

Understanding the Distinction Between China's "QE" and Quantitative Easing in Developed Economies

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Abstract: As a result of various economic shocks, such as the recession, the European debt crisis, the global financial crisis, and the COVID-19 pandemic, developed economies like the United States, Japan, and the euro area have gradually reduced their policy interest rates to nearly 0 percent. They have also implemented strategies like quantitative easing (QE) and Operation Twist, which involve expanding the balance sheets of central banks and restructuring their assets. These measures have had a significant and far-reaching effect worldwide. In light of these circumstances, China has also encountered a complicated financial situation in response to the global crisis. This study does a comparative analysis of the QE policies of the United States, Japan, and the Eurozone. It utilizes research and literature review methods to examine how China might gain insights from the QE measures employed in these advanced economies. China's economic system and financial features are distinct, leading it to adopt a different approach in response to the financial crisis. Instead of resorting to QE like developed countries, China employed a combination of fiscal and monetary measures to address the crisis. This study aims to enhance comprehension of the significant influence of QE on the global economy and finance by more research and analysis. Furthermore, it seeks to investigate more inventive policy instruments to facilitate global economic development.

Keywords: Quantitative easing (QE), Financial crisis, Purchase of treasury bonds, China.

1. Introduction

Since the financial crisis, the winds of quantitative easing (QE), which originated in Japan, have been blowing faster from the United States to Europe. They have also affected China's financial and economic environment. Since transitioning into the post-COVID-19 era, there is a renewed demand for China to implement QE due to persistently unsatisfactory economic statistics.

Especially, on April 23, 2024, the People's Bank of China (PBOC) released a statement indicating that the central bank's buying and selling of treasury bonds in the secondary market can serve as a means of managing liquidity and as a reserve for monetary policy tools. Additionally, the Ministry of Finance (MOF) issued a statement expressing its support for the gradual expansion of treasury bond transactions in the central bank's open market operations. There has been a lot of speculation about the possibility of China's central bank purchasing treasury bonds, which would signal the initiation of a QE operation. However, from China's financial environment standpoint, there is ongoing debate

in the market on whether "central bank's acquisition of treasury bonds" may be classified as QE. Regarding this matter, it is necessary to elucidate the concept of QE.

In fact, there is no uniform definition of quantitative easing in academia and the financial industry. Shiratsuka defines quantitative easing as the use of both the asset and liability sides of a central bank's balance sheet to counter unforeseen economic shocks by implementing a range of unconventional monetary policy measures [1]. In contrast, Fawley and Neely propose a definition of QE that focuses on its role as a policy instrument. They argue that QE is a form of monetary policy in which the central bank buys assets and expands credit, among other things, with the aim of expanding the monetary base [2]. Bini Smaghi, a member of the Executive Board of the European Central Bank, argues that one of the main objectives of QE is to ease financial market tensions [3]. Nevertheless, QE, as defined by the People's Bank of China, is a central bank intervention that involves injecting a significant amount of liquidity into the market through the purchase of treasury bonds and other medium- to long-term bonds. This action aims to increase the supply of base money after the implementation of a zero- or near-zero-interest-rate policy [4].

This paper contends that it is worthwhile to investigate whether China's current efforts to stimulate the economy, such as the central bank's purchase of treasury bonds, indicate the initiation of QE. Consequently, this study will examine the key characteristics of QE in the United States, Japan, and the Eurozone. Furthermore, it will evaluate the future trajectory of the Chinese central bank's monetary policy and explore novel instruments for China's macroeconomic policy.

2. Characteristics of QE from the Policies of Developed Economies

2.1. QE in Japan

Since the start of the 21st century, Japan has been dealing with a long-lasting economic slowdown. In order to address the limitations of traditional monetary policy, efforts have been made to implement quantitative easing. In February 1999, the Bank of Japan became the pioneer in implementing unconventional monetary policy by adopting forward guidance and quantitative easing. This decision was made in response to Japan's unsecured overnight lending rate dropping to 0 percent. To address the extended period of deflation resulting from the economic bubble burst over twenty years ago, the Bank of Japan (BoJ) adopted a bold quantitative easing approach by acquiring substantial amounts of individual bonds.

Following Shinzo Abe's election as Prime Minister of Japan on December 26, 2012, the BoJ has implemented a more assertive economic stimulus program in order to reach its goal of 2% inflation. On April 4, 2013, the BoJ established Quantitative and Qualitative Targeting as the primary operational objective of its monetary policy, with Quantitative and Qualitative Easing (QQE) serving as the primary mechanism for implementing this policy. QQE emerged as the primary monetary policy instrument of the BoJ [5]. QE, like the Federal Reserve's quantitative easing program, involves the BoJ increasing the size of its asset holdings by purchasing assets and injecting a significant amount of liquidity into the market. On May 22, 2020, the BoJ announced the implementation of an uncapped QE policy in response to the economic effects of the COVID-19 pandemic. This policy involves removing the limit on the speed of purchases, which was previously set at 8 billion yen per year, and allowing the purchase of Japanese government bonds based on actual needs without any maximum limit [6]. As of September 2022, the BOJ possessed more over 50 percent of the government securities issued by the Japanese Ministry of Finance in terms of market value.

2.2. QE in the US

From 2008 to 2012, the United States has implemented three rounds of QE, referred to as QE1, QE2, and QE3, respectively. QE involved large-scale purchases of financial assets (LSAPs), such as long-dated government bonds and mortgage-backed securities [7].

Following the emergence of the subprime crisis in the United States during the latter half of 2007, the Federal Reserve reduced interest rates in a series of ten consecutive cuts, from 5.25 percent to 0.25 percent. However, despite these efforts, the subprime crisis has not been successfully contained, and the United States Government is facing significant financial strain. To aid the U.S. economic recovery, the Federal Reserve declared on November 24, 2008, its intention to buy \$100 billion worth of bonds issued by Freddie Mac, Fannie Mae, and the Federal Home Loan Bank. Additionally, it pledged to guarantee \$500 billion of asset-backed securities. This marked the initial application of the QE monetary policy. Until the end of QE1 in March 2010, the Federal Reserve's holdings of securities climbed from \$496 billion in December 2008 to \$2.06 trillion in March 2010.

Affected by the expansion of the Greek sovereign debt crisis, the Federal Reserve initiated its second round of QE, known as QE2, in November 2010. This involved the purchase of \$600 billion worth of medium- and long-term United States Treasury bills. The last round of QE showcased two significant characteristics. Firstly, unlike the previous round, the Federal Reserve did not prioritize purchasing housing credit-related assets. Instead, they focused on acquiring medium- and long-term Treasury bonds issued by the Treasury. Furthermore, during the second phase of the QE program, the Federal Reserve not only disclosed the total amount of assets it intends to purchase, but also stated its intention to establish a specific timetable for achieving this objective. This was done to enhance the credibility and clarity of the Federal Reserve's loose monetary policy, as communicated to the market [8].

In 2012, the US economy once again shown indications of a recession. In mid-September 2012, the Federal Reserve initiated its third round of QE by implementing measures such as maintaining low interest rates until mid-2015 and acquiring an extra \$40 billion worth of mortgage-backed securities (MBS) each month. In contrast to the initial two rounds of QE, the third round of QE did not provide a specific goal for the total amount of asset purchases. Instead, it solely disclosed the monthly rate at which the underlying assets would be acquired. Nevertheless, this alteration included the potential danger that the Federal Reserve could only terminate the asset purchase program if the economy experienced a substantial improvement; otherwise, it would be equivalent to acknowledging the failure of the program. In a Federal Open Market Committee press conference on 19 June 2013, the then Fed Chairman Ben Bernanke announced that the Federal Reserve would gradually decrease the scale of its asset purchases later that year if employment and inflation were showing positive performance. Ben Bernanke further stated that the asset purchase program would eventually be completely halted by mid-2014 [9].

In 2020, the United States is also confronted with an unparalleled outbreak of the COVID-19. There was a widespread halt in economic activity in the United States and a swift increase in unemployment. Consequently, as Figure 1 shows, the consumer price index experienced its first decline in ten years. Furthermore, the turbulence in the financial markets resulted in four instances of stock market crashes and prompted the activation of the meltdown mechanism. The United States Federal Reserve has indicated its intention to resume QE in order to restore macroeconomic stability. In order to address this, it would be necessary to make an extra \$700 billion worth of asset purchases in the upcoming months, in addition to implementing two interest rate reductions. Nevertheless, it failed to halt the ongoing decline of the US stock market. On March 23, 2020, the Federal Open Market Committee (FOMC) released a statement declaring the implementation of unrestricted QE.

They declared their plan to acquire an indefinite quantity of U.S. Treasuries, agency mortgage-backed securities, and commercial mortgage-backed securities as required.

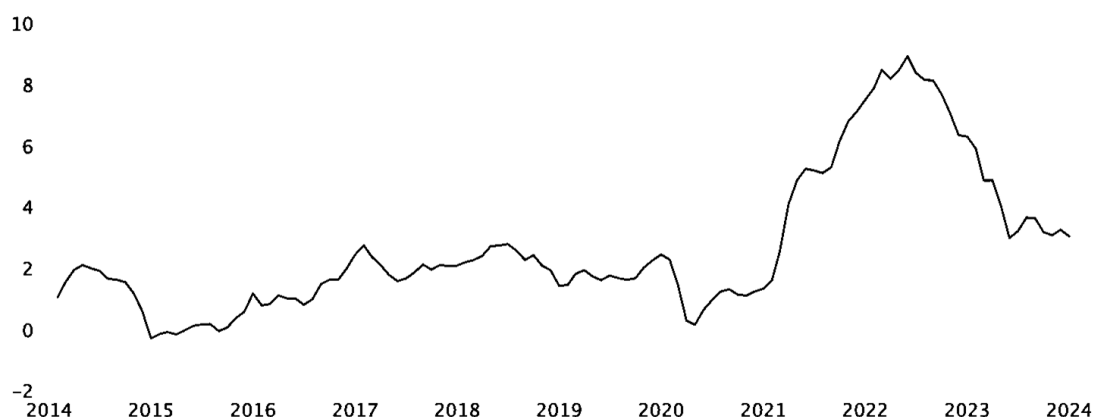


Figure 1: Consumer Price Index (CPI) Growth in U.S., 2014-2024

2.3. QE in Eurozone

In contrast to the United States and Japan, the Eurozone has exercised a slightly more cautious approach towards implementing QE. Even during the depths of the recession in 2008 and 2009, the European Central Bank (ECB) refrained from directly purchasing government bonds. This decision was driven by the ECB's concern that such actions would be perceived negatively by external parties, as it would involve printing money to alleviate debt burdens for financially irresponsible member states, potentially damaging the bank's reputation. In order to lessen the impact of the debt crisis, the ECB initiated a more relaxed approach to monetary policy. This involved officially deploying QE starting in March 2015, with monthly purchases of €60 billion worth of government bonds from eurozone member states, as well as asset-backed bonds (ABS), Covered Bonds, and EU agency bonds [10].

In December 2018, the ECB formally declared the conclusion of its extensive bond buying program, which amounted to 2.6 trillion euros (\$3 trillion) in bond purchases over a period of almost four years [11]. Through the implementation of the QE program, the European Central Bank's balance sheet has significantly expanded to approximately €4.65 trillion, surpassing its size in early 2015 by more than double. At this point, it was the second largest balance sheet globally, with the Bank of Japan being the only institution with a larger balance sheet [11].

In response to the challenges posed by the COVID-19, the ECB has implemented a monetary strategy that bears resemblance to that of Japan. The announcement of a 120 billion Euro increase in bond purchases and a 600 billion euro increase in the Emergency Anti-COVID-19 Bond Purchase Programme (EABP) signifies a continuation of the monetary policy's efforts to stimulate the economy.

2.4. The Impact of QE

Based on economic theory, it is believed that QE will ultimately result in worldwide hyperinflation. This means that "watering down" the currency will inevitably cause an increase in commodity prices. Undoubtedly, central banks may effectively reduce long-term interest rates, encourage borrowing and investment, facilitate job creation, and support economic recovery and growth by acquiring substantial quantities of bonds and assets through QE.

Nevertheless, upon reflecting on the transformations in the aforementioned three affluent economies throughout the years, the impact of QE is diminishing. Despite the significant increase in the combined balance sheets of the world's four largest central banks - the BOJ, the ECB, the Federal

Reserve, and the PBOC - from \$5 trillion (8% of global GDP) in 2006 to \$31 trillion (32% of global GDP) in 2021, inflation in advanced economies has remained low [12].

Simultaneously, due to the extended application of QE, rates at the longer end of the yield curve are too low, which diminishes the connection between risk and potential gain, and also exposes them to substantial unforeseen hazards. According to Joseph Gagnon, an economist at the Peterson Institute for International Economics in Washington, D.C., the ECB has reached its limit for implementing additional QE. Furthermore, the fact that yields on all of Germany's sovereign debt, which is typically regarded as the safest asset in the region, are now below zero implies that investors will incur losses simply by holding these bonds. In addition, QE may be less effective in offsetting economic shocks that are not triggered from within the financial system [13].

3. QE with Chinese Characteristics Sets China Apart from the US, Japan and Eurozone

3.1. Controversial QE in China

In fact, QE is not new to China. In the 1990s, China's four largest state-owned commercial banks suffered huge losses. Media estimates indicate that by the end of 2002, the non-performing rate of the four major state-owned commercial banks had reached 26.12 percent, suggesting that they were already technically bankrupt [14]. In 1999, the Chinese government faced a fiscal revenue of 584.9 billion yuan and a fiscal deficit of 174.4 billion yuan, as reported by the CEIC Data. This financial situation prevented the government from using fiscal measures to address the issues of the four major state-owned commercial banks. Consequently, the Chinese government and the central bank implemented refinancing and divestment strategies for these banks, specifically targeting their non-performing assets. This action helped reduce the risk of bank insolvency and brought stability to the country's financial sector. Although China has not been linking refinancing to QE, both intervene in the economy through the creation of money by the central bank.

Furthermore, in 2008, China took action in response to the financial crisis by initiating a stimulus package known as the "four trillion yuan" stimulus program. While not officially recognized as China's QE, it can be considered a sort of "QE" by examining the exact sources and characteristics of the funds in Table 1. However, this softening policy differs significantly from the United States of America's more aggressive approach to water release.

Table 1: Sources of funding for the "four trillion yuan"

Source	Amounts (billions)
Fiscal deficit	7500
Local bond	2000
Corporate Bonds	2000
Corporate Bonds	28000

China's central bank is currently considering the implementation of QE measures by engaging in the buying and selling of government bonds in the secondary market. This action aims to enhance the effectiveness of its monetary policy. However, in contrast to the central bank bond purchases in the United States, Japan, and Europe, the central bank of China is stipulated to conduct its bond purchases on the secondary market. Additionally, any future central bank operations related to treasury operations will also involve two-way transactions.

3.2. The Uniqueness of China's QE

Upon examining China's "QE", it becomes evident that it diverges dramatically from the QE policies used in the United States, Japan, and Eurozone. China's QE policy injects vitality into the market by generating additional money, but it is characterized by a more systematic and cautious approach. Firstly, China's QE strategy has prioritized the coordination between monetary and fiscal policies. To a significant degree, QE in China has been a modification of fiscal policy. Furthermore, considering the overall situation, the PBOC still possesses a significant capacity to reduce both interest rates and interest rates. Unlike certain developed economies, China's central bank did not adopt a zero-interest rate policy. Furthermore, in recent years, the central bank of China has extensively utilized treasury bonds as collateral in its monetary policy operations. However, based on the current balance sheet of the central bank, the direct holdings of treasury bonds by the central bank of China represent a relatively small proportion of the total volume. Therefore, there is still a reasonable amount of flexibility available.

4. Effective Fiscal and Monetary Mix Adequate Financial Instruments Policy

Market liquidity remains ample, as funds rates are close to the interest rate used to stabilize the economy. The monetary policy toolkit is well-equipped with quantitative measures, including rate cuts, interest rate reductions, and other price-based instruments. Simultaneously, China's monetary policy places greater importance on maintaining a healthy balance sheet and managing inflation expectations rather than engaging in excessive money supply and surpassing monetary targets. Thus, it is imperative for fiscal and monetary policies to utilize their respective efficacious instruments, both autonomously and in conjunction, in order to attain favorable policy outcomes.

Thus, China's policy strategy for 2024 will involve a coordinated effort to manage both wide money and broad finance.

China's current situation involves the implementation of an active fiscal policy aimed at boosting domestic demand. This is achieved through measures such as tax rebates, tax credits, issuance of local special bonds, tax incentives for technology research and development expenses, and steady growth of government and private investment. The focus is on precision and sustainability, with the goal of improving quality and making structural adjustments. Moreover, the monetary policy is cautious and aims to maintain a moderate level of liquidity. Policy decisions are made based on a combination of aggregate and structural regulation.

China's economic recovery is currently facing pressure, but the monetary conditions index remains low due to the impact of the COVID-19. This indicates that the monetary environment is still relatively tight. However, with the Federal Reserve's interest rate cuts and the weakening of external constraints, there is potential for further expansion of monetary policies. Simultaneously, spontaneous financing remains weak and heavily reliant on government debt support. In the short term, this situation is unlikely to alter, with the central government debt likely to continue as the primary source of funding. On the one hand, local governments have mostly concentrated on issuing special refinancing bonds between August and October 2023. On the other hand, although there is still some room left within the local government debt ceiling, the potential for substantial issuance in 2024 may be restricted. Alternatively, if central transfers are increased, it could alleviate the financial limitations faced by local governments and provide them with more options for fiscal policy. This includes the ability to spend more on climate change mitigation and adaptation measures, as well as social security. Additionally, reducing transaction costs for direct transfers from the central government to financially struggling municipal and county governments would ensure that funds are more effectively distributed at the local level.

5. Conclusion

This article examines the attributes of China's QE primarily by comparing it to the QE policies implemented by advanced economies. Initially, the article examines several significant QE advancements in the United States, Japan, and the Eurozone, and assesses their influence on the worldwide economy. Subsequently, the paper examines the progression of China's QE and juxtaposes it with that of advanced nations. It then scrutinizes the distinctive features of China's QE and anticipates future policy orientations. This study concludes, based on research, that China's QE policy is characterized by greater flexibility, reasonableness, and prudence. In contrast to the QE implemented by developed countries, China's "QE" is not unilaterally compelled to "release water," but rather utilizes a combination of fiscal and monetary measures. Both monetary mechanisms for regulating market behavior and fiscal measures for risk control.

Subsequent studies can go deeper into "QE" with distinct Chinese attributes, so establishing a theoretical basis for future evaluations of economic development.

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