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Evaluating Quantitative Easing: The Importance of Accounting for Forward Guidance

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Failing to account for concurrent changes in the FOMC's forward guidance could overstate the effects of asset purchase programs.

During the COVID-19 pandemic crisis, policymakers used large-scale asset purchases (LSAPs) along with forward guidance about the future path of the federal funds rate to help stabilize financial markets. However, policymakers and economists have yet to reach a consensus on the efficacy of LSAPs in providing accommodation and improving macroeconomic outcomes. Because announced changes in LSAPs often coincide with changes in forward guidance, the market responses to these two tools can be difficult to disentangle and each tool's efficacy challenging to evaluate.

Brent Bundick and A. Lee Smith attempt to measure the efficacy of the FOMC's previous asset purchase programs during the Great Recession while explicitly accounting for changes in forward guidance. They find that controlling for concurrent changes in forward guidance implies a roughly 25 percent reduction in the accommodative effects of the FOMC's first two asset purchase programs relative to estimates that do not disentangle the two tools. The effects of an asset purchase program could thus be overstated if researchers fail to account for changes in interest rate uncertainty induced by forward guidance occurring at the same time.

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