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For professional investors

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Helicopter money flies into view at central banks

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- **Standard monetary policy measures are becoming ineffective**
- **Evidence mounts that negative rates does more harm than good**
- **The time may becoming for a more direct injection of QE money**

Helicopter money is moving onto central banks' radar as they run out of ammunition to stimulate economies, says Robeco's Lukas Daalder.

It follows fears that after years of historically low interest rates that in some countries are now negative, and endless quantitative easing through bond purchases, the time may be coming to give cash directly to the public.

Under this kind of drastic action, money is metaphorically thrown out onto the streets from a helicopter, though in reality it would be paid into millions of private bank accounts. While directly stimulating public spending, it has the added bonus of creating much-needed inflation, or at least staving off deflation.

"Monetary policy is running out of steam, and the time may be approaching for a more radical solution to economic stagnation," says Daalder, Chief Investment Officer of Robeco Investment Solutions. "Trying to stimulate economies by taking the financial markets route is pretty indirect. Lower interest rates and bond yields seem to have lost their ability to stimulate the economy and might even have become part of the problem."

Buying bonds is losing its effectiveness

"Buying more bonds and pushing the yield curve further into negative territory appears to be losing its effectiveness, though that does not mean that the central banks are running out of options. With a printing press at your disposal, you can go a long way, as long as you are willing to make the jump."

"One option is to expand purchases into Real Estate Investment Trusts (REITs) or equities, a step already taken by the Bank of Japan. Although this has the advantage that it does not affect interest rates and yields, it is still a pretty inefficient way of trying to stimulate the economy."

"A more direct way would be to finance public spending directly or set up and finance an infrastructure investment fund. And the most direct route of all would be to take the big step of handing out money directly to people, popularly known as QE for the people, or helicopter money."

'Where there is a will, there is a way'

"For sure, all of these options come with risks and (legal) limitations, and have been considered too radical in the past. However, faced with the risk of a loss of confidence in central banks and the financial system at large, or going for the next step of helicopter money, the outcome is probably going to be for the second option. Where there is a will, there is a way."

Five reasons not to be cheerful

Daalder cites five reasons why the methods used so far, led by QE and negative rates, won't work for much longer:

- Their impact on bank profitability. Charging money on deposits held by banks at the central bank will have a negative impact on their earnings, hurting their ability to lend money to the real economy.
- The move to cash. Negative rates do not apply yet for consumer deposits, but once we get to that point, it could trigger an unwanted move towards cash, to escape the 'tax' of keeping money in the bank.
- The lost element of positive surprise. Stimulative measures so far have been largely supported by financial markets as currencies fall, stocks rally and inflation expectations rebound, but this is becoming less impactful, and more recent moves have caused negative reactions.
- No boost to the economy: Low rates normally promote consumption and investments, but it is questionable whether a minus 0.5% interest rate environment would benefit growth and jobs. If companies and consumers cannot be tempted to spend more at 0%, it is highly questionable whether they will do so at -0.5%.
- Encouraging debt(ors): While lower rates do have a positive effect for consumers (lower mortgages), producers (margins) and governments (deficits), it also leads to an incentive to increase debt, leading to future problems.

'Faith in monetary policy appears to be wavering'

"These arguments all seem to point in the direction that monetary policy is indeed experiencing diminishing returns," says Daalder. "The recent experience in Japan in introducing negative rates, although clearly frustrated by the turmoil in the international financial markets, only serves as a clear example that a small additional rate cut can lead to a negative outcome."

"Given the crucial role that central banks have played in the developments in financial markets, either indirectly (by supplying the famous 'put option' under the stock market) or directly (by buying bonds), it is clear that this credibility issue is not without risks. The fact that during the last six months all three of the major central banks have triggered sell-offs in the stock markets (the Fed in September 2015, the ECB in December 2015 and the Bank of Japan in February 2016), does not help confidence either. Faith in monetary policy appears to be wavering."

Central bank credibility at stake

Daalder says such negative reactions may prompt central banks to resort to drastic action to try to restore their credibility. "If the medicine starts to hurt more than the good that it does, it is clear that this raises concerns about the credibility of the policy pursued, if not central bank policy at large," he says.

"This does not mean we are heading for a meltdown of confidence in central banks and with it the financial system at large. But the 'things would be a lot worse if we had not done this' argument by central banks is impossible to test so long as they are all pursuing the same policy mix. And there are some clear signals though that this 'more of the same' approach is reaching the end of the line in terms of effectiveness."

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