The Open University

Fiscal responsibility and monetary policy

Quantative Easing

Pontus Rendahl:

I can see arguments when monetary policy like QE can actually have an effect. But I can also see arguments when they don't have an effect. And the whole issue with the liquidity trap is that you create a situation in which investors are basically indifferent between holding cash and assets. But assets applies to a lot of types of assets. Short run assets like the Gilts or long term assets like long term Gilts or long term Corporate Bonds, or equities, etc. So when the government said QE is basically their monetary authority stepping in and purchasing long term assets I'm not sure if that will do much. Because the indifference between cash and long term assets is basically the same as for short terms assets. So what I think will happen is that you've got an investor who is holding a 30 year Corporate Bond. And you purchase that from him and you give him the cash instead. He will think that that cash is as good of an investment as his long-term bond. And he will keep it in his mattress. And when he keeps the money in his mattress it doesn't go out and being spent in the economy. And when it's not being spent it won't have a kick back.

So the important thing is you need to introduce money in the economy. But you need to make sure that that money is also spent.