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A BNP Paribas Investment Partner

# Weekly commentary


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## Deploying helicopters for economic stimulus


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### Key takeaways

- The economic malaise that followed the financial crash of 2008 has prompted central banks around the world to explore new, innovative monetary policy measures to stimulate their economies in the face of weak demand and low inflation.
- More extreme options may be considered in the future, including a permanent cash injection into the economy, also referred to as a 'helicopter drop'.
- Many central banks have already set off down the road towards helicopter drops through Persistent QE, in which bond purchases are not reversed for many years, if not decades.
- The Bank of Japan may be going further down this road than other central banks, given the possible pairing of fiscal stimulus with additional QE by the end of the year. In this manner, the central bank effectively monetizes government debt, even if authorities refrain from saying so.

### Full commentary

The economic malaise that followed the financial crash of 2008 has prompted central banks around the world to explore new, innovative monetary policy measures to stimulate their economies in the face of weak demand and low inflation. To date, some of the unconventional tools used by monetary leaders to inject stimulus have included large-scale asset purchase programmes, negative deposit rates and multi-year fixed-rate loans to banks. However, inflation has yet to recover, so the period of innovation may not yet be over. As a result, more extreme options to prompt a recovery have been considered, including a permanent cash injection into the economy, also referred to as a 'helicopter drop'. Below, we describe a range of policy interventions that fit under the broad umbrella of a helicopter drop of money, assess their likely impact and highlight some of the constraints on implementation.

By definition, helicopter drops allow policymakers to better stimulate the economy by putting cash directly in the hands of the general public as opposed to relying on traditional, more indirect measures of monetary stimulus. While unconventional monetary policy still plays a pivotal role in the real-world implementation of a helicopter drop, the technical details are far less radical than you might think.

Popularized by American economist Milton Friedman, helicopter drops call for the central bank to print currency and distribute it to the public. However, while central banks may be well-equipped to distribute cash to banks, finance ministers are better positioned to deliver cash to households and companies through their ready-made distribution pipelines, the tax and benefit system. While the central bank might finance the drop, the government would likely distribute it.

In practice, central bank financing of government cash distributions can be accomplished as follows:

1. The government finances a fiscal stimulus program by issuing bonds, which the central bank buys in the secondary market and commits to holding indefinitely
2. When the bonds mature, the central bank simply reinvests the proceeds back into new bonds. All interest income that the central bank receives from the government on its bond holding is remitted back to the government.

### This week's market developments

**Monday, June 6**
- Germany Factory Orders growth decreased to -2.0% m.o.m. (s.a.) for April

**Tuesday, June 7**
- Germany Industrial Production growth increased to 0.8% m.o.m. (s.a.) for April
- Eurozone First Quarter GDP growth (final estimate) increased to 0.6% q.o.q
- Japan First Quarter GDP growth (final estimate) increased to 0.5% q.o.q

**Wednesday, June 8**
- UK Industrial Production growth increased to 2.0% m.o.m. (s.a.) for April
- UK Manufacturing Production growth increased to 2.3% m.o.m. (s.a.) for April
- Japan Machine Orders growth decreased to -11.0% m.o.m. (s.a.) for April

**Thursday, June 9**
- US Wholesale Inventories growth increased to 0.6% m.o.m. for April

**Friday, June 10**
- US University of Michigan Sentiment Index (preliminary estimate) decreased to 94.3 for June

Source: Bloomberg, as of end June 10, 2016

The key thing to note is that what distinguishes the drop from ordinary quantitative easing (QE) is the central bank's commitment to hold the bonds in perpetuity. From the finance ministry's perspective, the drop could prove more powerful than a conventional fiscal stimulus because the cash injection is never paid for through future tax receipts. From the central bank's perspective, the drop could prove more powerful than a conventional monetary stimulus because the injection of money is permanent, which is consistent with a higher path for prices.

Other forms of helicopter drops are also possible, but the key element they share is the central bank's permanent cash injection into the economy. For political and legal reasons, including prohibitions in some jurisdictions on direct central bank financing of government spending, the central bank may not be able to fully commit to a permanent cash injection. In any case, it is unclear whether the market would view any announcement of a helicopter drop as 100% credible. As a result, weaker forms of helicopter drops are more likely to occur. In fact, one could argue that some central banks have already engaged in these. Persistent QE by the Federal Reserve, European Central Bank and Bank of England is one form of a helicopter drop, where the public comes to expect that bonds purchased by the central bank will be held for years, if not decades. For example, the Federal Reserve began asset purchases over seven years ago and is unlikely to unwind its purchases and remove the associated cash from the system for another five years. The prospect of weak growth or a recession could delay the cash withdrawal even longer.

The Bank of Japan (BoJ) has gone a step further than the three aforementioned central banks by engaging in Enhanced QE, which we also refer to as a Stealth Drop. In a Stealth Drop, fiscal stimulus and QE occur around the same time, and the public has little-to-no expectation that the central bank will ever unwind these bond purchases. An additional Stealth Drop may soon be imminent – investors are already discussing the possibility of the Abe Administration delaying a VAT hike while the BoJ increases its QE program.

For additional information please refer to the Central Bank Watch: Everything you ever wanted to know about helicopter drops (but were afraid to ask).

## Central Bank watch

| | Last move | Date of move | Current policy rate | Implied 3m rate on September 2016 Interest Rates Futures Contract | Next meeting |
|---|---|---|---|---|---|
| **Fed** | +25 basis points | December 16, 2015 | 0.25 % - 0.50 % | 0.43 % | June 15, 2016 |
| **ECB** | -5 basis points | March 10, 2016 | 0.00 % | -0.20 % | June 21, 2016 |
| **BoJ** | -20 basis points | February 16, 2016 | -0.10 % - 0.00% | 0.01 % | June 16, 2016 |
| **BoE** | -50 basis points | March 5, 2009 | 0.50 % | 0.56 % | June 16, 2016 |

Source: Bloomberg

## Next week's market developments

**Tuesday, June 14**

- UK CPI growth is expected to increase to 0.4% y.o.y. for May
- UK Core CPI growth is expected to increase to 1.3% y.o.y. for May
- UK PPI Output growth is expected to increase to -0.5% y.o.y. for May
- US Retail Sales Advance growth is expected to decrease to 0.3% m.o.m. (s.a) for May

**Wednesday, June 15**

- US PPI Final Demand growth is expected to increase to 0.3% m.o.m. (s.a.) for May
- US Industrial Production growth is expected to decrease to -0.2% m.o.m. (s.a.)

**Thursday, June 16**

- Eurozone CPI growth is expected to increase to 0.3% m.o.m. for May
- US CPI growth is expected to decrease to 0.3% m.o.m. for May

**Friday, June 17**

- US Housing Starts are expected to decrease to 1,149,000 (s.a.a.r.) for May

Source: Bloomberg, as of end June 10, 2016

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