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US stimulus having no direct impact

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By Mark Smith

Quantitative easing is having little direct impact on the market, according to Cato Institute senior fellow Dr William Poole.

In a presentation at the CFA Institute Investment Conference in Melbourne yesterday the former president of the Federal Reserve Bank of St. Louis said that the expansionary effect that can be seen in the market is coming from investors' expectations rather than any direct effect on pushing up market prices.

"If you're pumping water into an ocean then you're not going to see a noticeable rise in the level," he said.

"The Fed is pumping all this money into the system but the rates of money growth have been quite modest and bank credit has actually tailed off a little. Banks are sitting on $2 trillion in cash and not lending it out."

In spite of a seemingly gigantic $85 billion a month asset purchasing program, Federal Reserve chairman Ben Bernanke's first hint back in May that he would consider slowing the rate of stimulus was met with a sharp 100 basis point spike in bond yields.

"Quantitative easing (QE) is small relative to the scores of trillions of dollars worth of highly correlated bond assets out there in the market. But clearly Fed talk moves rates," Poole continued.

According to the policy expert, the Fed has until recently managed the market's expectations quite well by giving clear caveats about what to expect. However, Poole said the recent surprise decision to delay the start of tapering caught 90% of investors on the wrong side of the trade - a sign that the Fed had lost its way.

Poole predicts that the great unwind, or 'the taper caper', is still some way off with labor market figures disappointing, business fixed investment lagging behind. He added that regulatory and tax uncertainty were a disincentive to expansion.