St. Louis Fed president rebuts criticisms of QE2

By Editor Test *Wed, Dec 8, 2010*

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At a recent meeting of the National Economists Club in Washington, St. Louis Fed president James Bullard said the benefits of the Federal Open Market Committee's decision to pursue additional quantitative easing outweighed its risks.

On November 3, the FOMC announced it would purchase about $75 billion worth of Treasury securities per month through the first half of 2011. Bullard addressed some of the risks and criticisms raised about this policy, known as QE2:

- On criticisms that the program may not be effective, Bullard said that the financial market effects of the program have been about what one would expect from an easing of monetary policy.
- On concerns that QE2 depreciates the dollar, Bullard noted that dollar depreciation is a normal by-product of an easier monetary policy, provided all else is held constant in the rest of the world, and that the U.S. has long maintained an independent monetary policy, a flexible exchange rate, and open capital markets. He stated that other countries need to have systems in place that can adjust to modest changes in U.S. monetary policy.
- Regarding the rise in nominal interest rates, Bullard said that QE2 puts downward pressure on nominal rates through securities purchases but that the effects of successful policy would put upward pressure on nominal rates. Therefore, Bullard argued, looking at the level of nominal rates alone is insufficient to judge the success of QE2.
- On inflationary concerns, Bullard said that while too much inflation is a legitimate concern, the 2010 disinflationary trend is worrisome right now. He emphasized that keeping inflation near the implicit inflation target is very important for maintaining the FOMC's credibility.
- Regarding arguments for using a commodity money standard, Bullard stated that although this approach was widely discussed in previous decades when inflation was high and variable, the volatility of commodity prices in recent years has made this approach problematic. He argued that inflation targeting can be seen as the intellectual descendant of commodity money standards. "Inflation targeting forces accountability for inflation outcomes onto the central bank," he said.
- On fears that the Fed is monetizing the debt, Bullard said the FOMC has often stated its intention to return the Fed balance sheet to pre-crisis levels over time. Once the FOMC returns the Fed balance sheet to its normal size, Bullard noted, the Treasury will be left with just as much debt held by the public as before the Fed took any of these actions. On claims that QE mitigates fiscal problems, Bullard argued that QE has no impact on the longer-run U.S. fiscal outlook and that this outlook remains very poor no matter what the Fed does.