Fiscal Dominance

- A new era for central banks
  - Started with Fed QE in March 2009
  - QE was intended as a cyclical tool at ZLB
  - But that cyclical aspect has gone missing
  - Central bank debt holdings only go up

- Fiscal fragility is rising
  - Spending needs are high
  - Public debt levels are elevated
  - Recent bond market accidents:
    - US: March 2020
    - Euro zone: June 2022
    - UK: September 2022

- Fiscal dominance of G10 central banks
  - Fiscal dominance is extreme for the BoJ
  - No sign of fiscal dominance for the BoE
  - All others – including ECB – in between
The G10 Central Banks

- There’s a spectrum of fiscal dominance across G10 central banks
- Bank of Japan is at one end of the spectrum: full fiscal dominance
- The Bank of England is at the other end: zero fiscal dominance
- Every other G10 central bank – including ECB - is in between
- A monetary union without a fiscal union
- Implicit subsidy of high-debt sovereigns is large
- COVID QE dropped capital key and reduced data transparency
- Coming full circle: Europe’s new fiscal rules use market interest rates
ECB

- ECB buys debt issuance in bad shocks
- That ECB buying keeps interest rates low
- Budget deficits post-COVID are staying wider
- Latest fiscal rules will not help remedy this
The United States is not immune
Debt issuance has shifted to very short tenors
Intention is likely to reduce upward pressure on long yields
This has eased financial conditions (runs counter to the Fed)