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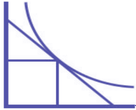

"The Optimal Bundle"

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Special Report on the Federal Reserve

Quantitative Easing: When Desperate Times Call

Quantitative easing is the process of pumping money in an economy to pull the it out of a dire situation. This rather high-risk policy has had some good and bad effects on the economy. Since its start under the Federal Reserve in 2008, increased supply of money has created new jobs as firms have more cash to finance new recruits. The unemployment rate has had a great fall from 7.3% in Dec. 2008 to 5.9% today. This extra cash has also led to an increase in overall spending which has increased in economic growth. The economic growth rate has improved from -2.8% to 2.8%. Spending accumulates debt, and this might have a negative effect on economic growth. Now that QE has reached its end, the recovery could get put on hold or worsen. Just as interest rates start to rise, investments might start to go down leading the stock markets to fall. Quantitative easing is a double-edged sword: it can revive an anemic economy or drown it in debt.—WI

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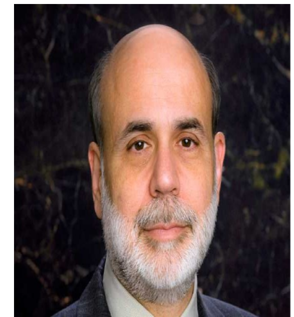

The Fed undertook three rounds of quantitative easing under former Chairman Ben Bernanke.

Chairwoman Janet Yellen has resisted pressure to raise interest rates, even from opposing Federal Reserve Governors like Charles Plosser and Esther George.

The Curious Case of the Interest Rate

As quantitative easing comes to an end, people are turning their attention to a hostage situation. Federal Reserve Chairwoman Janet Yellen is steadfast in waiting to raise interest rates, yet speculators and investors are handcuffed by having to wait to gain a higher return on their interest-bearing assets. The Federal Reserve kept rates near zero since December 2008 and pledged to keep them this way for a "considerable time" in March. Americans are now at the edge of their seats, and most agree that it is high time to raise interest rates in order to fend off an inflationary surge. There is hope, though. The most recent rate projections suggest a faster pace of rate hikes: 1.375% at the end of next year instead of 1.125%. Does this mean interest rates hikes could be near? Dr. Yellen has her finger on the trigger.—CM

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A $4 Trillion Balance Sheet: Welcome to the Fed's New Normal

The end of quantitative easing does not mark a return to the Federal Reserve's doctrine of minimal interference prior to the Great Recession. Rather, the Fed's management of a record $4.3 trillion balance sheet consisting of Treasuries, mortgage-backed securities, and housing-agency debt will likely continue for several years. This strategy shows that the Fed remains fearful of the economy's health despite a decreasing unemployment rate. James Bullard, president of the Federal Reserve Bank of St. Louis, argued that massive sales of assets could raise interest rates, which would slow consumption and investment. Fed officials are further reluctant to initiate drastic changes in the central bank's portfolio because they fear repeating the stock market's "violent reaction" in June 2013 when then-chairman Ben Bernanke said the Fed would soon begin to taper its asset purchases. A large balance sheet has eased the fears of investors, but it remains a roadblock to normalized monetary policy. Markets are still dependent on the Fed because they are afraid of fear itself. – JK

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More than 80% of the money dispersed by the Fed under QE now sits in banks as excess reserves.

Are the Fed's Powers Effective Enough?

Hung Up on Monetary Policy

Sometimes the biggest debates revolve around one simple principle. The debate surrounding the Federal Reserve's actions since the 2008 financial crisis does just that, as it concerns the most fundamental activity of the Fed: judging whether or not the scope of the Fed's powers during the recovery is appropriate. This debate has important ramifications on the economy, and even some Fed officials dispute the impact of the Fed's current monetary policy. Former Nobel Prize winning economist Ed Prescott has led that charge, but his constant cries against the Fed's actions should not be heeded. Labor market weakness, predictions of when full employment should occur, and policy implementation lag shows the Fed's powers are too important to do away with in the context of a fragile economy.

If the Fed adopts Prescott's prescription, the U.S. labor market would succumb to its vulnerabilities from the 2000s financial crisis. Many workers have left the labor force altogether, with recent economic research suggesting that 5.9 million people are would-be workers: They are unemployed and would be in the labor market if not for economic difficulties. The Fed's post-recession policy of keeping rates at their current zero lower bound should help these would-be workers. Moreover, data shows the point of full recovery is a long way off. JP Morgan's Chief Economist, Michael Feroli, recently released research saying that the economy will be in danger of overheating in 2018. To avoid the damaging risks of slow growth, interest rates should be kept near zero until 2016. The Fed's current monetary policy is designed to prevent economic overheating, but this goal would be unfulfilled if it does not stay the course.

It is ultimately time to end the call for a passive monetary policy. The current weaknesses of the U.S. economy are predicted to be completely fixed years from now, and research shows that Fed economists know to time the raising of rates to prevent overheating. Raising them too much, too soon will only contribute to the economic disaster that the U.S. is still recovering from. The Fed has answered the call and they should not get hung up. - CL

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Rethink and Retool the Fed

The Federal Reserve has tried to play a larger role in recent years in trying to stimulate economy. The issue of how extensively the Fed should intervene in the economy and debates over the extent of the central bank's autonomy has misled people into thinking the Fed's current monetary policy can effectively resolve the nation's economic problems. Given the unusual time involved in recovering from the 2008 - 2009 crisis, economists have unsuccessfully tried to figure out ways to head off similar disasters. Wealth inequality has worsened in the aftermath of the recession, while the Fed has not adequately improved bank supervision and regulations. The Fed still has a long way to go until it effectively guides the nation through economic recovery.

The Fed needs to go beyond its dual mandate of addressing unemployment and inflation because many Americans have not benefited from the economic recovery. The biggest shortcoming of current monetary policy is that it fails to address the economic problems faced by middle class and working Americans. "Gain from the recent uptick in the stock market go almost entirely into the hands of the rich" according to Edward Wolff, an economics professor at NYU. Many smaller investors exited the market during the crisis and the wealthy kept more money in the stock market benefiting from the 2009 surge. Stock prices have gone up because of quantitative easing, meaning people who own equity--largely the rich--have benefited disproportionately. As of 2010, the top 20 percent owns 89% of the wealth, leaving 11% for the bottom 80% which consist of wage and salary workers.

Now that the recession is over, the Fed needs to identify ways to stimulating economy by increasing living standard and curving poverty and income inequality. The Federal Reserve doesn't have the tools necessary for creating better living standards for the bottom 80%. The dual mandate to keep inflation at 2% and unemployment at 5.4% does not take into account the quality of jobs obtained by people entering the workforce. Restrictions and regulations need to be implemented on banks, so that they will make appropriate loans to low income families stimulating economic growth and decrease income inequality. The Fed can and should act immediately to address problems affecting millions of poor and middle class Americans. Let's not get hung up by the dual mandate. - MB

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Upcoming Events:

Oct. 29– Expected end of QE

Oct. 30– GDP

Psuea.org — EA Homepage

Psuea.org/blog — Education Blog