

US Federal Reserve announces new round of bond purchases

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4 November 2010

The Federal Reserve Board on Wednesday announced a new round of bond purchases, in effect printing up hundreds of billions of fresh dollars and injecting them into the US economy. The move, widely expected after repeated hints from Fed Chairman Ben Bernanke and other central bank officials, will likely fuel a further rise in the US stock market and in corporate profits, while doing little to reduce near double-digit unemployment.

The new round of what is called "quantitative easing," coming a week before the G20 summit of major economies in Seoul, South Korea, will further weaken the US dollar against other currencies, intensifying global economic tensions and heightening the risk of trade and currency wars.

The Federal Reserve's policy-making Federal Open Market Committee (FOMC) issued a statement at the conclusion of its two-day meeting in Washington in which it announced that it would purchase \$600 billion in US Treasury securities between now and the end of June, 2011. It also said it would continue a program begun in August of using the proceeds from maturing mortgage-backed securities on its balance sheet to buy more Treasuries. The Fed estimated the latter program would result in additional purchases of US government debt of \$250 billion to \$300 billion.

The statement added that the Fed would consider increasing its bond purchases if economic growth continued to falter.

The FOMC presented a grim picture of the US "recovery," noting that its pace "continues to be slow," with "high unemployment, modest income growth, lower housing wealth and tight credit." The Fed committee said "progress toward its objectives" was "disappointingly slow."

Significantly, the statement reiterated language from

the previous meeting of the FOMC in September to the effect that the inflation rate, currently about 1 percent, was below the Fed's target rate (2 percent). This suggests that the Fed is deliberately seeking to raise the inflation rate in a calculated bid to encourage a further sell-off of dollars on international currency markets and lower the US currency's exchange rate.

This has the effect of cheapening US exports and making imports more expensive, giving US business a trade advantage over competitors in countries such as Germany, Japan and China.

The FOMC statement also repeated language the Fed has used since December of 2008 to signal its intention to keep its benchmark short-term interest rate—the federal funds rate for overnight inter-bank loans—between zero percent and 0.25 percent. The statement said that conditions would likely warrant "exceptionally low levels for the federal funds rate for an extended period of time."

The Fed carried out a program of quantitative easing between March of 2009 and March of 2010 in which it purchased \$1.4 trillion in mortgage-backed securities and \$300 billion in Treasuries. Together with near-zero interest rates, the printing of hundreds of billions of dollars flooded the financial markets with cheap credit, enabling the US banks and big corporations to record bumper profits even as they slashed jobs and costs and suffered revenue declines.

The new round of dollar-printing will likely have the same effect. Since August, when Bernanke first indicated he was leaning toward a new round of quantitative easing, the US stock market has risen by 12 percent. On Wednesday, US stock indices moved from negative territory prior to the Fed's announcement to close with modest gains. The Dow Jones Industrial Average recorded its highest close

since the collapse of Lehman Brothers in September 2008.

Over the same period, the dollar has declined sharply in relation to the Japanese yen, the euro, the Swiss Franc, the Australian dollar and other major currencies. On Wednesday, the dollar index, which tracks the US currency versus six major peers, lost another 0.5 percent.

The Obama administration has been directing its cheap dollar policy most openly against China, demanding that Beijing allow its currency to appreciate more rapidly against the dollar.

One result of US monetary policy is a flood of hot money into so-called emerging market countries, where higher exchange rates and more robust economic growth attract capital seeking higher returns. A range of countries, including South Korea, Thailand, India and Brazil, have taken measures, from currency market interventions to controls on capital inflows, aimed at protecting their exports and warding off investment bubbles and inflation.

On the eve of the Fed meeting, India and Australia raised their interest rates in preemptive moves to counter the effect of a new round of US dollar-printing. Duvvuri Subbarao, the governor of the Reserve Bank of India, said: “While the ultra-loose monetary policy of advanced economies may benefit the global economy in the medium term, in the short term it will trigger further capital inflows into emerging market economies and put upward pressure on global commodity prices.”

In a column Wednesday in the *Financial Times*, Mohamed El-Erian, the chief executive of the giant bond fund Pacific Investment Management Company (Pimco), warned of the likely global impact of the US cheap-dollar policy:

“The rest of the world does not need this extra liquidity... Several emerging economies, such as Brazil and China, are already close to overheating; and the euro zone and Japan can ill afford further appreciation in their currencies.

“Despite polite rhetoric to the contrary in the lead-up to the Group of 20 leading economies summit in Korea this month, other countries are likely to counter what they view as an unnecessarily disruptive surge in capital flows caused by inappropriate and short-sighted American policy. The result will be renewed currency tensions and a higher risk of capital controls and trade

protectionism.”



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