

**FED'S "QUANTITATIVE EASING ACTION" – MORE THAN A MOVE FOR US ECONOMY REVITALIZATION?\***

Lect. Ph.D Rizescu Sabin  
Lect. Ph.D Stanciu Cristian Valeriu  
Prof. Ph.D Spulbar Cristi  
University of Craiova  
Faculty of Economics and Business  
Administration  
Craiova, Romania

**Abstract:** On March 18<sup>th</sup> 2009, FED has made a move it hasn't done since 1960 (the so-called Operation Trust conceived by the Kennedy administration): it stepped into the market in order to buy long term securities for an amount of some 1.25 trillion dollars. FED also said this program could be expanded to include a lot of other financial assets. The key issue here is the money resulting from this quantitative easing action taken by FED has not US economy as main destination, but, through IMF, US are due to become the main creditor of the world.

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**Key words:** FED, long term bonds, quantitative easing measure, open market action

Just before the last G20 meeting in London and following the quantitative easing measures taken by FED it has broken into the news that, during an internal discussion, IMF raised a really provocative issue: should the non-Euro EU members join the Euro very rapidly?!

At a first glance, the selected G20 members dismissed or at least played down such kind of action. But the question still remains: will be such an action a bad one or a good one?!

Considering the developing international economic situation we plead that adopting the Euro at a fast pace will be favorable for both sides of Europe: the Western developed countries and the Eastern emerging economies.

On March 18<sup>th</sup> this year, FED has made a move it haven't done since 1960 (the so-called Operation Trust conceived by the Kennedy administration): it stepped into the market in order to buy long term securities for an amount of some 1.25 trillion dollars. The move is due to take place following two steps:

-1<sup>st</sup> step: an immediate release of 300 billion dollars in order to buy long term Treasuries (especially 10year T-bonds)

- 2<sup>nd</sup> step: the purchase (in an unspecified period of time) of mortgage backed securities guaranteed by Fannie Mae and Freddie Mac for the rest of 950 billion dollars.

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The move is aimed at re-launch the banking system credit operations and lifting the US economy out of recession by lowering rates on mortgages and other consumer debt of any kind.

In the same kind of respect, FED also announced a program to restart consumer and small businesses lending. FED also said this program could be expanded to include a lot of other financial assets. The program is designed on spurring lending for autos, credit cards and loans for businesses' capital spending. However, FED suggested that the help for the embattled mortgage industry might be over – at least for a while – saying any broadening of the program will be beyond this area.

Since the last FOMC meeting in late January "the US economy continues to contract" the FED members stated. Also, they noticed that "job losses, declining equity and housing wealth and tight credit conditions have weighed on consumer sentiment and spending".

But, there was a remark that kept our attention in a very particular way. In its statement, FED said that "problems overseas have crimped demand for US exports, dealing domestic companies another blow". And all that when the US international trade gap has become less than half (26 billion dollars in February) of its picks reached in mid 2007 (more than 60 billion dollars)!

Great investors like Warren Buffet and George Soros heavily criticized the FED action but they really meant what they said?! Among other issues they raised they were saying that, far from resuming the lending activity in the business sector, this move will only artificially and temporarily revamp the price of assets and of goods and services – finally conducting to inflation without gains in productivity (stagflation).

We argue that, at least for the time being, inflation is out question in US. We have only to remind that both values of PPI (Producer Price Index) and CPI (Consumer Price Index) were showing in recent months that inflation is well contained. More else, PPI has known its first Y/Y decline since 1955. Also, we have to add to the picture that for the month of April 2009 we've just seen a monthly decline in the CPI number (-0.1% M/M) and only a modest increase in the PPI number (+0.1 M/M) while in their Y/Y dynamics both numbers have shown sharp year/year declines:

- April PPI Y/Y: - 3.6%;
- April CPI Y/Y: - 0.4%.

Also, we have to say that the recent monthly job losses in US were huge indeed and that could mean everything (anything!) but inflation. In the last three months we've seen dramatic declines in the non-farm payrolls number as well as well as in the jobless rate number:

- April non-farm payrolls M/M: actual: - 663,000 (consensus forecast: - 650,000);
- April jobless rate: actual: 8.5% - in line with expectations;
- March non-farm payrolls M/M: actual: - 651,000 (consensus forecast: - 648,000);
- March jobless rate: actual: 8.1% (consensus forecast: 7.9%).

So, assuming that all money released by FED is to have the US economy as destination, still we don't see any inflationary pressures to develop at least for the next 6 to 12 months ahead.

But, the key issue here is the money resulting from this quantitative easing action taken by FED has not US economy as main destination!

## **Economic Theories – International Economic Relations**

The last G20 meeting (April the 2<sup>nd</sup> 2009) has given free way for 500 billion dollars at the IMF disposal in order to help emerging economies. We have to remember that Romania itself has borrowed money from IMF just recently! We did notice that the main contributor - as a sovereign country – to this kind of “world stimulus package” is, actually, the United States of America (100 billion dollars)!

So, US are due to become the main creditor of the world, but in a very strange way – and that because US is also the main debtor of the world.

So, a third of those 300 billion dollars released by FED by purchasing long term T bonds are actually designed to finance emerging economies.

At the last G20 meeting, the status of the US dollar as world’s reserve currency was subject of serious discussion actually for the first time in the post World War II era.

It seems , in the aftermath, that America has learned its lesson in recognizing that the “laissez-fair economic policy” and excessive deregulation in the banking system were mistakes.

US wants to puts an end to the “consumerism era” and to put its economy back on track by regaining in terms of productivity in order generate a new kind of growth based more on added-value and less on assets. The ignition of such a process seems to be this main contribution it made to the IMF efforts in assisting emerging economies. These economies will restart to re-think their own kind of growth and are suppose to buy more capital goods “made in USA” and, so, lifting more pressure of its already 6 months sharp narrowing trade deficit.

Growing demand overseas for US made goods and services will stimulate the entire business sector and the US economy will start to generate some new and fresh liquidities. We also have to add to the picture that the average American homeowner will never-ever spend (especially on imported goods) the way he or she has done in the last decade. The US dollar is due to remain weak, at least for a while, and that will also be a “plus” for the American international trade position. As the US international trade will improve, this country will start to pay down its national debt. The US economic growth engine will never be the same it was in the last four decades. The work will be re-priced as well as capital gains.

Our guess is that “easy money policy” will reach its end sooner rather than later and that because the US economy has an enormous potential of growth. In this kind of respect we have to remind that this economy produced growth at 140 – 150 dollars/oil barrel and the recent sharp decline in oil prices has created a huge “productivity reserve” by diminishing energy costs in the entire US business sector. So, the profit margins will benefit, too.

On the other hand, we have to notice that US is actually the only country being in a position to lend money to the world, directly or via IMF, with no bad effects on its own economy. That could happened because any other big dollars detained (big exporters like China, for example, that has the US dollar as main currency in its reserves and continues to buy US debt) that eventually has intended or do intend to lend US dollars to the world will reach nothing but undermine its own economy by putting down the value of the dollar and diminishing its own reserves.

As many analysts already noticed, big exporters like China have created economic engines for nothing!

Also, we have to add that the US capital markets are the most liquid, the largest and the deepest in the world. These capital markets assure large doors for good capital coming to US as well as large doors for insane capital leaving US. In this kind of

respect we have to notice that US Treasury made its moves by using market instruments while the FED's quantitative easing measure is, basically, an open market action.

The US economy is an innovation-based, versatile, and very dynamic one. Its workforce is the most flexible and mobile in the world. By re-thinking the capital distribution and re-pricing work, the US government will encourage the development of new products (goods and services) with good outcomes in terms of productivity gains.

As we've noticed earlier, the average American consumer's behavior has changed dramatically in recent months and is due to continue this way. As the Americans will start to leave the consume-on-debt behavior by dropping down their credit cards and to save more, the behavior of the banking system will also change by switching from finance consumption to finance investment-based activities.

It's time to remind that US still has the most powerful and prestigious academic system in the world. Its well-known universities ( MIT, Harvard) are still the places where the world top researches do work and put out their results. It is to expect that some of those results will soon reach some interests in the economy and will attract investments in order to create those new products we were talking about.

At the last G20 meeting the american voice was a little bit milder than usually, but, while the US dollar is contested indeed but nobody sees a valuable replacement for it, US is to remain the largest and the most powerful economy in the world and, of course, it will use the power of the dollar as the single world reserve currency.

The last FED action will relieve the world economic tensions and will be a support for growth to the developing countries (like Romania!). Those countries will start to consume more than they do now and the IMF will watch closely to their economic policies, avoiding mistakes made in the past.

The world has changed dramatically in recent months but the economic laws remain, basically, the same.

The economic war will continue reaching worldwide dimensions that world has never seen before. The US economy will face fierce challenges in fighting with its deficits but exporters like China and – why not ?! - Germany will face even tougher tasks. These big exporters have built their economic policies on the assumption that the US consumption market is kind of “black hole” and is to remain this way forever. They were deadly wrong – Germany output has already fallen 6% Y/Y and China's recent slowdown has never been seen in the last two decades. Oil exporters like Russia and Arabic countries that built their economic plans and budgets assuming the oil price will remain above 100 US dollars/barell, will also be in trouble. The US mood to consume-on-debt has change dramatically.

The world economy itself is about to experience dramatic changes. One thing will remain in place, at least for the foreseeable future: the US Dollar will remain the world reserve currency.

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