A Portfolio Model of Quantitative Easing

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The views expressed here are my own and do not reflect those of the FRB

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Summary

The authors take a closer look at central bank large scale asset purchases and their effect on asset prices...

$$\text{LSAPs} = \underbrace{\text{“Bills Only”}}_{\substack{\text{Increase in central bank's}\\ \text{monetary liabilities}}} + \underbrace{\text{“Operation Twist”}}_{\substack{\text{Change in the composition of}\\ \text{central bank's assets}}}$$

?

Eg, Vayanos-Villa (2009) mechanism

Summary

...and propose a new channel

- Central Bank
  - A: Increase in bond holdings
  - L: Financed with an expansion of reserves
- Non-Banks
  - A: Substitution of bonds by bank deposits

    Bond price increases, standard channel
- Banks
  - A: Increase in reserves
  - L: Increase in deposits

    Additional increase in bond price to induce banks to hold reserves as a counterpart to new deposits

Comments

- Minor: SNB sight deposit accounts do not seem to be restricted to depositary institutions
- Does the proposed mechanism work when rates are zero or, more generally, when market rates are equal to the interest on reserves?
  - No opportunity cost of holding reserves: demand for reserves should be perfectly elastic
  - Reserves are not scarce: return differences between risk-free assets and reserves should shrink
  - SNB expansion of reserves in August 2011 was initiated under positive rates (and brought them to zero)

Comments

- Under what assumptions does a "passive" expansion in deposits lead to higher demand for risky assets?
  - Relevant question, even assuming that banks are not owned by the same investors as non-banks
  - An increase not in banks' wealth but in leverage
  - Not clear why bank equityholders will find this increase optimal and will not undo it by holding reserves, especially as risk premia are low
- The focus on the role banks is very interesting
  - Compare with Haddad and Sraer (2016): income gap is related to bond risk premia; its components added as separate variables are not significant

Comments

- If the proposed channel is first order, QE1 should have been significantly more effective in reducing LT yields than QE2
    - In QE1 banks were played the central role as central bank's counterparties

Conclusion

- Very interesting and promising paper
- Puts emphasis on QE practical implementation and the role of banks
- Would like to see more microfoundations and evidence