Evaluating the trade-offs between immediate advantages and long-term dangers will determine whether central banks should pursue an expansionary monetary policy during recessions. On the one hand, expansionary policies like interest rate reductions and quantitative easing can support economic growth and help avert severe, protracted recessions. Lower rates make borrowing cheaper, encouraging consumption and investment spending. Asset purchases inject liquidity into the financial system. This additional stimulus can boost output and employment in the near term.

However, expansionary policy does have downsides. As mentioned, it leads to the accumulation of debt by firms, households, and governments. This debt eventually needs to be repaid or refinanced, which creates headwinds for growth down the road. Asset purchases can distort prices in bond and stock markets. Maintaining a loose policy for too long risks higher inflation. Central banks may then have to abruptly tighten policy, destabilizing the economy.

There are reasonable arguments on both sides. In moderation, expansionary policy seems justified to smooth out the business cycle. To avoid overstimulating the economy or keeping policy overly lax for an extended period, central banks should exercise caution. Although expansionary policy can lessen short-term suffering, it does come with risks, expenses, and trade-offs that policymakers must consider in the long run.

References:

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