How Do Economic Experts Assess the Effects of Large-scale Government Bond Purchases by Central Banks in the Short to Medium Term?

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In response to the financial and economic crisis of 2007/08 and the following sluggish recovery, major central banks have lowered interest rates to the zero lower bound and have adopted unconventional monetary policies to provide additional stimulus. Although highly debated, one of those unconventional measures was central banks massively buying government bonds in secondary markets. Examples of large-scale government bond purchasing programmes are given by the Federal Reserve, the Bank of England, the Bank of Japan, and the ECB. In April 2014, the Ifo World Economic Survey (WES) asked about 1,000 economic experts globally to assess the short to medium term effects of such programmes. As revealed by the survey results presented in this article, for the short-term assessments are rather positive and agreement among experts is quite high. However, for the medium-term potential risks gain importance and higher disagreement in expert assessments within and across regions may reflect both considerable uncertainty and regional differences in economic beliefs.

The IMF distinguishes between two different objectives that central banks' large-scale government bond purchases (LSGP) and related unconventional policy measures can contribute to (see IMF 2013). On the one hand, increasing demand for government bonds can be aimed at lowering long-term yields and therefore easing monetary policy conditions, despite the zero lower bound. On the other hand, bond purchasing programmes can be targeted to resolve financial market distortions and to ensure a proper monetary policy transmission mechanism (as in the case of the ECB's OMT programme). Overall, the effects of bond-buying programmes on the real economy are rather uncertain, since these effects materialise over a longer horizon and are hard to disentangle from other influencing factors (see, for example, Williams 2014).

In April 2014, a special question in the WES asked the economic experts surveyed to evaluate given statements on the possible effects of central banks' LSGPs. Experts could indicate whether they (dis-)agree with a given opinion on a four-point scale ("strongly agree", "rather agree", "rather disagree", "strongly disagree"). The statements referred to the broad effects of LSGPs in the areas of monetary and fiscal policy, overall economic policy, and financial markets. More specifically, the list of statements reads as follows:

"In general, large-scale government bond purchases are likely to…

- …be an effective policy tool to combat deflationary spirals.
- …lead to high inflation in the medium-term due to excess central bank money.
- …reduce public and private sector funding costs.
- …reduce fiscal discipline in the medium-term.
- …allow more time to introduce structural reforms.
- …lead to a loss of central bank independence from fiscal policy.
- …trigger asset price bubbles in the medium-term.
- …prevent short-term irrational overshooting in the financial market.
- …trigger large capital flows into emerging markets, which may probably reverse quickly once the programmes terminate".

Each potential short-term effect of LSGPs was contrasted with a potential medium-term effect as discussed by the general public, such as the trade-off between fighting deflationary spirals in the short-term and the possibility of high inflation in the medium-term due to excess central bank money.

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The results of the WES special question across regions are shown in Table 1. The answers are presented as balance statistics, which reflect the difference in the shares of respondents agreeing with a given statement and those who disagree.[2] As far as the effect of LSGPs in the field of *monetary policy* is concerned, respondents worldwide agree that such programmes help to combat deflationary spirals, with the largest approval for this statement in the Near East and Latin America. By contrast, there is a high level of dissent among experts concerning the statement that LSGPs might lead to high inflation in the medium term. While CIS countries and the Near East in particular do not expect excess central bank money to be sterilised on time to prevent high inflation, respondents in North America in particular strongly disagree with the statement.

In the field of *fiscal policy*, economic experts in all regions agree on the effectiveness of LSGPs in reducing public and private sector funding costs. At the same time, the majority of experts (notably in Asia and Oceania) believe that government bond purchases reduce fiscal discipline in the medium term. Only experts in Africa do not agree on balance with this statement.

As far as *overall economic policy* is concerned, experts worldwide agree that LSGPs allow more time for structural reforms. However, there is a high level of disagreement about whether such programmes lead to a loss of central bank independence from fiscal policy, as indicated by the standard deviation of regional balance statistics (reported in the final row of Table 1). Whereas experts in Asia and Europe in particular agree with this statement, experts in Oceania and North America strongly object.

Given the effect of LSGPs on *financial markets*, experts worldwide generally agree that such programmes might lead to asset price bubbles in the medium term. This statement received the highest consensus among respondents, as indicated by the average approval rate across regions. By contrast, there is a high level of dissent concerning the effectiveness of LSGPs in prevent-

[2] Since the categories at the higher and lower end of the response scale were less selected, the two statements on agreement or disagreement ("strongly"/"rather") were summarised without weighting in one category each.

Table 1

Balancing statistics* on the effects of large-scale government bond purchases by central banks

	"In general, large-scale government bond purchases are likely to…"								
	combat deflationary spirals	lead to high inflation in the medium term	reduce public and private sector funding costs	reduce fiscal discipline in the medium term	allow more time for structural reforms	lead to a loss of central bank independence from fiscal policy	trigger asset price bubbles in the medium term	prevent short-term irrational overshooting in the fin. market	trigger large capital flows into emerging markets
	Monetary Policy		*Fiscal Policy*		*Economic Policy*		*Financial Markets*		
Western Europe	28	– 7	43	28	41	28	63	– 11	29
Eastern Europe	31	13	40	49	34	29	34	– 18	31
CIS	33	48	21	34	12	23	42	15	18
North America	48	– 25	42	29	45	– 42	56	– 10	7
Asia	44	33	34	61	24	40	68	5	40
Latin America	51	21	37	30	53	20	27	19	51
Near East	70	45	46	40	83	– 24	54	34	– 7
Oceania	33	15	37	59	68	– 64	56	– 92	81
Africa	42	– 10	37	– 13	37	7	16	33	38
Consensus	42	15	37	35	44	2	46	– 3	32
Disagreement	13	25	7	22	22	37	17	38	25

* The table reports balancing statistics that represent the difference in the shares of respondents (strongly) agreeing with the respective statement and those who (strongly) disagree. Results at the regional level are obtained by weighting the experts' opinion according to the country-specific exports and imports as a share of total world trade. Negative entries are marked red, whereas the highest value for each statement is marked green. Consensus is measured by the mean of regional balances. Disagreement is the standard deviation of regional balance statistics.

Source: Ifo World Economic Survey (WES) II/2014.

ing short-term irrational overshooting in the financial market, with the majority of experts in Oceania, Europe and North America disagreeing. Moreover, this statement was the only one that received a negative consensus value. Finally, experts were asked to assess a statement referring to potential spillovers of domestic LSGPs to emerging markets. Most experts agree that such measures might lead to large capital flows into emerging economies, which may probably reverse quickly once the programmes terminate. Interestingly, the lowest approval rate for this statement is found in the Near East and North America, probably because these economies were barely affected by changes in capital flows in recent years.

Two main messages can be derived from Table 1. Firstly, economic experts worldwide seem to broadly agree on the short-term effects of LSGPs. The majority of experts hold the opinion that massive government bond purchases help to fight deflationary spirals, reduce public and private funding costs and allow more time to introduce structural reforms. One exception is the effectiveness of LSGPs in preventing short-term overshooting in financial markets, as advanced economies tend to disagree with this opinion. Secondly, medium-term effects are generally more uncertain than short-term effects, as reflected by a higher level of disagreement among respondents on a given statement. The greatest degree of uncertainty pertains to the credibility of monetary policy, emphasising the importance for central banks of clearly communicating their unconventional monetary policy strategies. Survey results also indicate challenges for future exit strategies from unconventional measures such as LSGPs, given that experts across regions disagree on their effect on emerging markets capital flows and, given the high degree of consensus that such programmes trigger asset price bubbles in the medium term.

Table 2 shows the balance statistics for selected countries. Experts' opinions in economies whose central banks introduced LSGPs mainly to ease monetary policy conditions at the zero lower bound (United States, Japan and Britain) are rather heterogeneous,

Table 2

Balancing statistics* on the effects of large-scale government bond purchases by central banks in selected countries and regions

		"In general, large-scale government bond purchases are likely to…"								
		combat deflationary spirals	lead to high inflation in the medium term	reduce public and private sector funding costs	reduce fiscal discipline in the medium term	allow more time for structural reforms	lead to a loss of central bank independence from fiscal policy	trigger asset price bubbles in the medium term	prevent short-term irrational overshooting in the fin. market	trigger large capital flows into emerging markets
	(No. of responses)	*Monetary Policy*		*Fiscal Policy*		*Economic Policy*		*Financial Markets*		
USA	*(23)*	39	**– 22**	39	30	39	**– 39**	**57**	**– 4**	**– 4**
Japan	*(30)*	60	33	40	**67**	7	**67**	53	0	45
UK	*(9)*	40	**– 40**	40	0	56	11	**78**	**– 78**	56
Euro area (core)[a)]	*(171)*	20	3	31	35	35	38	**63**	**– 7**	28
GIIPS[b)]	*(84)*	54	**– 26**	**58**	14	52	5	53	15	36
Brazil	*(29)*	47	33	29	27	**57**	0	31	41	**57**
Russia	*(33)*	31	**45**	9	33	0	15	44	3	9
India	*(13)*	54	69	9	38	**85**	**– 8**	69	8	54
China	*(11)*	50	40	33	64	17	45	**82**	**– 9**	33
South Africa	*(25)*	28	12	28	60	12	20	68	**– 25**	**76**
Turkey	*(17)*	63	29	65	41	29	**– 13**	53	29	**76**

* The table reports balancing statistics that represent the difference in the shares of respondents (strongly) agreeing with the respective statement and those who (strongly) disagree. Results at the regional level are obtained by weighting the experts' opinion according to the country-specific exports and imports as a share of total world trade. Negative entries are marked red, whereas the highest value for each country or region is marked green.
[a)] Euro area without GIIPS (Greece, Ireland, Italy, Portugal, Spain).
[b)] Greece, Ireland, Italy, Portugal, Spain.

Source: Ifo World Economic Survey (WES) II/2014.

but with a high consensus on the risk of asset price bubbles in the medium term. Respondents in the United States object the most to the given statements, notably concerning high inflation and a loss of central bank independence as a result of LSGPs. In 'euro area core' countries, the majority of experts also agree that LSGPs lead to asset price bubbles in the medium term. Interestingly, experts in core countries generally do not agree that LSGPs prevent short-term irrational overshooting in the financial market, although financial market tension was a major reason for the ECB to introduce large-scale government bond purchases.[3] However, results strongly differ for the periphery of the euro area (Greece, Ireland, Italy, Portugal and Spain). Here, experts agree on balance that LSGPs help to overcome financial market overreactions, accompanied with a strong approval rating for the easing of public and private sector funding costs. Finally, within the BRICS countries LSGPs are widely considered to trigger large and reversible capital flows to emerging markets, notably in Brazil, India and South Africa, as well as in Turkey. This mirrors the financial turbulences faced by these countries since the Federal Reserve announced the possible reduction of its bond-buying programme in May 2013 and the actual reduction ('tapering') in January 2014.[4] Country-specific heterogeneity on this issue might also reflect a challenge concerning recent calls to coordinate monetary policies, like that made by the leaders of emerging economies on the occasion of this year's meeting of the G20 in Sydney.[5]

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[3] See e.g. the introductory statement to the ECB's Governing Council press conference in September 2012 by Mario Draghi, http://www.ecb.europa.eu/press/pressconf/2012/html/is120906.en.html.

[4] As shown by results of the special question in the Ifo WES I/2014, the majority of experts in these countries also expected large portfolio-investment outflows due to quantitative easing tapering in the United States – see Plenk *et al.* (2014).

[5] Recent literature documents sizeable spillovers from unconventional monetary policies in advanced economies to emerging markets – see e.g. Mohan and Kapur (2014).