# The Economist explains+What is quantitative easing?

And how does it work?

### [The Economist explains](http://www.economist.com/blogs/economist-explains)

Mar 9th 2015

by R.A.

TODAY the European Central Bank (ECB) launches its long-awaited program of quantitative easing (or QE), adding lots of public debt to the private kind it has already been buying. Its monthly purchases will rise from around €13 billion ($14 billion) to €60 billion until at least September 2016. The ECB is just the latest central bank to jump on board the QE bandwagon.

Most rich-economy central bankers began printing money to buy assets during the Great Recession, and a few, like the Bank of Japan, are still at it. But what exactly is quantitative easing, and how is it supposed to work?

Central banks are responsible for keeping inflation in check.

Before the financial crisis of 2008-09 they managed that by adjusting the interest rate at which banks borrow overnight.

If firms were growing nervous about the future and scaling back on investment, the central bank would reduce the overnight rate. That would reduce banks' funding costs and encourage them to make more loans, keeping the economy from falling into recession.

By contrast, if credit and spending were getting out of hand and inflation was rising then the central bank would raise the interest rate.

When the crisis struck, big central banks like the Fed and the Bank of England slashed their overnight interest-rates to boost the economy.

But, even cutting the rate as far as it could go, to almost zero, failed to spark recovery.

Central banks therefore began experimenting with other tools to encourage banks to pump money into the economy. One of them was QE.

To carry out QE central banks create money by buying securities, such as government bonds, from banks, with electronic cash that did not exist before.

The new money increases the size of bank reserves in the economy by the quantity of assets purchased—hence "quantitative" easing.

Like lowering interest rates, QE is supposed to stimulate the economy by encouraging banks to make more loans.

The idea is that banks take the new money and buy assets to replace the ones they have sold to the central bank.

That raises stock prices and lowers interest rates, which in turn boosts investment.

Today, interest rates on everything from government bonds to mortgages to corporate debt are probably lower than they would have been without QE.

 If QE convinces markets that the central bank is serious about fighting deflation or high unemployment, then it can also boost economic activity by raising confidence.

Several rounds of QE in America have increased the size of the Federal Reserve's balance sheet—the value of the assets it holds—from less than $1 trillion in 2007 to more than $4 trillion in 2015.

The jury is still out on QE, however.

Studies suggest that it did raise economic activity a bit.

But some worry that the flood of cash has encouraged reckless financial behaviour and directed a firehose of money to emerging economies that cannot manage the cash.

Others fear that when central banks sell the assets they have accumulated, interest rates will soar, choking off the recovery.

Last spring, when the Fed first mooted the idea of tapering, interest rates around the world jumped and markets wobbled.

Still others doubt that central banks have the capacity to keep inflation in check if the money they have created begins circulating more rapidly.

Central bankers have been more cautious in using QE than they would have been in cutting interest rates, which could partly explain some countries' slow recoveries.

At least a few central banks are now experimenting with stimulus alternatives, such as promises to keep overnight interest-rates low for a very long time, the better to scale back their dependence on QE.