

From fiscal to monetary stimulus: US Fed to Obama's rescue? (Feature)

By Chris Cermak Nov 4, 2010, 2:24 GMT

Washington - President Barack Obama has received an admitted 'shellacking' at the polls that will undermine his ability to use the tools of government to stimulate a faltering US economy.

On Wednesday, the US central bank that came to Obama's rescue.

The Federal Reserve announced a new round of 'quantitative easing' that will see the central bank buy up 600 billion dollars of government debt in the next eight months to boost [economic activity](#).

The state of the world's largest economy will no doubt be the top priority for Obama and US lawmakers in the coming year. Unemployment has remained stuck at 9.6 per cent for months, while the economy grew at just 2 per cent in the third quarter.

'People are frustrated. They're deeply frustrated with the pace of our economic recovery,' Obama said Wednesday in a press conference from the White [House](#).

'I think I've got to take direct responsibility for the fact that we have not made as much progress as we need to make.'

But the landslide victory of Republicans in Tuesday's congressional elections will almost certainly prevent Obama from passing any major government spending efforts that might have been his answer to kick-starting the world's largest economy.

Republicans take a sharply different line on how to revive economic growth: lower spending and lower taxes for businesses and consumers. In other words, government should step aside and let the private sector lead the way.

'It's pretty clear the American people want a smaller, less costly and more accountable government here in Washington,' Republican Congressman John Boehner, who is set to become the next speaker of the [House](#), told reporters Wednesday.

The lack of spending tools is as much a product of the election as of economic realities: the budget deficit skyrocketed to 10 per cent of economic output in 2009 as Obama used a 787-billion-dollar public stimulus to fill the gap left by a then-contracting private sector.

The measures may have helped pull the US out of recession, but the recovery has hardly been robust. Voters vented their frustrations Tuesday by putting Republicans back in

control of the House of Representatives and shrinking the Democrats' majority in the Senate.

Given the disagreements between Democrats and Republicans, what are the prospects for congressional action to revive the economy?

'The most likely scenario is nothing. You end up with gridlock,' Dean Baker of the Centre for Economic and Policy Research told the German Press Agency dpa.

Enter the Federal Reserve. The independent central bank's pledge to restart the printing presses could be one of the most significant actions taken by US policymakers in the coming year.

'I'm glad to see they're doing something rather than nothing,' Baker said. But he added: 'I'm not terribly confident this will accomplish much.'

Economists are divided on just how much the central bank can do to revive growth and create jobs, just as they disagree over the next steps for lawmakers in [Congress](#).

For some, the Fed is part of the problem, continuing a fruitless round of printing money that poses more risks to the recovery than it does rewards. The Fed first bought up nearly 2 trillion dollars in Treasury debt in the aftermath of the 2008 [financial crisis](#).

Mark Calabrio of the conservative free-market CATO Institute said the economy will get 'very little bang' from the Fed's new round of quantitative easing. The Fed's move instead risks causing an upward spiral in inflation and weakening the dollar.

'I see these risks as easily outweighing what little bump one might get from a few basis points decline in long-term [interest rates](#),' Calabrio said.

The limited clout of the Federal Reserve, coupled with the prospect of a gridlocked [Congress](#), would suggest dim prospects for the US economy returning to robust growth anytime soon.

'I'm not optimistic, certainly about 2011,' said Baker, predicting the jobless rate could rise above 10 per cent. 'Maybe by 2012 we start to see people getting out from underneath their debt.'