Economic article analysis

News Article from MSN Fed, in major shift, floods system with cash With short-term rates nearing zero, Helicopter Ben tries new approach The US Treasury and the Federal Reserve, as well as many economic observers, have seen that the recession has been taking shape in the United States because of falling consumer confidence and consumer spending particularly on durable goods, high levels of new for unemployment benefits claims, and shrinking of the gross domestic product (GDP) in the third quarter, considered the worst since the 2001 recession. Also, commercial banks which had been granted big interest rate cuts, reducing the rate to near zero, had been sitting on their funds and refusing to lend which, a move which would otherwise have led to more spending and investments. Banks, chastened by the recent credit disaster due to the subprime mortgage loan debacle, have refused to take more risks by way of lending. Seeing that the stimulus package did not work as expected, both Treasury and the Fed decided to inject funds directly -- from the helicopter, so to speak -- into the economy by buying distressed assets in order to pump more money into the economy to spur growth. This took the form of programs named Term Auction Lending Facility, Term Securities Lending Facility, and Asset Backed Paper Money Market Mutual Fund Lending Facility. This buyback program had recently reached $2. 2 trillion from $950 billion last September 2008. Such an approach sought to stave off a " catastrophic downturn" although some observers think that the recession is already running, the worst since the early 1980s.

From the economists point of view the attempt of the US government to intervene is based on what has been learned from the Great Depression of the 1930s when the so-called " invisible hand." was found no longer reliable.

A British economist, John Maynard Keynes, proposed that the government should take direct action to stimulate the economy, by way of infusing liquidity through direct spending to stimulate consumption and industrial activity. The injection of cash could be made through the banking system, through low interest rates, or through fiscal policy via a budget deficit, or by a combination of both monetary and fiscal policy. First, the Fed offers low discount rate to the banks, and the latter should be able to to lend the money to borrowers at just a slightly higher interest to account for their income derived from the spreads In the present situation, however, the banks are not extending credit. Consequently, the Fed had to take direct action by purchasing distressed assets. When the economy recovers as widely believed it will, starting -- hopefully -- around the second half of 2009, employment would increase, the gross domestic product would slowly improve, thereby ending the recession, and the values of the assets that the government had purchased will also increase. The government is therefore not throwing away money, but is trying to invest in Americas future by managing the economy through the purchase of assets at their lowest values. Once the economy recovers, it will be necessary for the Fed to siphon off the excess liquidity on a gradual basis so that high inflation can be prevented while not causing the GDP growth to decline.

In addition to the present level, the new Obama administration is expected to provide an additional stimulus package, which, based on economic models, should generate a certain level of increase in the GDP. For example, a stimulus package of about $600 would trigger a multiplier effect in the economy that will result in a 1 percentage point increase in the GDP. Economists do not expect this reversal of the recession to happen in the first

half of 2009, but optimistically it can happen in the latter half of that year or in 2010.

Despite the recession and the low interest rates, the US dollar has strengthened as global investors have found the US dollar to be a haven of safety in these uncertain times. This new demand for the dollar is not based on the same logic of higher relative interest rates as in the past but because of the safety it offers.

REFERENCES

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