Debate Club: Should There Be More Quantitative Easing?

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Cheaper Credit Will Not Fix the Housing Market

By **MARK CALABRIA** | July 20, 2012

Continued weakness in the labor market has renewed calls for an additional round of quantitative easing by the Federal Reserve; that is the large scale purchase of assets, mostly treasuries or agency (Fannie Mae and Freddie Mac) securities, with long maturities. Such additional purchases would be a mistake as the impact on the labor market would be minimal, potentially negative, and the long-run risks to the Fed and the economy would be substantial.

There are two claimed direct positive impacts of QE: a reduction in long-term interest rates and an increase in the value of financial assets as investors were "pushed" out of treasuries and agencies into other assets. As real interest rates are either negative, for shorter maturities, or historically low already, it is unclear how a few basis-point decline is going to spur investment or home purchases. Real, after inflation, 30-year mortgage rates are now under 2 percent. The problem facing the housing market—weak demand and excessive supply—will not be fixed by cheaper credit. If that was the fix, our housing market would be booming. The problem facing the mortgage market is the unwillingness to lend to anyone but sterling borrowers. Today's mortgage rates do not cover the interest rate risk, much less the credit risk. Higher rates would actually improve the housing market by increasing the willingness to lend.

[See a collection of political cartoons on the economy.]

Despite the repeated bumps that QE has offered to the stock market, these momentary asset bubbles have not increased employment. Outside of the financial sector, corporations are flush with funds. They are not short on equity. What they need is a stable economic environment and increased confidence. Repeated attempts to push up asset prices via monetary policy have also contributed to economic inequality, as it is the wealthy who predominantly own assets. It continues to be a puzzle why some of the loudest advocates for QE also complain about economic inequality.

The Federal Reserve exposes itself to considerable interest rate risk by increasing the maturity of its assets. The value of fixed income assets, like treasuries and agencies, is inverse to the level of interest rates. When rates inevitably increase, the Fed will

suffer real economic losses on its portfolio. The possibility of a central bank whose assets are exceeded by its liabilities is a risk where costs exceed a few basis-point declines in long-term rates.