



# What is quantitative easing?

KS3 KS4 Ages 11-18 ⌚ 5 min read

After the 2008 financial crisis, central banks around the world did something extraordinary: they created trillions of pounds, dollars, and euros out of thin air and pumped them into the economy. This process — called quantitative easing, or QE — sounds like it should cause chaos. Here's why it doesn't, quite, and why some people think it should.

## First — how does interest rate cutting normally work?

When an economy slows down, the usual tool is cutting interest rates. Lower rates make borrowing cheaper, which encourages businesses to invest and people to spend. That stimulates growth. But there's a floor: you can't cut interest rates below zero (or not much below zero). When rates hit the floor and the economy is still struggling, central banks need another tool. That tool is QE.

🔧 Think of the economy as a bathtub that's draining too fast. Normally you turn up the tap (lower interest rates) to keep it full. But if the tap is already fully open and water is still draining out, you need a different approach — so the central bank hooks up a hose directly to the water main and blasts water in from a completely new source. That's QE: new money, pumped directly in.

## So where does the money come from?

A central bank — like the Bank of England — creates new money electronically. Not physical banknotes: it's a digital entry in an account. It then uses this new money to buy assets, usually government bonds (IOUs issued by the government). The sellers of those bonds — typically banks and financial institutions — now have more cash, which they can lend out or invest. In theory, this cash flows through the financial system and into the real economy.

## Did it work?

The honest answer is: probably, but less than hoped. QE prevented a complete financial collapse after 2008 and again during Covid in 2020. Credit kept flowing, businesses could still borrow, and the worst-case scenarios were avoided. But the

benefits weren't evenly spread. Much of the money inflated the prices of financial assets — shares and property — which mostly benefited people who already owned shares and property. People without assets saw little direct benefit, which is one reason QE is often criticised for widening inequality.

## **What's the catch?**

Creating money isn't free. If you flood the economy with new money without a corresponding increase in goods and services, prices rise — that's inflation. For over a decade after 2008, this didn't happen much and QE seemed like a free lunch. Then, post-Covid, when QE combined with supply chain disruptions, inflation shot up sharply. Central banks had to rapidly raise interest rates to bring it back down — causing the very economic pain they'd been trying to avoid. The lunch turned out not to be entirely free after all.