing (QE) is one of the monetary policies used by central banks to print money with an aim of boosting the economy (Di Maggio, Kermani & Palmer, 2020). The central bank primarily creates opportunities for the government to purchase government securities from the market so as to have the interest rates lowered with an aim to increase the supply of money. As a result of these economic situations, financial institutions are forced to increase lending to enhance the circulation of liquid money.

On occasions where the economy of the country is stagnating or not performing as it should, the central bank is tasked with evaluating the factors affecting the status quo. After wards, it initiates appropriate measures to restore corrective measures by easing the issue. Inflation and higher interest rates are the major factors triggering economic slump, more specifically when the situation is getting unmanageable (Christensen & Krogstrup, 2019). Under normal circumstances, central banks cut off their interest rates to give an opportunity for banks to borrow more money from them.

The lower interest rates charged by banks reduce the funding costs of banks allowing them more opportunities to borrow more money. As a result, the action will help the issue affecting money supply and prevent the economy from going into recession. Nevertheless, despite cutting down the interest rates to almost zero failing to signify any recovery, the central bank may decide to initiate quantitative easing which is a policy that is mostly used in such scenarios (Song & Zhu, 2018). This is the last option that is considered by central banks especially when other standard policies have shown lack of any foreseeable outcomes.

In quantitative easing, the central bank purchases financial assets such as bonds and other financial assets with a sole aim of bringing money into the economy so as to expand the economic activities within the economy. Such an unconventional monetary policy is always used during negative or very low inflation situations in the economy and when other statutory regulatory policies have born no fruits in restoring the economy to normalcy (Song & Zhu, 2018). Quantitative easing is then implemented by the central bank through the purchase of financial assets from financial institutions and commercial banks. This raises the price of the respective financial assets resulting in a lower yield and increasing the supply of money in the economy (Rodnyansky & Darmouni, 2017). This policy is very different from the standard policies such as the buying of government bonds which solely keeps bank interests at a given standard.

Besides, quantitative easing has been proven to help the economy to come from recession and ensure that inflation is not restored below the target set by the central bank. However, there are various risks associated with this kind of policy. One of these risks includes its high rate of effectiveness beyond the intended level in its action against inflation resulting in inflation in the long run. There are also chances that it can become ineffective especially when commercial banks become reluctant in lending to the borrowers or when the borrowers refuse to borrow. The International Monetary Fund (IMF) has estimated that the US Federal Reserve System and that of many other economies applied quantitative easing during the 2007-08 financial crises (Kolasa & Wesołowski, 2020). This was helpful in mitigating various economic issues post the crisis. Besides, the latest application of this policy has been in responding to the current Covid-19 pandemic by the Federal Reserve, European Central Bank and the Bank of England.

As a policy, quantitative easing reduces the interest rates thus destroying the traditionally known financial helpers like the certificates of deposit, highly rated bonds, money market accounts, and treasuries (Joyce, Miles, Scott & Vayanos, 2012). This forces the investors to make risky investments with an aim of getting good returns. However, it has been proved that such investors always weigh their chances towards increasing prices in the stock market and equities. A fall in interest rates will also negatively impact decision-making in many companies because of lower costs of borrowing.

In conclusion, times of crisis push central banks to the corner and into making very critical decisions to bringing back the economy into normalcy. Economic stimulation using this policy results in reduced interest rates to allow more borrowing from the public to inject more money into the economy. However, this policy results in long term inflation although it is very effective in alleviating the present crisis.

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