Discussion of *"Macroeconomic and fiscal impacts of quantitative easing in New Zealand"*

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1 Introduction

The paper by Chipeniuk et al. (2025) provides a rigorous and policy-relevant assessment of New Zealand's Large-Scale Asset Purchase (LSAP) programme during COVID-19. The backdrop of this work is that the pandemic caused a collapse in global demand, financial volatility, and mobility restrictions. With the policy rate near the effective lower bound, the Reserve Bank of New Zealand (RBNZ) faced severe limits on conventional tools. In response, it launched several unconventional measures, most notably the LSAP, which expanded its balance sheet through large purchases of long-term government bonds. Fiscal authorities complemented this with programmes to boost aggregate demand.

The LSAP programme, amounting to nearly 59 billion NZD, represented an unprecedented intervention and quickly became a focal point of political and public debate. Questions emerged regarding its effectiveness, distributional implications, and its effects on inflation as well as the exchange rate. Concerns also centered on the fiscal risks arising from potential RBNZ losses during the eventual unwinding of the programme. Yet empirical evidence and analytical frameworks for assessing central bank balance sheet policies in small open economies such as New Zealand are scarce. To address this gap, Chipeniuk et al. (2025) propose a theoretical framework to examine the macroeconomic impacts and fiscal costs of LSAPs.

The remainder of the discussion is organized as follows. Section 2 provides some background by giving an overview of the mechanics of LSAPs and discusses how these programmes reshape the interaction between monetary and fiscal policy. Section 3 summarizes the framework and main findings of Chipeniuk et al. (2025), and Section 4 draws attention to critical aspects not emphasized in their analysis. Section 5 concludes.

2 Background

How do LSAPs work?

When policy rates reach the effective lower bound, central banks increasingly turn to unconventional monetary policy instruments to stimulate the economy. While forward guidance and targeted lending programs are frequently employed, large-scale purchases of government bonds have become quite common among central banks. These operations function through the central bank's balance sheet, reducing the supply of long-term public debt available to the private sector. By lowering yields and exerting downward pressure on the exchange rate, such interventions ease financing conditions and stimulate aggregate demand.

Purchases of government bonds expand the central bank's balance sheet by exchanging reserves for long-maturity public debt. Because reserves are remunerated, increasing them raises the cost of central bank liabilities. This is a burden that intensifies when the policy rate increases as the economy recovers. Under LSAPs, the central bank issues short-term liabilities while holding long-term government bonds, creating a maturity mismatch in its balance sheet. This exposes the monetary authority to short-term interest rate risk. During recoveries, higher policy rates may cause the interest paid on reserves to exceed the income generated from its bond portfolio, resulting in operating losses. Although these losses do not compromise monetary transmission or institutional solvency in New Zealand, they carry direct fiscal implications. This is the case as in New Zealand, as in many jurisdictions, central bank profits and losses are consolidated with the Treasury, thereby linking balance sheet outcomes to the government budget. This interdependence, while fiscally relevant, also risks weakening the distinction between monetary and fiscal policy. We examine these issues in the next section.

Monetary-Fiscal Interactions under LSAPs

The distinction between monetary and fiscal policy becomes increasingly blurred when central banks resort to balance sheet policies. In *normal* times, monetary policy operates through predictable and reversible adjustments to the policy rate, with minimal direct implications for the government's budget. The central bank, in *normal* times, maintains operational independence, and its actions are viewed as separate from fiscal decisions related to taxation, spending, and debt issuance.

However, this institutional separation weakens when central banks engage in LSAPs. These operations make the central bank a dominant player in sovereign debt markets. As a result, it absorbs a substantial

share of public debt and effectively alters the composition, maturity, and distribution of government liabilities available to the private sector. In doing so, the central bank performs functions traditionally associated with the Treasury, such as influencing debt costs, and long-term interest rates.

The fiscal nature of these operations invites heightened public and political scrutiny. As LSAPs blur the line between monetary and fiscal actions, questions arise about whether central banks are indirectly financing government deficits, managing debt service costs, or influencing income distribution. These perceptions can fuel concerns about central bank independence and change market expectations. This is particularly the case if monetary authorities are perceived to be subordinating their price stability mandate to fiscal considerations or political objectives.

From a macroeconomic perspective, LSAPs also alter both the risk profile and the liquidity characteristics of public debt available to the private sector. By exchanging long-term government bonds for reserves, the public central bank modifies the maturity structure of its obligations and changes how liquidity is provided to the financial system. These adjustments can affect financial stability, influence interest rate volatility, and shape fiscal sustainability. The risks become more pronounced when future monetary tightening raises the interest burden associated with central bank liabilities. This is not the case during *normal* times.

3 Framework and Main Findings

To examine the macroeconomic consequences of LSAPs, Chipeniuk et al. (2025) consider a two-country dynamic stochastic general equilibrium (DSGE) model based on Erceg et al. (2024). The model incorporates several structural features designed to realistically capture the transmission mechanisms of LSAPs in a small open economy. First, the model assumes financial market segmentation and consumer heterogeneity with restricted and unrestricted households, where only the latter have full access to financial markets. In contrast, restricted agents can only buy long-term public debt. As a result, government securities of different maturities are not perfectly substitutable. This segmentation prevents full arbitrage across maturities and allows changes in the composition of public debt to influence relative asset prices and real allocations. The model departs from standard linear frameworks by incorporating nonlinear Phillips curve and bounded rationality. This implies asymmetric responses of inflation and output to shocks and policy interventions, as well as more realistic expectation formation among agents. In terms of policy, the central

bank implements a Taylor rule for short-term interest rates that is subject to an effective lower bound constraint, limiting its ability to reduce the policy rate beyond this bound. The central bank can also purchase long-term bonds that are financed by issuing reserves to unrestricted domestic agents. These central bank reserves pay the short-term rate. Finally, the fiscal authority issues short and long-term bonds, collect lump sum taxes, and collect revenue from taxes on consumption and labour. They do so in order to pay interest on previously issued bonds, as well as to finance its expenditures.

Within this framework, Chipeniuk et al. (2025) show that during the COVID-19 period, LSAPs lowered long-term yields and depreciated the exchange rate. This stimulated external demand and accelerated the recovery of output and inflation. The authors find that LSAPs were particularly effective in the acute phase of the pandemic, providing rapid stabilization when other instruments were constrained. The model further indicates that LSAPs supported inflation and output during the crisis but did not materially contribute to the subsequent inflation surge. LSAPs may, however, have widened the output gap in the recovery phase by sustaining lower long-term rates and a weaker exchange rate. The results also suggest that losses on the RBNZ's asset purchases were largely offset by higher tax revenues and reduced government interest payments. Consequently, the long-run trajectory of consolidated public debt was not significantly altered. Overall, LSAPs delivered meaningful macroeconomic support during the crisis without imposing substantial fiscal costs.

To generate these results, the paper emphasizes three key transmission mechanisms. The first is the yield mechanism, whereby LSAPs reallocated long-term government bonds from unrestricted to restricted agents, raising their marginal value. This reduced long-term public debt returns and supported aggregate demand through higher investment and consumption. The second is the exchange rate mechanism, in which lower yields diminished the relative return on domestic assets, induced capital outflows, and depreciated the exchange rate, thereby strengthening net exports. The third is the fiscal mechanism, where lower borrowing costs reduced government interest payments and higher economic activity increased tax revenues. Taken together, these effects expanded fiscal space and enhanced the effectiveness of fiscal policy interventions.

Finally, Chipeniuk et al. (2025), in their counterfactual analysis, find that moderately negative policy rates (down to -0.75%) could have achieved similar macroeconomic outcomes as in LSAPs. However, the channels affecting the economy differ from LSAPs. Negative rates act mainly through domestic consumption, while LSAPs influence long-term yields, the exchange rate, and fiscal space.

4 Suggestions

The Importance of Bond Holder Composition

An often overlooked but critical factor in assessing the effectiveness of LSAPs is who the bond holders are. The transmission of LSAPs hinges not just on the volume of assets acquired, but also on the portfolio rebalancing behaviour of the agents that sell these assets to the central bank. When the central bank absorbs long-term government bonds, it changes the composition of financial assets held by the private sector. The extent to which this alters portfolio allocations, risk-taking, and spending decisions depends on who was initially holding those bonds and how they respond to the liquidity injection.

In Chipeniuk et al. (2025), unrestricted agents can be interpreted as banks, while restricted agents can be thought as other financial institutions.

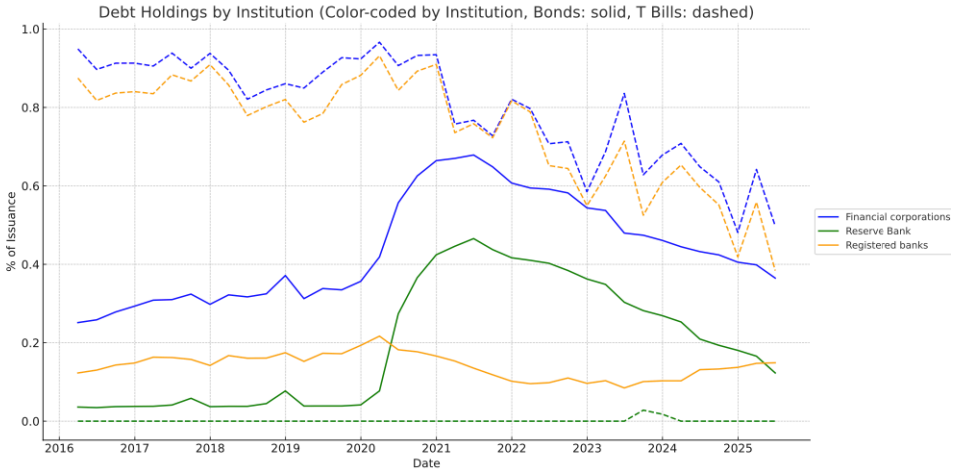

Figure 1: Bond Holder Composition in New Zealand

As Figure 1 shows, in New Zealand, non-bank institutions hold a substantial share of both long and short-term government debt. These institutions differ from commercial banks in risk preferences, regulatory constraints, and liquidity needs.[1] Such heterogeneity is important for the effectiveness of LSAPs. The impact of this programme depends on the identity of bond holders. If sales originate mainly from less responsive non-banks, effects on asset markets and credit conditions may be limited. If instead stems from households with greater portfolio elasticity, rebalancing can lower risk premia more sharply, stimulate credit growth, and strengthen aggregate demand.

Recognising the importance of the identity of debt holders and their likely behaviour during central bank interventions is essential for predicting and interpreting the full macroeconomic effects of LSAPs. This

[1]For example, non-banks may be less willing to shift into riskier assets or may face institutional mandates that restrict portfolio adjustments in response to yield changes.

consideration also has implications for debt management and central bank communication, as expectations about asset purchases can vary markedly with the institutional composition of the investor base.

Integrating Fiscal Stimulus

A key insight from Chipeniuk et al. (2025) is that central bank balance sheet policies must be evaluated within a framework that integrates fiscal and monetary policies. LSAPs influence fiscal space through their effects on borrowing costs, tax revenues, and the scope for fiscal stimulus. This interdependence implies that fiscal and monetary policies must be modelled jointly.

LSAPs are often introduced alongside large fiscal interventions during periods of economic stress. In New Zealand, the programme coincided with the NZD 58.5 billion COVID-19 Response and Recovery Fund and the NZD 19 billion Funding for Lending Programme. These measures were of similar size to LSAPs and significantly affected the size, composition, and maturity profile of public debt available to the private sector. These features are not currently incorporated in Chipeniuk et al. (2025).

A robust assessment of LSAPs should therefore not abstract from concurrent fiscal actions. It should model explicitly how fiscal stimulus is financed and how Treasury issuance interacts with the central bank's balance sheet. Such an approach provides a richer understanding of the macro-fiscal consequences of LSAPs and can help guide more effective policy coordination in future crises.

Imperfect Substitution

Evaluating the overall effectiveness and the total fiscal costs associated with LSAPs requires recognising that short-term government debt and central bank reserves are not perfect substitutes. Both securities are liquid and safe, but they differ in terms of holders, functions within the financial system, and consequences for monetary and fiscal operations. Assuming perfect substitutability can lead to misleading conclusions about the transmission of LSAPs and the associated fiscal costs of their eventual unwinding.

A key distinction lies in the liquidity services of short-term government debt, particularly for non-bank financial intermediaries. These institutions value such instruments not only for safety and yield but also for liquidity, and collateral provision. By contrast, central bank reserves are held exclusively by commercial banks and are used to meet settlement obligations, satisfy prudential liquidity requirements, and comply with regulatory capital rules.

This segmentation has important implications for LSAPs. When the central bank purchases government

debt and issues reserves in exchange, it withdraws partially liquid assets from the wider financial system and replaces them with liabilities that only banks can hold. If short-term debt provides valuable liquidity to non-banks, this substitution can tighten conditions in some market segments and offset part of the stimulative effect of LSAPs. At the same time, a reduced supply of liquid assets for non-banks may increase demand for other safe instruments, compress yields more broadly, and shift portfolio risk in ways that influence financial stability and monetary transmission.

Short-term debt and reserves also differ in their fiscal implications. Interest on reserves is set administratively by the central bank, and higher policy rates during exit from LSAPs increase the cost of servicing these liabilities. In contrast, the cost of short-term government debt is market determined and linked to the term structure. Replacing short-term debt with reserves can therefore raise the fiscal burden of policy normalisation. Higher interest expenses fall on the central bank's balance sheet and may necessitate fiscal transfers from the Treasury to offset losses.

5 Conclusions

Chipeniuk et al. (2025) present a clear and well-structured framework for evaluating the macroeconomic and fiscal effects of quantitative easing in small open economies. Using a two-country DSGE model calibrated to New Zealand, the paper shows how LSAPs acted as an effective stabilisation tool during the COVID-19 crisis. The results indicate that LSAPs supported output and inflation when the policy rate was constrained by the effective lower bound. The associated fiscal risks, though present, were manageable when viewed from a consolidated public sector perspective.

The broader lesson from Chipeniuk et al. (2025) is that unconventional monetary policy, even when motivated by macroeconomic stabilisation objectives, has fiscal implications. Balance sheet policies such as LSAPs alter the composition and risk profile of public debt, affect the intertemporal fiscal path, and shape expectations about future interest rates and inflation. These dynamics highlight the need for coordination between monetary and fiscal authorities in both policy design and evaluation.

Three main implications follow. First, policymakers should employ integrated frameworks that capture fiscal–monetary interactions, since treating these policies in isolation can obscure important spillovers and trade-offs. Second, clear and consistent communication is essential to preserve credibility, anchor expectations, and delineate institutional responsibilities when unconventional tools are used. Third, future

research should refine the modelling of financial frictions, including relaxing assumptions of perfect substitutability between reserves and government debt, to better reflect the liquidity and collateral roles of public assets in modern financial systems.

In sum, Chipeniuk et al. (2025) provide practical guidance for central banks and treasuries confronting the challenges of unconventional monetary policy. The analysis underscores the importance of tools that are not only effective in the short-run but also sustainable and transparent over the long-term.

References

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