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RESEARCH ARTICLE

EMBARKMENT OF QUANTITATIVE EASING AS POLICY.

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Abstract

In response to the financial crisis in 2008, the Federal Reserve implemented all possible monetary policies without significant success. The result was the presentation of the quantitative easing (QE) policy, which is a monetary policy where the Federal Reserve purchases mid-to long-term bonds and thus liquidates the market and increases money supply. This paper will illustrate how the quantitative easing benefitted the US economy to overcome the financial crisis. It will illustrate difficulties that QE has not solved like a strong increase in national debt along with US companies' hording large amounts of cash abroad, which has made the mission of recovery very difficult for the Federal Reserve. Lastly, it will look at potential solutions besides QE to stabilize the United States economy.

Introduction:-

Quantitative Easing (QE) is a monetary policy where Federal Reserve purchases mid-to long-term bonds and thus liquidates the market and increases money supply (Lu, 2013). The cause behind QE is due to banks holding immense amounts of excess reserves. One reason banks retain large amounts of excess reserves is that there is a weak loan demand associated with regulatory uncertainty alongside a slow recovery of the economy. Another motive is the unprofitability to lend loans since interest rates are at or below cost of capital, which more likely will lead to a potential loss (Thornton, 2010).

One of the reasons QE occurred was that the previously implemented monetary policy of setting interest rates between 0-0.25percent did not lead to the anticipated relief in the market (Farley& Juvenal, Quantitative Easing: Lessons We've Learned, 2012). In addition, other measures were pursued with the same negative outcome. As a last resort, the Federal Reserve under Bernanke implemented the first quantitative easing measure on November 25th, 2008.

There were three main problems the QE was supposed to solve, 1) stop the economy from worsening, 2) stabilize various industries and markets in the United States, and 3) improve and create growth throughout the Unites States economy.

The decision to implement the quantitative easing was difficult since there wasn't much data on prior integrations and its success rate. One could only speculate the consequences but the Federal Reserve under Bernanke valuated the risk of implementation lower than the alternative of not doing anything additionally. An indication of success can be found by assessing the Unites States unemployment rate from 2006 to 2014. As a reminder the crisis didn't start until late 2007 and the first quantitative easing wave was released late 2008.

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It can be observed that after 2010 the unemployment rate has consistently decreased and has reached 6.7 present in March 2014. This indicates that the quantitative easing policy did benefit the economy bydecreasing unemployment although it is not back to pre-crisis levels, it is moving in that direction.

Besides the unemployment rate decreasing, an improvement in the gross domestic product (GDP) has been observed. The GDP is a significant measure because it provides a good indication of the growth of a country. In 2008, the United States GDP depreciated 3.3 present, which revealed the actual impact of the financial crisis, especially since the Federal Reserve?Anticipated growth of 2.4 present (Silver, 2012). One of the reasons that this unfitting forecast occurred was that the economists of the Federal Reserve often overestimate forecasts to protect themselves and their names as economists (Silver, 2012). In addition, it is a very difficult job as an economist to forecast future growth based off economic statistics alone since there are so many variables they potentially have to account for. Although the forecast was falsely projected and the economy slid into a recession, it showed the positive impact QE had on the United States GDP. As observed in the unemployment and GDP, the financial crisis had its worst impact on the United States economy in 2009.

Concerns In Qe:-

There have been multiple indications that the quantitative easing policy was a beneficial choice to prevail the impending crisis. Although this is true there are a variety of concerns for the future.

One of these concerns is inflation. The idea behind quantitative easing was to avoid deflation by buying mortgage based securities (Dabrowski, 2010). This did prevent deflation but buying mortgage based securities means that more money is put into circulation, which by definition should increase the inflation rate. Authorities feared that this increase in monetary flow could potentially cause a hyperinflation as experienced by Germany in 1919.

Another prevailing concern besides inflation is the fact that US companies are holding over $1.5 trillion in cash abroad due to the high corporate taxes in the United States (Kaisaris, 2013). This has been a major setback to the US economy and the Federal Reserve since the economy would greatly benefit from this amount of cash flow. But US companies do not see any reason to lose 35% of their revenue through corporate taxes; therefore they leave their cash in foreign subsidiaries (Kaisaris, 2013). With that said, US businesses will maintain their cash back abroad unless the United States decreases its corporate tax rate to a more competitive rate as of 15-20 present (Kaisaris, 2013).

Beside the concerns of inflation and foreign cash stacks, the United States should pay close attention to its rapidly increasing debt rate. Although the quantitative easing by the Federal Reserve has been effective in decreasing the unemployment rate as well as increasing the gross domestic product, it led to a high increase in expenditure by the Federal Reserve. It is showed how rapidly the Federal Reserve expenditure has grown since 2002. It prevailed that the Federal Reserve has increased their output from around $850 billion in 2007 to $4,100 billion in 2013; this is a substantial increase of over $3 trillion in five years (Farley& Neely, Four Stories of Quantitative Easing, 2013). This expenditure can be directly correlated to the national debt of the United States, which has been increasing since the early 2000s but took a significant leap since 2009.

As we can see the National Debt has severally increased over the last decade and has surpassed the annual GDP. Currently the National Debt is 1.0153 times greater than the GDP of the United States, which could lead to tensions in the future if the budget doesn't get improved accordingly. In addition, it is seen that the GDP to debt ratio of the United States has rapidly worsened since the implementation of QE in 2008.

As we can see the Federal Reserve had to make a trade-off by improving the economy in the expense of heavily increasing debt. The QE policy is stated to stay in effect till 2015, but what will happen afterwards? This question is difficult to answer, but one thing seems certain to occur and that is uncertainty. If the United States does not continue to grow at the anticipated rates it will cause questions about the stability of the United States economy. It is also difficult to forecast how long the United States will need to figure out their debt and budget reduction. The US might lose its financial status of a safe haven and might be downgraded even further by rating institutes like Moody. With that said, research by Yangzi Lu has shown that there is a solution to reduce any potential uncertainty and benefit the US financially, which would be by developing and implementing a world currency (Lu, 2013).

Alternatives To Qe:-

In this paper, there is a discussion on the effects of the quantitative easing implementation and described research that documents how QE has been beneficial in stabilising and improving the United States economy. One of the main issues with the accomplishment is the expenditure by the US government that had to be implemented to realize this task. The reason why this high expenditure has not affected the United States, as it has other countries like Greece, is that the United States uses its "sovereign currency as the international reserve currency" (Lu, 2013). Before the US dollar became the international reserve currency, precious metals were the international reserve currency. Due to the complex outreach of today's world economy the possibility of returning to precious metals as the international reserve currency is not an option anymore, instead something new should be established that has no direct link to any sovereign country (Lu, 2013). This new establishment has been perceived as a World Currency. The advantages of it would include more certainty in the world economy, stabilization of the United States and no interference of politics involvement.

An increased amount of certainty could singlehandedly be worth the transition to a world currency. In today's difficult economy, entities always look to the big countries like the United States, China or Germany for advice and more importantly financial support. But if a country likes the United States is heavily struggling itself and needs all its resources for themselves, where should these other countries or the United States itself seek assistance? In the case of a world currency, countries could look for support from the world currency rather than be reliant on the larger nations. This improved environment would benefit investors since thatwould have the trust and certainty that every country was overseen and protected by an independent entity. A board of directors could lead this entity similarly to the International Monetary Fund.

There are several factors that could benefit the United States and the rest of the world from having a world currency; there are also factors that speak against an implementation. The most important factor being that the United States would lose their financial independence and leverage over every country linked to the US dollar. In addition, a more radical budget restructure would have to be enforced similar to what was seen in Greece, Ireland, and Island because the United States would not have their financial leverage anymore. Because this would be devastating to the United States and its economy, it is the main reasons why a world currency will not be enforced anytime soon.

Conclusion:-

This paper tries to find out the reasoning behind the implementation of quantitative easing. It looked at the benefits it created with stopping the financial crisis from getting worse. The unemployment rate has been decreasing since the implementation along with the gross domestic product increasing. Although there were many benefits from QE there have been deficits as well, as the heavily increase of Federal Reserve expenditure that caused the national debt of the United States to surpass the gross domestic product. A potential solution of the dilemma would be to implement a world currency as the international reserve currency, relieving the US dollar from that role. Although this could be very beneficial for the United States and other countries, it will not be implemented any time soon sincethe United States would lose all its financial leverage. At this time the US cannot afford to lose that leverage since that would cause economy turmoil and lead right back into a recession.

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