Quantitative easing program report sample

Sociology, Shopping

Answer 1)

a)History of Quantitative Easing:

Quantitative Easing, also known as Open market Operations is one of the conventional method of Credit Control which is followed by central/federal banks to stimulate economic growth and to circumvent the banking system. The history of this method credit control has two phases i. e pre 2007 and post 2007 period. (Parkin, 2011)

i)Pre-2007 Period:

The very first use of Quantitative technique of Credit Control is attributed to Bank of Japan on March 19th , 2001. The Bank authorities before accepting this method, rejected the efficiency of QE method and rejected its use for monetary policy. The Bank during 1999 had maintained short term interest rate to zero since 1999 and when it used QE Method, it provide high liquidity to the commercial banks of Japan . This was done with primary objective of promoting funding amongst private players so as to ensure that industrialist and businessmen have excess reserves and should not be face liquidity concerns in their entity.

BOJ accomplished their objective of providing flood of funds to the commercial banks by buying more government bonds and asset backed securities and equities. In another attempt, it extended the terms of its commercial paper purchasing operation. As a result, the central bank(BOJ) increased the current account balance of commercial banks to $300 Billion in four year after initiating Quantitative Easing in 2001. Important to note that BOJ accomplished their objective by buying government bonds more than the quantity of what was required to set the interest rate at or close to zero.

ii) Post 2007 Period:

Quantitative Easing became more popular in USA and UK after the global financial crisis of 2007-08. QE was used as an additional arm to the monetary policy by both US and Eurozone because the risk free short term interest rates of these countries were also zero or close to zero. As a result, the central banks of these countries expanded their Quantitative Purchasing by adding new assets and liabilities without sterilizing these by corresponding subtractions.

What is Quantitative Easing?

Also known as Open Market Operations, Quantitative Easing is used an additional arm to the monetary policy by the federal/central banks in order to stimulate the economic growth and to circumvent the banking system. For instance, at the time of inflation in the economy, Federal Bank in order to stimulate the economy and to evade the inflationary pressures(to an extent), initiates selling the financial assets like treasury bonds in the general market and since the private investors have more faith in risk free investments, they start purchasing the securities so issued by Federal Bank. As a result, this creates leakages in the economy as the excess money held by public is now in the reserves of Federal Bank. This lowers the level of aggregate demand in the economy and helps to keep the inflation under sustainable levels.

In the United States, Quantitative Easing Program has been used in three rounds, popularly known as QE1, QE2, QE3 which are discussed here under:

QE1:

It was the first step by the Federal Bank where it involved in asset purchasing to stimulate the economic activity in the nation after the recessionary period of 2007-08. However, Q1 was complete different planned program which involved the purchase of agency securities and other mortgage backed securities rather than treasury securities.

Initiated in January, 2009, the Fed under the QE1 Program purchased $1. 25 trillion of mortgage backed securities and $175 billion of debt securities. As a result, the Fed became the market with shadow banking system almost vanished. Thus, the fed tried to put the entire mortgage backed security market on its balance sheet to ensure that there is no second depression hitting the US Economy.

QE2:

QE2 was the second round of Quantitative Easing Program executed by Federal Bank during August 2010. The objective of QE2 Program was to stimulate the US Economy after it had been hit hard by financial crisis of 2007-08. The program started with Fed reinvesting the principal payments received on agency debt and mortgage backed securities which the Fed had during the QE1 program as long term treasury securities. Later, during November, 2010, Fed announced additional purchase of $600 Billion of Treasury Assets.(Harrison, 2011)

The whole process was a replica of what the Bank of Japan had done in early 2000's.

Q3:

Announced in later part of 2012, this is the third round of Quantitative Easing

Program in USA and also the most debated program with Fed pressurized to taper this round of Quantitative Easing. However, Fed surprised the US Economy when on December 18th, 2013, it indeed announced to taper its program and restrict it to $75 Billion/month asset purchase. US Dollar was immediately reported slightly higher and volatile.(Veccio, 2013)

The reasons why QE should or should not be tapered?

After the Federal Bank shook the US Market by letting go the Q2 Tapering of Quantitaive Easing method during September, there are now speculations in the market over probable response of US Central Bank over its decision to taper or not to taper the QE Method now. However, the market sentiment again goes for the view that Federal Reseve should taper the Quantitative Easing because of following reasons:

i)Fall in Unemployment Rates and solid job growth:

Recent reports related to Non-Farm Payrolls reported that there is a gain of 203K jobs in US while the 200K level of job is said to be the benchmark for growth in the economy. Aprt from this report, the JOLTS figure which relates to employment figures also showed increasing trend in new job opportunities in the economy. Further, a sustainable fall in unemployment rate and natural fall in participation rate is experienced. The unemployment rate dropped to 7% while the participation rate dropped to 63% but this drop in participation rate was mainly concerned with retirement. Thus, the drop in unemployment rate is not because of discouragement to find job, which indeed is a good sign for US Economy.

ii) Healthy Rate of Inflation:

The Quantitative Easing was introduced with the fear of deflation in the economy which further triggered QE2. Thus, now with inflation in healthy and moderate figure of 1. 7% it is likely that Fed will now taper the QE Program.

iii) Market preparedness:

When the tapering rumor was waved for the first time in June, the US Stock Market and the financial system of US was badly hit. As a result, stock prices fell. But the Fed decided to neglect the Taper Decision in September because of ‘’tighter financial condition’’ However, now the US Economy does not experience the so called ‘’tighter financial condition’’ and Fed should taper the QE.

iv) Strong rise in house prices:

Various Housing Price Index has shown a 1% rise in house prices in 20 cities of the United States during September. On yearly accumulated basis, this increases approximates to 13. 3% and economist cite that the rise in prices is because of long term interest rates of Quantitative Easing Program. Now considering the housing bubbles which were primarly reason for the financial crisis, Fed will not like to fuel other bubble and will head towards taper.

v) Less political headwinds:

The decision of Fed as not to taper the QE program in September was proved a sensible decision after the economy witnessed government shutdown and debt ceiling scare seen in October. However, now the US Economy has not only shrugged off the government shutdown but also a mutual deal between the politicians is another reason for now the Fed to taper the asset buying program. (Elam, 2013)

vi) Bernanke’s legacy:

Fed’s chief head, Mr. Bernanke, was the first to introduce the unconventional and controversial policy of QE when the US economy was going through financial crisis. During the first round of its introduction was efficient during crisis, the second round prevented deflation and third was objectified to recover the employment. Now with most of the objectives of the QE Policy achieved, Mr. Bernanke would like to push for the beginning of the end of QE.

Impact of Federal Tapering Decisions:

With the growing arguments over the decision of Federal Reserve to taper the Quantitative Easing approach for stimulating the economy, there has been concerns over the impact of tapering by federal reserve on an average American. The same is discussed below:

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i)Timing of the taper:

With US Economy coming back on sustainable stand recovery, the Federal Bank is now aiming to taper back its monthly purchase of US Treasury Securities as well as Mortgage Bonds which ranges at $85 Billion every month. However, the timing to taper the QE Program will determine the impact of Fed's Decision on US Economy. In other words, the objective of Fed's Policy will be to taper back the Quantitative Easing so that the stimulus is fully removed just as the economy reaches the level of full employment. Thus, if fed decides to taper the policy too late, the US Economy will be vulnerable to inflationary pressures cited with excess aggregate demand.

However, since Fed can tackle the inlfationary pressures quickly, it will reverse this error before it became too costly. However, the bigger issue is concerned if Fed decides to taper the buy back early as this will cause unemployment to continue and may even boost the unemployment figures which will be a great set back to the objectives of Fed’s central policy. Higher unemployment is, of course, very costly to households that are struggling to find work and make ends meet.

Thus, wrong timing by Federal Reserve Bank for tapering Quantitative Easing will have biggest impact on households and thus the decision of fed should be on rational and most importantly timely basis i. e it should be executed as and when it is required. Thus, it can be believed that with such severe consequence related to timing of tapering decision, the central bank is unlikely to make an impactful and costly mistake.

ii) Asset values:

Quantitative Easing has always been cited as the reason for increase in the price of financial assets like stocks and bonds and academicians claim that recent rise in stock market of US is attributed to the Bond Buyback Program of Federal Bank. Although there is some other section of academician who consider that effect of quantitative easing is modest. However, in either case, the common investors i. e households who invested in retirement or any other saving plans were benefitted from the Fed’s Quantitative Easing plans

Thus, once the Fed decides to taper the buy back program it will likely wear off the upward price trend in US Stock market and Bond Market, which were being continued because of quantitative easing program. However, if economy is in the bullish trend and is turning out top be strengthening after the Fed gets the timing and magnitude of taper correct, then this will push the asset prices in the other direction.

Thus, where QE Program are the reasons for increase in asset prices, the taper of this prgram will not mean that prices will fall. However, it does mean that the taper of QE Program will remove the upward price trend so caused by it in financial markets.

iii) Interest rates:

As the Federal Bank begins tapering the Quantitative Easing, interest rates, primarily the long term interest rates are most likely to increase. However, the impact from rise in interest rates are liley to be negligible because of modest reduction in long term interest rates so achieved with the program. Thus, if long term interest rates increases, it will have a negative impact on households that are considering to borrow and positive impact for the lenders of the capital as rise in interest rates means increase in their interest income.

iv) Exchange rate:

Apart from its impact on Asset Values and Interest Rates, the decision to taper quantitative easing will also have impact on Interest Rates. Although its impact on exchange rate is hard to document economically, but the program of quantitative easing will depreciate the US Dollars. This will have a certain positive impact for households employed or otherwise associated with firms engaged in exports of goods and services but would be detrimental to the households associated with import firms.(Thoma. 2013)

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