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Fed Counts on 'Psychological Bump' With Borrowing, but May Just Add to Debt, Inflation

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Published November 09, 2010 | FoxNews.com

Investors beware: The Federal Reserve may have just agreed to make $600 billion more available for borrowing, but don't expect to see that money flooding the market any time soon.

At least that's the warning from some financial experts who say the Federal Reserve's pledge to buy $600 billion in Treasury bonds is unlikely to help improve inflation or interest rates, which are at historically low levels, but it will add to the U.S. debt.

The Fed is "looking for a psychological bump to get (Americans) out of the doldrums they're in," said Michael Canet, head of Prostatis Financial Advisors Group and host of the "Savvy Investor" radio show out of Baltimore, Md.

"Unemployment is still 9.5 percent ... manufacturing is still at 70 percent capacity," he noted.

Canet is among a slew of economists, politicians and financial planners who say the Fed's use of monetary policy to push the economy forward could have the opposite effect of what Federal Reserve Chairman Ben Bernanke intends.

"We already have very loose monetary policy, very, very low interest rates. This is going to give us an inflation problem in the future. It's going to give us an interest rate problem in the future. It is destabilizing investment horizons," Rep. Paul Ryan, R-Wis., the next House Budget Committee chairman, said on "Fox News Sunday."

The Federal Reserve's plan, called "quantitative easing" by policy wonks, is an effort to make more money available so that banks will lend more and people will feel freer to spend. Three years ago, the Federal Reserve did a similar trick, purchasing $300 billion in Treasury bonds to make credit more accessible.

That was at the start of the recession. The economy has started to grow since then, which to many means Fed policy should be looking at ways to wipe debt from the books, not take more on.

"I didn't argue with the first quantitative easing but the economy is growing for 16 months now," said Alan Reynolds, a senior fellow at the libertarian Cato Institute and member of Ronald Reagan's transition team at the Office of Management and Budget.

Reynolds noted that "3.1 percent real growth in the past year is about half what it ought to be but it's not nothing." He argued that with growth, people expect inflation to rise so the Fed doesn't need to "throw fuel on the fire."

But with interest rates nearly zero and banks still tight-fisted with the cash they have available to lend, the Fed announced last week that it will buy an additional $600 billion in Treasury bonds in the next eight months.

"Currently, the unemployment rate is elevated, and measures of underlying inflation are somewhat low, relative to levels that the (Federal Open Market) Committee judges to be consistent, over the longer run, with its dual mandate," the central bank announced in a statement last week.

"To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the committee decided today to expand its holdings of securities," it said.

President Obama -- traveling in India on Monday -- praised the move.

"The Fed's mandate, my mandate, is to grow our economy. And that's not just good for the United States, that's good for the world as a whole," he said, adding that the Federal Reserve is an independent agency from his administration.

"The United States has been an engine for growth, for trade, for opportunity for decades now. ... And the worst thing that could happen to the world economy, not ours -- not just ours, but the entire world's economy -- is if we end up being stuck with no growth or very limited growth. And I think that's the Fed's concern, and that's my concern as well," he said.

Canet told FoxNews.com that the Federal Reserve is trying to flood money into the market in an effort to push down interest rates and encourage borrowing. For instance, he said, if mortgage rates do down from 3.5 percent to 2.5 percent, it ideally would spur home purchases. The action conceivably would also drive down the value of the dollar and make U.S. products more desirable and affordable overseas.

But the problem with the plan, Canet warned, is that there aren't enough remaining buyers in the housing market who were just holding off to wait out interest rates. Likewise, the middle class globally isn't large enough to close the trade imbalance that is adding to U.S. indebtedness.

"I don't know if it's going to play out that way," Canet said of the Fed's intentions. "I think they're wrong but that's what they're hoping for."

He added that the other problem with the plan is that banks aren't lending the money the Federal Reserve is trying to make available.

"The banks make their bottom line look better, their stock prices go up ... the fact that it's all smoke and mirrors is irrelevant," Canet said.

Former Republican vice presidential contender Sarah Palin argued that inflation rates are already on the rise, which Americans can feel when they go grocery shopping. That being the case, the Federal Reserve doesn't need to make more money available for spending.

"Pump priming would push them even higher," she said of inflation rates, using the slang for government-sponsored stimulus.

Reynolds predicted that the positive impact of the move will be "temporary at best," and he likened it to the government's "cash for clunkers" program that offered incentives for people buying new, high gas mileage cars. Auto purchases rose during the length of the program, but quickly dropped again once the rebate offer ended.

"The Fed can print money but it can't print jobs," he said.

Canet and Reynolds did offer some practical advice. They agreed that it's unwise for investors to put all their eggs in one basket -- and the adage that the older one gets, the more liquid one's assets should be is dead.

"Bernanke is really messing with those people" who live by that rule, Reynolds said.

Canet said the bond market still can make sense for people who want to save, but consumers probably want to look at individual bonds and not invest in mutual funds with a basket of bonds unless it is short-term.

He said he is on a wait-and-see approach to bonds to give time to "let the QE2 shake itself out."

As for the stock market, it has had a good year.

"Lots of people say the stock market has gone up because of Bernanke. I don't buy that.

... It's hard to square that circle," Reynolds said.

"The approach you need today is how do I create an income stream that I'm not going to outlive," Canet said

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