

Pandemic Bills Are So Big That Only Money-Printing Can Pay Them

By Ben Holland, Liz McCormick and John Ainger

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Barriers between monetary and fiscal policies are disappearing. Federal Reserve is set to buy \$3.5 trillion of bonds this year

Forced into record spending by the threat of another Great Depression, policy makers are blurring the lines between borrowing the money they need and simply creating it. Most modern economies have tried to keep the two activities as separate as possible. The typical setup has been for elected politicians to take charge of budgets, and meet any shortfall by borrowing on bond markets — while the money-printing machinery was walled off in another branch of government, the central bank. But those barriers began to look porous after the financial crisis of 2008. And in the coronavirus slump, they've all but disappeared.

With entire industries shuttered and unemployment soaring, only public spending is keeping millions of households and businesses afloat. The governments on the hook for this relief effort are running up some of history's biggest budget deficits. And they're paying at least some of the bills with what are effectively loans from their own central banks — debt that can be rolled over indefinitely, and is really more like money.

"We've had a merger of monetary and fiscal policy," says Paul McCulley, the former chief economist at Pacific Investment Management Co. "We've broken down the church-and-state separation between the two."

"We haven't had a declaration to that effect," says McCulley, who now teaches at Georgetown University. "But it would be surprising if you had a declaration -- you just do it."

In the U.S., the Federal Reserve is set to buy \$3.5 trillion of bonds this year, according to Bloomberg Economics estimates. Most of that will be Treasuries, covering the best part of a [fiscal shortfall](#) forecast to reach at least \$3.7 trillion. Nobody knows when the debt will be offloaded from the public balance sheet into the hands of private investors, if it ever is. Similar stories are playing out across developed economies from Europe to Japan -- and even in some emerging markets, with Indonesia and Poland joining the fray.

Behind the longstanding taboo against what is known as "monetizing debt" lies the fear of inflation. History is full of episodes when politicians grabbed control of the printing presses and splashed too much money around the economy, causing prices to spiral out of control and eroding the real value of all kinds of savings, from bank accounts to bond portfolios.

Central banks were kept apart from the rest of government precisely in order to apply the brakes when politicians went too far. That autonomy will likely be needed again one day, says McCulley, who helped steer Pimco through the 2008 financial crisis and came up with terms like "shadow banking" and "Minsky moment" to define it. "It's just not needed now. So for now, let's just suspend it."

In the pandemic, economists see the threat as coming from the opposite direction — with deflation a bigger risk. In slow-growing developed countries, policy has already been tilted that way for years. The challenge was to stimulate economies, not cool them down. When policy makers ran out of room to do it by cutting interest rates, they tried other ways. The effect was

gradually to undermine the orthodox separation of monetary and fiscal policies. Looking back, it's hard to see exactly if or when the Rubicon was crossed.

After Japan became the first country to hit zero rates in the late 1990s, its finance ministers stepped up deficit-spending while central bankers started to buy up the resulting debt. The purchases were made via banks, not directly from the finance ministry -- and they were billed as temporary holdings, not permanent ones. Those nuances allowed policy makers to argue that no monetization had occurred. Critics weren't persuaded. But the things they warned about, like a spike in inflation or flight from bond markets, never happened.

After the 2008 crash, the debate got replayed all over the world as more countries combined bigger budget deficits with so-called quantitative easing. The Fed bought Treasuries in the open market, through a select list of dealers, and other central banks made similar arrangements. And those policies have been taken even further in the current pandemic.

There was no real alternative, according to Stephen Roach, a senior lecturer at Yale. "The economy is in the biggest hole it's ever been in, so we need massive fiscal stimulus," he said. "The central bank has to be brought in to fund it".

That doesn't mean there are no consequences, said Roach, a former nonexecutive chairman of Morgan Stanley in Asia. In the U.S., the Fed-backed spending spree means that "inflation is likely to begin moving up post-virus," he said. "Bond-holders always get punished in a period of rising inflation."

It's been decades since developed economies endured anything remotely like that. Inflation has remained subdued or non-existent, however much governments borrowed or central bankers lent. Its long absence has spurred calls for even bolder policies to drag economies out of the virus slump, even if that means further blurring the lines between debt and money.

In the European Union, for example, veteran investor George Soros has proposed that member states join forces to issue "perpetual bonds" that never have to be repaid. He suggested they might pay a coupon rate of 0.5% or so. Lower that by a half-point and the securities would basically be cash, says Alessandro Tentori, chief investment officer at Axa Investment Managers in Milan. "There would be no difference between a 0% perpetual bond and a coin."

Minting coins — platinum ones, worth \$1 trillion each — is what the U.S. Treasury would do under a [bill](#) submitted by House Democrats Rashida Tlaib and Ilhan Omar. The measure would fund stimulus checks for households without adding to the national debt and triggering a fight about repayment down the road, its backers say.

If those steps are far-fetched, others are already under way. The Bank of England extended an overdraft to the government. New Zealand's central bank said it was open to buying sovereign bonds directly. The Bank of Japan has been pegging 10-year government debt around 0%, a policy known as yield-curve control that may get adopted more widely.

Governments and their central banks will likely stop short of overtly turning public debt into money, judging that the risks to monetary stability outweigh any benefits, according to Nicola Mai, a portfolio manager at Pimco:

"I don't think you necessarily need that explicit cooperation," he says. "It's an implicit cooperation." But the result isn't so different: "The bank is effectively backing the sovereign market -- allowing the government to spend money."