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Sink The QE2

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Monetary Policy: Top Federal Reserve officials plan to inject massive amounts of new money into the banking system after next month's midterm elections. But it's a dangerous policy, one that could create a new crisis.

The minutes of the Fed's policymaking Open Market Committee meeting in September indicate that it won't be too long before the central bank adds even more money to the banking system.

With inflation weak — the preferred Fed gauge of inflation is rising annually at a tepid 1.4% — and unemployment stubbornly stuck above 9.5% for almost a year, the Fed feels it can err on the side of ease right now.

So, sometime after the Fed's Nov. 3-4 meeting, analysts believe it will launch a new round of quantitative easing. That means the central bank will print huge sums of money, buy government Treasuries and agency debt, and hope like heck that this pushes long-term interest rates low enough to revive economic growth.

That's the theory, anyway. But some, like Cato Institute Senior Fellow Steve Hanke, are skeptical. Quantitative easing, he says, doesn't automatically translate into credit in the economy and economic growth.

Hanke may be right. The first round of quantitative easing, which began in March 2009 and ended a year later, achieved little.

True, the Fed created $1.7 trillion in new money over that time, and much of it was deposited in banks. As a result, private bank reserves soared from the normal average of about $5 billion to nearly $1 trillion — an unprecedented expansion in loanable reserves.

But businesses, fearful of more "stimulus" packages, TARP programs and government takeovers of key industries such as health care and autos, sat on the sidelines. Even with rates at record lows, they're still not borrowing. And neither are jobless consumers.

Since the first quantitative easing, 3 million jobs have disappeared and unemployment has jumped from 8.2% to 9.6%. In the five quarters after easing began, total real GDP grew just 2.7% — a measly rate largely due to businesses restocking their depleted shelves after a record drop in inventories in 2008.

Now the Fed plans a second round of quantitative easing, dubbed QE2, to print another $1 trillion.

If the first one didn't work, why risk a second? One look at the plunging dollar and surging gold prices over the last year and you see how investors view this. They think the Fed is debasing our currency to give an inflationary boost to the economy.

Luckily, some on the Fed may be having second thoughts. Janet Yellen, the Fed's usually dovish vice chairman, warned her colleagues on Tuesday that easy money could come back and bite us.

The objection by Yellen, a former Clinton administration official, comes as a surprise. She seems truly worried about the Fed's extraordinary efforts to refloat the economy with low interest rates and literally trillions of dollars of money created from nothing.

Obviously chastised by the experience of the last decade, and perhaps the 1970s, she worries about making the same mistakes again.

"It is conceivable," she told the annual meeting of the National Association for Business Economics in Denver, "that accommodative monetary policy could provide tinder for a buildup of leverage and excessive risk-taking in the financial system."

We have often disagreed with Yellen in the past, but not this time. If the Fed embarks on a new round of quantitative easing, it will be duplicating its earlier mistakes, staying too easy for too long and helping create a new inflationary bubble in the economy.

No one wants another financial bubble. We all know what happens when those pop.