Yield-curve control

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A yield curve: background

- A yield curve is a line drawn through the effective interest rates on government securities with different maturities.
- In normal times, this line slopes upward: long-term rates are higher than short-term ones, to compensate for the higher risks—mainly inflation—of investing for a longer period.

Prepare for future downturns (Jan 2020)

- Many hazards complicate the job of Jerome Powell, the chairman of the Federal Reserve, from meddling presidents to pandemics.
- At the press conference following the Fed's monetary-policy meeting on January 29th, he was grilled on its likely response to all of these.
- But Mr Powell's biggest problem is a more enduring and global one: interest rates are stubbornly low.

“Unconventional” tools

- The Fed’s main policy rate will almost certainly be cut to zero, forcing it to rely once more on its “unconventional” tools.
- Mr Powell has said he is open to considering yield-curve control, a new approach borrowed from Japan.

Overnight interest rates would rise

- During the global financial crisis the hope was that when recovery arrived overnight interest rates—central banks' preferred policy lever—would rise, restoring business as usual
- In fact, despite a resilient global expansion, few rich-world countries have left zero behind.
- In a recent lecture Ben Bernanke, a former Fed chairman, argued that the unconventional tools used during and after the crisis worked reliably and effectively, and could do so again.

QE (quantitative easing)

- Before the crisis, the Fed traded bonds to keep overnight interest rates within a desired range.
- With QE by contrast, bond purchases are an end in themselves.
- Rather than announce changes to rates, central bankers inform markets of the quantity of bonds they will buy (hence “quantitative”) with newly created money.

Effects of QE

- When investors sell long-term government bonds to the central bank, the thinking goes, they use the cash they receive to buy other assets, such as corporate bonds or equities.
- Higher stock and bond prices in turn encourage firms to invest, boosting the economy.
- Some evidence suggests that QE is subject to diminishing returns.

Yield-curve control

- Yield-curve control would allow a central bank that has cut its overnight rate to zero to set rates for bonds of longer maturities.
- The Bank of Japan began its programme by targeting a yield of 0% for ten-year Japanese government bonds.
- An American version might begin by capping the rate for one-year bonds, then adding in longer durations as needed.

Keep yields on target

- No announcements regarding the buying or selling of bonds would be necessary; the Fed would simply transact in the bond market to keep yields on target, as it does for overnight rates.