



L'Éco en court – Episode 14

Quantitative easing: when key interest rates are no longer enough

(recorded on 24/02/2026)

Introduction

VOICE-OVER: In our previous episode, we saw how central banks use key interest rates to maintain price stability.

They raise them to curb inflation and lower them to support lending and economic activity and a return to their inflation target.

But what happens when this tool has gone as far as it can go? When key interest rates are already at zero – and even below – and the economy is still struggling?

It is precisely in response to this situation that central banks developed a completely new tool: quantitative easing (QE). So let's take a look at this unconventional monetary policy instrument.

My name is Lucile and I work at the Banque de France. Welcome to L'Éco en court.

SECTION 1. Why key interest rates alone are no longer enough, and how QE steps in

VOICE-OVER: Let's look-back to 15 September 2008.

David Pujadas, excerpt from the 8.00 p.m. news broadcast on France 2.

In the news tonight: a storm on the financial markets. The prominent investment bank Lehman Brothers declares bankruptcy, a victim of the subprime crisis. Stock markets are plummeting. The Paris stock exchange has lost nearly 4%.

The financial crisis is global: trust between banks has collapsed and they no longer lend to each other. The interbank market is at a standstill, lending to households and businesses has dried up, economic activity is in freefall, and deflation looms.

Central banks react as they would normally do: they cut their key interest rates to lower the refinancing costs for banks, support economic activity and maintain the general price level.

They cut them again, and again, right down to 0%.

François Villeroy de Galhau, Governor of the Banque de France:

EXTRACT – François Villeroy de Galhau: *But there have been times when interest rates have reached very low levels, 0%, or even turned temporarily negative, meaning we could no longer use the weapon of interest rates.*

VOICE-OVER: Negative key interest rates – what does that mean? For example, in March 2016, the European Central Bank set its deposit facility rate at -0.4%. Practically speaking, this means that banks have to pay to deposit their liquidities in their accounts held with the central bank. The objective: to encourage them to use their liquidities to grant loans and thereby revive the economy. But against a backdrop of lacklustre growth and the looming risk of deflation, even that is not enough. Conventional monetary policy, which relies on key interest rates, no longer works. A new tool is needed.

EXTRACT – François Villeroy de Galhau: *So we used what we call unconventional measures, notably by using the size of the central bank balance sheet and the ability to purchase public assets – quantitative easing, or QE. These were times when inflation was too low.*

VOICE-OVER: Despite its somewhat technical name, quantitative easing is based on a simple idea: if very low key interest rates are no longer enough to encourage banks to grant loans, central banks will inject liquidity directly into the economy. But how? By buying massive amounts of bonds – debt securities, and most often government debt securities – that were already held by banks.

To pay for these purchases, central banks create central bank money by crediting the reserve accounts held for those banks. The banks therefore get liquidity that they can use to grant more loans, refinance their own activities, invest, or purchase other assets.

And above all: these massive purchases increase demand for bonds already in circulation, pushing up their price and bringing down their rate of return – as bondholders are paid a fixed rate, when the securities become more expensive to buy, their return declines mechanically. The decline in the rate of return is not limited to bonds already in circulation: it spreads across the entire bond market and, in particular, to newly issued bonds.

However, government bonds, and particularly those issued by western governments, are considered a very safe form of borrowing. Government bond yields therefore act as a benchmark rate for setting the cost at which businesses and households can borrow as well. The result: if governments borrow at a lower cost, so do businesses and households.

EXTRACT – François Villeroy de Galhau: *Buying public assets is a way of influencing interest rates, notably long-term rates. The central bank sets key interest rates – short-term rates – directly, and when we buy bonds, this is a way to lower long-term interest rates as well, injecting liquidity into the economy, and thus stimulating economic activity and pushing inflation up towards 2%.*

SECTION 2. QE or printing money: a fundamental distinction

VOICE-OVER: At this point, the question that often arises is, “Isn’t a central bank buying government debt a way of financing governments by creating money?” The infamous “printing money”. The answer is a definite no.

EXTRACT – François Villeroy de Galhau: *We purchased public assets, but it wasn’t to finance states. I think it’s important to stress that because it can be ambiguous sometimes. Our only focus is the mandate I talked about earlier, the 2% inflation target. Quantitative easing isn’t a way of financing states. I sometimes hear in French political debate that the ECB holds the key to France’s fiscal problems. That’s completely false. So how do we make sure there’s no monetary financing? There are two main rules. The first is that the purchases can’t be made on what we call the primary market, in other words at auction, but rather on the secondary market, from private investors.*

VOICE-OVER: The first safeguard: the ECB does not buy newly issued bonds directly from governments – they only buy them on the secondary market, from investors who have already purchased them. This separation ensures that governments are financed first at market conditions, via private participants who assess the price and risk.

François Villeroy de Galhau: *And then there’s a second rule which is that for each security there are limits to how much we can buy. In each case only a minority of securities can end up in central bank hands.*

VOICE-OVER: These two rules ensure the independence of central banks from governments – a guiding principle of modern monetary policy. Central bank interventions are thus intended to influence overall financial conditions (particularly medium and long-term interest rates), and not to provide direct funding to governments. The objective is clear: to stimulate economic activity and push inflation up towards the 2% target.

SECTION 3. The history of QE: from Japan to the pandemic

VOICE-OVER: Large-scale QE was first used in 2001 by the Bank of Japan. In the euro area, the ECB has implemented it twice. The first time was between March 2015 and September 2016 when the ECB launched the APP – the Asset Purchase Programme.

Excerpts from the press conference given by Mario Draghi, President of the European Central Bank, on 5 March 2015.

We will, on 9 March 2015, start purchasing Euro-denominated public sector securities in a secondary market.

We have already seen a significant number of positive effects from these monetary policy decisions. In particular, borrowing conditions for firms and households have improved considerably. Thereby, our measures will contribute to a substantial return of inflation

towards a level below, but close to 2% over the medium term and underpin the firm anchoring of medium to long-term inflation expectations.

VOICE-OVER: Then, in March 2020, the Covid-19 pandemic struck. The PEPP – the Pandemic Emergency Purchase Programme – was decided from homes under lockdown in a matter of hours.

EXTRACT – François Villeroy de Galhau: *I have a very vivid memory of the start of Covid: in March 2020, activity plummeted, there were real fears of economic deflation, and we held an extraordinary Governing Council meeting in mid-March. When everybody was locked down at home, I was on the phone and within two hours we decided to launch the biggest asset purchase programme – unanimously, including the most hard-line members of the Governing Council, because something had to be done to support activity and bring inflation up to 2%.*

SECTION 4. Where do we stand now?

VOICE-OVER: While quantitative easing has undoubtedly played a stabilising role during major crises, it still has its limitations: its effectiveness on the real economy depends on bank and investor behaviour, and it leaves the balance sheets of central banks significantly bloated.

But in 2022, the situation changed radically. As the health crisis came to an end, consumption picked up quickly but then the war in Ukraine sent energy prices soaring. The result: inflation reached levels that had not been seen in decades. The priority for central banks shifted: it became a question of cooling down demand, not stimulating it. So central banks raised their key interest rates and began reducing their balance sheets in a process known as quantitative tightening. The Fed set out on this path in March 2022 with the ECB following suit in July of the same year: a return to conventional key interest rates.

Conclusion

VOICE-OVER: Thank you all for listening. A big thank you also to Paul Sabalot for his help in writing this episode. In the next episode, we will continue to explore the monetary policy instruments available to central banks and we will see that there is a subtle tool that makes no purchases, does not create money, and yet alone can be enough to calm panicked financial markets. That tool is communication. Till next time!