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**QE3 coming – and economists expect it**

**Reuters 6/21**/12 – (Accessed via: Business Standard, “Fed ramps up economic stimulus, says may do more”, http://www.business-standard.com/india/news/fed-rampseconomic-stimulus-says-may-do-more/175529/on)

It also slashed its estimates for U.S. economic growth this year to a range of 1.9 percent to 2.4 percent, down from an April projection of 2.4 percent to 2.9 percent. It cut forecasts for 2013 and 2014, as well.

In addition, Fed officials said they expect the job market to make slower progress than they did just a couple months ago, with the unemployment rate now seen hovering above 8 percent for the remainder of this year. It stood at 8.2 percent in May.

The announcement of the extension of Twist met with a mixed reaction in financial markets. Prices for U.S. stocks and government bonds see-sawed. The dollar fell against the euro and rose against the yen.

"This is a small step. This is probably the least of their unconventional easing tools that they could have used," said Ethan Harris, North American economist for Bank of America/Merrill Lynch in New York.

A number of economists said the Fed was likely to eventually launch a third round of outright bond purchases, or quantitative easing, which would expand the Fed's holdings of assets.

"If we don't see continued improvement in the labor market, we will be prepared to take additional steps if appropriate," Bernanke said. "I think there should be some conviction that they are needed, but if we do come to that conviction, then we will take those additional steps."

DOWNBEAT ASSESSMENT

Hiring by U.S. employers has slowed sharply, factory output has slipped and consumer confidence has eroded. Europe's festering debt crisis and the prospect of planned U.S. tax hikes and government spending cuts weigh on the outlook.

The economy grew at only a 1.9 percent annual rate in the first quarter, and economists expect it to do little better in the second quarter.

**Fiscal stimulus trades off with monetary stimulus**

**Sumner 1/2**/12 - Professor of Economics at Bentley University, PhD in economics from the University of Chicago (Scott, An interview of Sumner hosted by Russ Roberts, Library of Economics and Liberty, “Sumner on Money and the Fed”, <http://www.econtalk.org/archives/2012/01/sumner_on_money.html>, 35th minute)

But then what's the implication of what we ought to be doing? The left-of-center approach is, say: We just need to spend more. We need to get nominal income up--they agree with you. Nominal income has been falling or is not rising at a fast enough rate, so something needs to fill that gap by spending more money. That's their standard argument. Why are they wrong? They are arguing for government spending, which I think first of all won't really help very much. And second, monetary stimulus. The best way and probably the only way to promote faster nominal GDP growth is to get a more expansionary monetary policy. So, I think the mistake on the left is to put too much faith in fiscal stimulus. Fiscal stimulus is relatively weak, and it also tends to be offset or neutralized by monetary policy. But let's say monetary policy stayed as it is; the President and the Congress got the Keynesian religion; they listened to Paul Krugman and they increase government spending in the United States by over a trillion dollars this year, which is what many people are advocating who are Keynesians. They argue interest rates are too low; the Fed has no bullets left. So, they can't lower the interest rate any more; so the best thing to do is have government spend. Government spending a trillion dollars--isn't that going to increase nominal income? Here's the tricky part: When you said, let's leave monetary policy as it is, you slid over a very subtle and complicated question, and that is: What is monetary policy? And I find when I talk to people, everybody I talk to seems to have a clear and definite idea in their mind about what we mean by holding monetary policy constant. But they don't equate with each other. So, for some people that means the Fed keeping the money supply constant. For others it means keeping interest rates constant. Which is a very different policy. And I think both of those are wrong because it's not what the Fed is actually doing. What the Fed is actually doing is adjusting monetary policy to conditions in the aggregate economy. So, they'll do some quantitative easing (QE), then they'll back off; they'll do some more. Or Operation Twist. Or they'll promise to keep interest rates low for two years. And these policies are not highly effective, but they are probably effective in slightly nudging the economy a little bit faster, a little bit slower. So, what the Fed is doing is these on and off policies as it reads the incoming economic data. If the data gets stronger, the Fed does less. When the data gets weaker, the Fed does more. What that means is fiscal stimulus does succeed in promoting a little bit faster growth; the Fed will react by doing less quantitative easing and other policies of that sort; and it will very likely neutralize most of the effect of the fiscal stimulus. Now, I'm not trying to stake out an extreme position here. If the Federal government did an enormous amount of fiscal stimulus, yes, I think it would boost nominal GDP. Whether it would be a good idea would be another question. But obviously, if you took it to the extreme like the spending in WWII, it would definitely boost measured GDP in the economy. But for the amounts that are politically realistic, I really don't think--let me put it this way: The original stimulus bill was originally around $800 billion, in 2009. Ended up being $825 billion. I think it was a mixture of spending and some tax rebates. About 1/3 each--1/3 tax rebate, 2/3 spending, and of that 2/3, 1/3 on payments to the states and 1/3 on various so-called expansionary activities of various kinds. And that was done in early 2009. About the same time the Fed was getting very worried about the economy. It wasn't "done" in 2009. The legislation authorizing it was enacted. It took a while to spend it; it spent out over 2 or 3 years. Right. But importantly, by the way, a lot of modern theories say the effect on demand should come with expectations; so it should start even when the program is not enacted. You've got that program, then. The standard way of looking at it is to assume the Fed is just this passive bystander. But everything we know about Ben Bernanke, throughout his career, tells us very clearly he had no intention of allowing a Great Depression II on his watch. He's a scholar of the Great Depression. He passionately believes the Fed blew it by not being more aggressive. He's also insisted all along the Fed has lots of ammunition they haven't used. He's talked about things they could do, things he recommended the Japanese do that he hasn't done yet. So, the Fed has a lot of ammunition left including the most powerful tools, which they haven't pulled out yet. Which are? Setting a higher inflation or nominal GDP target is the most powerful one probably. If they could. That would be politically controversial, especially if they did it in terms of inflation. I prefer nominal GDP. But here's my point: Suppose Obama did nothing in 2009. There's no way the Fed would have just sat back passively and watched the economy collapse. What would have happened is with less fiscal stimulus there would have been a lot more monetary stimulus. I don't know exactly what it would look like. I'm not saying it would have exactly made up for the lack of fiscal stimulus, but my point is this: Any estimate of the effects of fiscal stimulus are probably really wildly exaggerated by not taking into account the reaction function of the monetary policy makers. And that's the big flaw in the way we think about fiscal stimulus. And no matter how many times I make this point, I find it's very hard for people to absorb it. They want to think in terms of other things equal--like, okay, there's the monetary policy; now let's see what fiscal policy can do. It doesn't work that way. If fiscal policy does more, monetary policy will do less. That's how things work.

**Quantitative Easing solves the economy – multiple reasons**

**Gagnon 11** – a visiting associate director at the Division of Monetary Affairs at the US Federal Reserve Board, PhD in economics from Stanford (Joe, Interview, 6/14/11, “Interview with Joe Gagnon on Quantitative Easing, its Criticisms and the Argument for QE3”, http://rortybomb.wordpress.com/2011/06/14/interview-with-joe-gagnon-on-quantitative-easing-its-criticisms-and-the-argument-for-qe3/)

Since the Federal Reserve is buying other assets, does QE have the same kind of effect regarding interest rates?

Yes it does. The way to think of monetary policy is that it tilts the playing field between savers and spenders. Normally it just works on short-term interest rates, which encourages corporations to invest more and savers to save less. Quantitative easing impacts longer-term interest rates, but this also has the same effect on savers and spenders. It makes it easier to borrow and less attractive to save.

So did QE2 work? And if so, how can you tell?

It did work. I think QE2 had two elements. One element was of moderate importance, one element was of minor importance. The moderate one is that QE2 convinced markets that the Federal Reserve would not allow deflation or a double dip recession to happen. This is good because it inspired confidence and kept inflation expectations from falling any further. That was the most important step, because it convinced financial markets that the United States wouldn’t turn into Japan, which they were worried about. The element of minor importance was that it lowered long-term bond rates a little bit. It takes a lot of purchases to move these interest rates even a little bit, and QE2 wasn’t big enough to move them dramatically. It’s not nothing, but it is small in the scheme of things.

Why is deflation bad, and what would it mean to be the next Japan?

The interest rate that matters for households and businesses is the real interest rate, which is the nominal interest rate minus the inflation rate. Why is that? Because when prices of everything are going up, when you pay back a loan at a certain interest rate some of that is just eaten up by inflation. The lender doesn’t get in real terms — in terms of goods and services — as much back as he lent because of this inflation. Higher inflation lowers the real rate of interest. Deflation raises the real rate of interest. If deflation gets big enough, when you hit the zero bound, you have a positive rate of interest and get into deflationary spiral, where the real rate of interest is choking the economy and choking the economy makes the deflation worse, which is a vicious cycle.

Japan has been in a mild version of that. It hasn’t accelerated, but it hasn’t gotten out of it either.

So how do you know that QE has worked? What kind of studies are conducted, and how do they draw their conclusions?

I have a paper that looked at two things. When the Fed made announcements on QE1, what happened to bond yields? Yields on the things the Fed was buying went way down, but yields on things the Fed wasn’t buying also went down. All yields went down. So that was one piece of evidence. As for the other piece of evidence, we looked back thirty years and ran a regression of how the government’s net supply of long-term bonds affects bond yields. We found when the government issues more long-term bonds, bond yields increase. When the government buys back long-term bonds, bond yields go down. QE, really, is like the Treasury buying back long-term bonds and issuing short-term bonds. There’s a long history of this, including in non-crisis times. So for both pieces of evidence, when the government buys long-term bonds and issues short-term bills, it can push down the yield curve.

So QE2 helped with the job growth of the past year?

It definitely contributed by relieving businesses’ fears of a double-dip recession and deflation. This helped with some growth in the economy. But really, not enough. The Fed has not been aggressive enough, it has been too timid.

II: Addressing Criticisms of Quantitative Easing

I want to talk about some criticisms of QE that have come up. There’s an argument that QE generally can provide a floor on how bad the economy will go, but can’t, by itself, get us back to full employment and trend growth. What do you make of that argument?

There’s no reason to think that there’s any limit to the effectiveness of quantitative easing or monetary policy. There’s no theoretical or practical reasons to think that monetary policy will stop working. They’ve just been too timid.

What about the argument that QE has caused massive inflation?

Look at measures of underlying inflation. Wage inflation is the most important thing. Think about slow-moving prices that are inside the US economy.

Wage inflation is not spiraling.

Right. Commodities have spiked, but oil has come back. If monetary policy was to respond to commodities, you’d have really unstable policy. You don’t want to ignore any price, but you want to smooth through the noisy ones. Wages are an important one. Monetary policy works through the labor market. If inflation is too high, we throw people out of work to cool the economy and keep wages low. And if inflation is too low, you want to hire more people to get the economy going faster. If you look at wages there’s no worry about any future inflation.

There are two other criticisms of QE2 that go in different directions. One is that the new capital has just sat on banks’ balance sheets and not impacted the recovery. The other is that, with rates being so low, QE just helps create asset bubbles. How would you address these?

They are both different. The first is rather easy. We know that the banks aren’t lending the money out. There’s little the Fed can do about that. So QE2 wasn’t aimed at the banks. It would be good if the banks lent that money out, because we wouldn’t then have to do so much QE. But the banks aren’t. Given that they aren’t, we need QE3 to push down other prices to work through the bond market or the foreign exchange markets.

Can you talk a bit more about these alternative channels?

The basic channel is the bond market. The Fed is buying up long-term bonds and that pushes interest rates down on those bonds. That’s what makes it attractive for people to borrow. The market then does some arbitrage. The equity market looks at the bond market and says “oh, well, long-term bond rates are low, so we are going to discount future dividends and profits differently.” This makes the value of stocks more attractive and raises their values. And this encourages businesses to invest. Also, international investors look at rates of return in other countries, and they say “these other countries have higher rates of return than in the U.S.,” so that pushes the dollar down. These aren’t direct channels of monetary policy, but they are linked.

Some might interpret that as saying QE deliberately creates a stock bubble, which makes them nervous.

Well, there’s two important things to keep in mind. First of all, the harm of a bubble arises almost entirely if it’s leveraged. We have to make sure, through financial regulations, that people are not borrowing to buy stocks. And they aren’t as far as we know. The tech bubble wasn’t leveraged, and when it burst it had little effect. The housing bubble was leveraged, and it had a major effect. If we have an equity bubble, and equities don’t seem to be priced unusually high, but even if we did, we’d want to make sure it wouldn’t cause harm when it unwinds.

The second is that it’s not clear that it is even a bubble if monetary policy is working through interest rates, as monetary policy always does. You need equities to be priced highly when there’s a recovery, you want to encourage people to invest. Moreover, by creating a healthier economy, monetary policy can increase the fundamental value of equities, which by definition is not a bubble.

Some like Raghuram Rajan and Thomas Hoenig have taken the concern about bubbles further and argued that rates being “unnaturally low,” specifically short-term rates at zero for too long, creates conditions for moral hazard and distorts asset prices. How do you respond to this?

The cause of unusually low interest rates right now is two things: first, households and small businesses are repairing their balance sheets and do not want to borrow more; and second, developing economies — led by China — are funneling massive amounts of government money into the US and European economies. The correct response of monetary policy is to push interest rates as low as possible. Rajan and Hoenig are confusing cause and effect.

Recently, Rajan has argued the morality of monetary policy, saying that QE2 hurts “the patient and uncomplaining saver.” What do you say to the argument that QE (and monetary policy generally) is being too unfair to savers?

This is always an effect of monetary policy, which benefits borrowers when the economy is weak and savers when the economy is strong. Savers do not have any right to a specific rate of return and they are free to spend the money or invest in physical capital or equities if they want a higher rate of return. In any event, the distributional effects of monetary policy are much smaller than those of fiscal policy, which transfers from future generations to today’s generations.

One last argument against QE. The economist Richard Koo looks at the US recession and, comparing it to Japan and the Great Depression, says we suffer from a debt overhang that has devastated the balance sheets of households and firms.

I totally agree with him.

His critique then follows that QE, and monetary policy more generally, encourages people to take on more debt, but since everyone has too much debt, QE can’t help. Interest rates are at record lows, yet consumers are de-leveraging, implying that consumers want to shed debt regardless of how cheap it is. How would you address this?

People don’t want to borrow as much as they normally would. But QE helps by allowing people to repair their balance sheets. Households can refinance their debts into lower rates. Corporations are issuing long-term bonds at record-low rates. They are paying off older, higher-yield debts. This repairs their balance-sheets and increases their value. For households, if you can get a lower rate that reduces your payments. That’s a huge improvement to you.

Once you repair your balance sheet, you are prepared to spend sooner. So even if QE doesn’t immediately raise borrowing as much as it would in normal times, it is making it easier for you to repair your balance sheet and get the economy to a place where you’ll spend faster. It’s absolutely all the more essential because of the balance sheet nature of the recession. You want to raise asset prices to make people feel better off. You want to lower interest rates so people can refinance and repair their balance sheets. QE is the best way we have of addressing Richard Koo’s concerns.

# **\*\*\*Uniqueness**

## Quantitative Easing Coming Now

Quantitative easing coming now – analysts expect it

Jones 6/19/12 – Money Supply economics team writer (Claire, Financial Times, “More QE on the way”, http://blogs.ft.com/money-supply/2012/06/19/more-qe-on-the-way/)

After the surprise news today that annual inflation fell to a two-and-a-half year low of 2.8 per cent in May, analysts now increasingly expect the Monetary Policy Committee to announce more quantitative easing on 5 July.

Following Sir Mervyn’s Mansion House address last Thursday, it has largely been a case of when — not if — the MPC would plump for more money printing. But before today’s inflation number, analysts were split on whether more QE would come in July, or in August.

Now, the majority expect further asset purchases to come sooner rather than later. Here’s what economists are saying:

George Buckley, Deutsche Bank: The fall in CPI inflation to 2.8% in May (down from 3%, which was also the consensus view) increases the likelihood at the margin of more quantitative easing at the July meeting. Following last week’s speeches by the Chancellor and Governor we expect GBP50bn more gilt purchases to be announced in July with a sizable risk of a 25bps rate cut to boot.

Simon Ward, Henderson Global Investors: The fall in annual CPI inflation from 3.0% in April to 2.8% in May represents a significant favourable surprise that further increases the likelihood of an extension of QE – probably by £75bn – at the July MPC meeting.

Philip Shaw, Investec: At last week’s Mansion House speech the Governor mentioned that the case for further easing was growing. Indeed we consider that there is a very good chance that the MPC will turn the QE taps back on next month. With inflation coming down sharply over the past couple of months, the economic data disappointing and global uncertainties rising, there doesn’t appear to be much cause to hold back.

Howard Archer, IHS Global Insight: Good news for both consumers and the Bank of England as lower oil petrol prices helped drive consumer price inflation down to a 30-month low of 2.8% in May. This eases the still appreciable squeeze on consumers’ purchasing power and facilitates further Quantitative Easing by the Bank of England that is looking ever more likely to occur in July.

David Tinsley, BNP Paribas: This all makes the MPC’s job a little easier. The May Inflation Report had a forecast for CPI inflation of 3.15% in 2012 Q3. On current form it is likely to undershoot that significantly. There is therefore little stopping the MPC unleashing another burst of QE at its next meeting.

Melanie Bowler, Moody’s Analytics: Given this latest development, and the fact that inflation is coming down, we expect the BoE will also restart quantitative easing. We anticipate a further £50bn to be added to the asset purchase programme at the July monetary policy meeting, bringing the total fund to £375bn. Central bankers last increased the fund by £50bn to £325bn in February. Interest rates will remain at 0.5%.

Chris Williamson, Markit: With the economic data suggesting the UK is set for another quarter of economic decline in the current quarter, with even the previously strong-looking business surveys now turning down (notably for manufacturing), the odds have certainly increased that the Bank of England’s Monetary Policy Committee will vote for more quantitative easing at its July meeting.

Ross Walker, Royal Bank of Scotland: The inflation data are hardly the main issue for markets at this moment, but May’s data do serve to lower the hurdle to QE as soon as July, should the MPC wish to oblige.

Michael Saunders, Citi: The MPC is likely, in our view, to resume QE in July, raising it a lot further in coming quarters.

Though not all economists are convinced that the MPC will pull the trigger as soon as next month:

Alan Clarke, Scotia Bank: Against this background, it is likely that speculation of further QE will build. However, the key question is whether last week’s additional measures will substitute for more QE or come in tandem. Tomorrow’s minutes may provide more clues.

John Zhu, HSBC: The swifter fall in inflation should give the MPC more confidence to extend QE to support growth. The BoE Governor, Sir Mervyn King, made clear last week he thought the case for more monetary easing had risen since May and today’s data will only add weight to that view. We think this means a resumption of BoE gilt purchases and expect another GBP50bn of QE in September. This has been our long-held view, but following the recent deterioration in the global economic outlook, the risks now are that QE happens earlier. We will have more information tomorrow when the MPC minutes from June are published.

**Quantitative Easing now – bond investors expect it**

**Mackenzie 6/6**/12 – US Markets Correspondent for the Financial Times (Michael, Financial Times, “Bondholders look for word of more Fed help”, http://www.ft.com/intl/cms/s/0/5a158b8a-af1a-11e1-a8a7-00144feabdc0.html#axzz1wqcLEcbl)

Fears of systemic stress and weak US economic data spark dramatic declines in Treasury yields, followed by the Federal Reserve launching a new round of bond purchases, confirming the pre-emptive positioning of bond investors.

Against the backdrop of the eurozone crisis and a poor US jobs report for May, the big drop in Treasury yields and record low mortgage bond rates suggest this pattern may repeat itself and that a third round of quantitative easing, or QE3, looms when the Fed meets later this month.

Bond investors are on guard for any hint on Thursday, when Ben Bernanke testifies about the outlook for the economy before the Senate Banking Committee.

“A temporary soft-patch assessment will increase the odds of an extension in Operation Twist, while concern about a renewed downturn would imply QE3,” says Steven Ricchiuto, chief economist at Mizuho Securities.

More QE would vindicate investors such as Bill Gross, whose $260bn total return fund holds more than 50 per cent in mortgages and returned 5.6 per cent so far in 2012, beating most of his competitors and the 2.6 per cent gain of the market benchmark, the Barclays US Aggregate Index.

But for the Treasury market, prior rounds of QE have ultimately triggered a rise in yields as risk assets, led by equities, have rallied sharply and inflation worries have been fanned by the central bank expanding its balance sheet.

This week’s hopes of greater Fed accommodation have led to a rebound in stocks and sent the 10-year yield up from Friday’s low of 1.44 per cent back above 1.60 per cent.

**Slowing economy guarantees the government will follow through with another round of quantitative easing**

**Politi and Harding 6/7**/12 – James Politi is a US economics and trade correspondent for the Financial Times, Robin Harding is a economics editor for the Financial Times (Financial Times, “Fed officials look to easing option”, http://www.ft.com/intl/cms/s/0/db7b9196-aff7-11e1-ad0b-00144feabdc0.html#axzz1ywkiWXKc)

The US can and should consider easing monetary policy again if risks to the economy materialise, said senior Federal Reserve officials, increasing the chances of action at the bank’s next policy meeting, which will end on June 20.

Janet Yellen, vice-chair of the Fed board and one of its most influential policy makers, said that while modest growth was the single most likely outcome for the US, “I see substantial risks to this outlook, particularly to the downside.”

“If the committee were to judge that the recovery is unlikely to proceed at a satisfactory pace . . . or that the downside risks to the outlook had become sufficiently great . . . I am convinced that scope remains for the Federal Open Market Committee to provide further policy accommodation,” she said.

Ms Yellen’s very dovish remarks to the Boston Economic Club on Wednesday evening show that the Fed, alarmed by developments in Europe and weak economic data, is considering whether to act. The Fed’s stance may become even clearer when Chairman Ben Bernanke testifies to Congress on Thursday.

She said these risks to the economy meant policy might need to be even looser than otherwise to manage the risk. “It may well be appropriate to insure against adverse shocks that could push the economy into territory where a self-reinforcing downward spiral of economic weakness would be difficult to arrest.”

Ms Yellen also implied that the Fed’s best available easing tool might be its balance sheet rather than a promise to keep interest rates low even later than the current “late 2014”.

“If the recovery were to proceed faster than expected or if inflation pressures were to pick up materially, the FOMC could adjust policy by bringing forward the expected date of tightening,” she said. “If the committee judges that the recovery is proceeding at an insufficient pace, we could undertake portfolio actions such as additional asset purchases or a further maturity extension programme.”

Under the Fed’s current maturity extension programme – Operation Twist – it is selling shorter-term Treasury securities and buying longer-term bonds. Additional asset purchases would mean another round of quantitative easing, nicknamed QE3.

Separately, Dennis Lockhart of the Federal Reserve Bank of Atlanta said the current stance of US monetary policy was still “appropriate” but highlighted gathering risks to the recovery that could merit action if conditions get worse.

“Should it become clear that something resembling my baseline scenario of continued, though modest, growth is no longer realistic, further monetary actions to support the recovery will certainly need to be considered,” Mr Lockhart said in a speech in Fort Lauderdale, Florida.

The Fed has kept interest rates at rock-bottom levels, and officials said they expected this to continue until the end of 2014. Furthermore, the Fed last year extended the maturity on its asset portfolio to support the recovery.

Data released on Wednesday showing that unit labour costs in the first quarter advanced at a much slower pace than previously thought could reassure any Fed policy maker deterred from more easing by fears of inflation.

**QE3 likely soon**

**Mackenzie 3/12**/12 – US Markets Correspondent for the Financial Times (Michael, Financial Times, “US quantitative easing: Twist keeps QE on back burner”, http://www.ft.com/intl/cms/s/0/77c14fda-63bf-11e1-8762-00144feabdc0.html#axzz1ywkiWXKc)

While that disappointed some investors, concerns that the economy will expand at a lacklustre pace in the first quarter mean QE3 cannot be ruled out. The spike in oil prices this year poses a big risk that the economy could soften and counter the recent improvement in job hiring.

Steven Ricchuitto, economist at Mizuho Securities, says that QE3 could arrive in the second quarter should the economy weaken. “We may see some giveback, and if the economy suffers, the Fed will start QE3.”

Such a slide, after the US economy expanded by 3 per cent in the final three months of 2011, stands to arouse concerns that the US is stuck in a sluggish stop-start economic cycle, with the writing-down of debts incurred during the mortgage and credit bubble preventing a sustainable recovery.

Dan Greenhaus, chief global strategist at broker BTIG, says: “Without a meaningful and sustained improvement in the US economy, the likes of which we do not forecast, the Fed will launch another bond buying programme later this year.”

As it stands, the Fed is engaged in Operation Twist, its policy of selling short-dated Treasuries and using the proceeds to purchase long-term debt.

The Twist has kept long-term Treasury yields at low levels, with the 2 per cent yield on 10-year notes below the current annual inflation rate of 2.9 per cent.

“The Fed is still doing the Twist and that’s controlling rates,” says Gerald Lucas, senior investment adviser at Deutsche Bank.

With earlier bouts of QE sparking a sharply weaker dollar and surging commodity prices amid fears of higher inflation in the future, the Twist may remain a key policy tool after its proposed end date of June.

Mr Lucas says a scaled-down version of the Twist is likely after June, so as to keep rates low and boost the recovery.

Richard Gilhooly, strategist at TD Securities, says: “Twist is the electric shock wire that keeps yields contained, while the option of doing QE3 is more efficient and powerful than actually doing it and expanding the Fed’s balance sheet.”

That said, the threat of QE3 remains, should the US economy be hit by bad news – whether from Europe or the hard landing feared for China.

“QE3 will loom on the horizon,” says Professor Lo, “if there is a further deterioration in the eurozone with a spillover to the US.”

Worsening economy increases the likelihood the Federal Reserve takes action

Kramer 6/21/12 – Successful Wall Street equity analyst and investment manager, MBA from UPenn Wharton (Hilary, Investor Place, “Let’s Do the Twist: The Fed Steps in Again”, http://www.investorplace.com/2012/06/fed-steps-in-once-again-fed-pg/)

Here in the U.S., the news has not been so great either with a string of disappointing economic reports last week. The greatest concern remains the job market. First-time unemployment claims rose to 386,000 last week, and that was followed this week by a larger-than-expected decline in housing starts, though permits did jump. Another indication of weakness was U.S. employers posting the lowest number of job openings in five months. Job openings fell to a seasonally adjusted 3.4 million in April, down from 3.7 million in March.

In the view of Wall Street, however, bad news can be good news. That’s because investors look ahead. The economy has clearly weakened, which made it more likely that the Fed would step in, and step in they did.

**QE3 will happen but only if the economy doesn’t pick up in the next few months**

**Costa and Felsenthal 6/21**/12 – Journalists for the Business Times (Pedro Costa and Mark Felsenthal, Business Times, “US Fed extends stimulus measures”, LexisNexus)

In addition, Fed officials said they expect the US jobs market to make slower progress than they did just a couple months ago, with the unemployment rate now seen hovering above 8 per cent for the remainder of this year. It stood at 8.2 per cent in May.

The announcement of the extension of Operation Twist met with a mixed reaction in financial markets. Prices for US stocks and government bonds see-sawed. The dollar fell against the euro and rose against the yen. A number of economists said the Fed was likely to eventually launch a third round of outright bond purchases, or quantitative easing, which would expand the Fed s holdings of assets.

If we don’t see continued improvement in the labour market, we will be prepared to take additional steps if appropriate, Bernanke said. I think there should be some conviction that they are needed, but if we do come to that conviction, then we will take those additional steps.

Hiring by US employers has slowed sharply, factory output has slipped and consumer confidence has eroded.

Europe’s debt crisis and the prospect of planned US tax hikes and government spending cuts weigh on the outlook.

The US economy grew at only a 1.9 per cent annual rate in the first quarter, and economists expect it to do little better in the second quarter.

QE3 will happen but only if the economy does not improve

Ip 6/21/12 – US economics editor for The Economist (Greg, The Economists, “The limits of the unconventional”, http://www.economist.com/blogs/freeexchange/2012/06/federal-reserve-extends-operation-twist)

A more optimistic interpretation is that, before long, the Fed will do more. Mr Bernanke repeatedly promised the Fed will act if needed. At present, it is trying to sort through the economic data to figure out how much of the recent weakening in America’s economy is real, rather than a statistical fluke. It is also awaiting the outcome of events in Europe. Sadly, developments on both sides of the Atlantic seem likely to call for more action.

What form would such action take? By the end of Twist 2, the Fed will have exhausted its supply of one- to three-year paper. It could conduct "Operation Twist 3" by selling some of three- to six-year bonds (it had $583 billion as of May 30th, according to Macroeconomic Advisers) but Mr Bernanke seemed to rule that out, leaving QE as the favoured option. The Fed could also expand the range of assets it buys, to include mortgage-backed securities.

Mr Bernanke also seemed intrigued by a programme announced last week by Britain's treasury and the Bank of England under which the latter would make low-cost long-term loans to banks provided they then lent to business and individuals. One criticism of the Fed's efforts is that they have not eased the supply of credit for people that really need it. He noted, however, that such a programme might have fiscal costs which would require the cooperation of the Administration and, possibly, Congress.

As to when the Fed would act, that could come at any time. Conveniently, Operation Twist will expire after the presidential election campaign. At that point, the Fed can act without being accused of helping one candidate or another. If the economy really appears to be heading over the fiscal cliff, the Fed will not want to worsen the impact by holding back a monetary cushion.

**QE3 likely**

**Firth 6/20**/12 – an Investment Manager and Director at Global Prime Partners (Warren, Investors Chronicle, “FTSE flies again”, http://www.investorschronicle.co.uk/2012/06/20/tips-and-ideas/trading-ideas/city-trades/ftse-flies-again-6tOdPdAeomnXBCS11ze0FP/article.html)

With the uncertainty of the Greek election now behind us, the European Central Bank, the US Federal Reserve and the Bank of England are all likely to engage in quantitative easing, which could trigger a larger move towards the FTSE's longer-term objective at 6920.

## Markets Expect QE3

Investors expect QE3 - polls

Blanchard 6/4/12 – (“Gold-bullish QE3 coming this year, say 58% of CNBC poll respondents”, http://www.blanchardonline.com/investing-news-blog/econ.php?article=4465)

Sixty money managers, investment strategists, and professional economists responded to our “snap” CNBC Fed Survey just hours after Friday's jobs report from the government showed anemic growth in May.

Fifty-eight percent of them expect the Fed to launch a third round of quantitative easing in the next year. That's up from just 33 percent of those responding to our survey six weeks ago.

Economists expecting quantitative easing now

Hubbard 6/19/12 – Reuters journalist (Business Standard, “Global Investors eye central banks for help on euro”, http://www.business-standard.com/india/news/globalinvestors-eye-central-banks-for-helpeuro/175295/on)

"Across the Street economists largely anticipate some form of sterilized asset purchases and an extension of Operation Twist," said Morgan Stanley executive director Gabriel de Kock.

The liquidity boost delivered by previous doses of monetary stimulus from the Fed has lifted global equities and most commodities, and markets have become highly sensitive to the waxing or waning of expectations of more such measures.

Markets anticipate QE now

**Murphy 6/1**/12 – senior fellow in business and economic studies at the Pacific Research Institute, PhD in economics from NYU (Bob, “It’s worse than it looks”, http://www.themoneyillusion.com/?p=14627)

Every once and a while it’s appropriate to remind readers of the “circularity problem.” The Fed pays attention to markets when deciding what to do, and markets react to what they think the Fed will do. The seminal paper on the circularity problem is written by Michael Woodford and Ben Bernanke (JMCB, 1997.)

Right now the markets are mostly likely pricing in further Fed “easing”, something like QE3. I doubt it’s viewed as 100% certain, but it’s clearly a likely outcome given the rapid deterioration of the global economy.

Investors predict quantitative easing now

Gage and Torres 6/23/12 – Caroline Gage and Craig Torres are contributing writers for Bloomberg (TribLive, “Bernanke’s twist sharpens year-end stimulus anxiety”, http://triblive.com/business/2080210-74/fed-percent-bernanke-economy-fiscal-growth-policy-twist-2012-2013)

The fiscal cliff in America would result in a “very substantial withdrawal of income from the economy” that would damage the expansion, Bernanke said at a press conference after the FOMC decision. The Fed is “prepared to take additional steps if appropriate,” he said.

LIMITING DAMAGE

The tax increases and spending cuts would trim a combined 3 percentage points from growth next year, according to economists surveyed last month by Bloomberg News. Political compromises would limit the damage to 0.8 percentage point, sustaining the expansion, the survey showed.

Harris predicts the Fed will announce a third round of asset purchases in September, partly to minimize damage to the economy from fiscal cutbacks. He has maintained his forecast for 1.9 percent growth in 2012 since last year and projects a 1.4 percent expansion in 2013.

“Right now, there’s a guessing game about when the Fed intervenes,” he said. Announcing an open-ended program conditional on the economy’s health “would reduce the uncertainty around what the Fed’s objectives are.”

**Markets expect Quantitative Easing in August**

**Pannett 6/21**/12 – contributing writer for Wall Street Journal (Rachel, Wall Street Journal, “Australian Dollar Up Late; Eyes Federal Reserve Meeting”, http://online.wsj.com/article/BT-CO-20120620-701850.html)

"Markets are optimistic that conditions have deteriorated enough in the U.S., U.K. and Europe to warrant more policy easing," said National Australia Bank senior currency strategist Emma Lawson.

Still, the outcome of the Federal Open Market Committee meeting later "will likely be about managing disappointment" said Michael Turner, a currency strategist at RBC Capital Markets. The house expects further quantitative easing from the Federal Reserve, but not until August with a $300 billion expansion of the Fed's mortgage-backed securities portfolio.

**Markets expecting easing now**

**Heath 6/21**/12 – (Joanna, Australian Financial Review, “Stimulus alone can't scale US fiscal cliff”, LexisNexis)

Markets had built up expectations for easing measures to be announced at the US Federal Reserve's interest rate-setting meeting due overnight, but the bigger issue for the world's largest economy could be a fiscal problem that chairman Ben Bernanke's efforts could not fix.

Gold has rallied and the US dollar index has fallen by more than 2 per cent this month, as traders gear up for what they hope could be quantitative easing mark three.

Bets in favour of QE3 were ramped up following disappointing monthly employment numbers delivered in early June.

An impassive Dr Bernanke at a congressional hearing the following week temporarily dampened the fervour of QE3 bugs, but expectations were still high for at least an extension of the so-called Operation Twist program last night.

## Accommodative Monetary Policy Now

**Accommodative monetary policy until at least 2015**

**Board of Governors 6/20**/12 – (Board of Governors of the Federal Reserve, “Press Release”, http://www.federalreserve.gov/newsevents/press/monetary/20120620a.htm)

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee expects to maintain a highly accommodative stance for monetary policy. In particular, the Committee decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014.

## AT: Operation Twist means no QE

**Quantitative easing still possible despite extension of Twist**

**Board of Governors 6/20**/12 – (Board of Governors of the Federal Reserve, “Press Release”, http://www.federalreserve.gov/newsevents/press/monetary/20120620a.htm)

The Committee also decided to continue through the end of the year its program to extend the average maturity of its holdings of securities. Specifically, the Committee intends to purchase Treasury securities with remaining maturities of 6 years to 30 years at the current pace and to sell or redeem an equal amount of Treasury securities with remaining maturities of approximately 3 years or less. This continuation of the maturity extension program should put downward pressure on longer-term interest rates and help to make broader financial conditions more accommodative. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The Committee is prepared to take further action as appropriate to promote a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability.

**Operation Twist extended to the end of the year – that doesn’t preclude QE3**

**Westpac 6/21**/12 – (Westpac International Bank Team, “The US FOMC decided to extend 'Operation Twist'”, http://www.fxstreet.com/fundamental/market-view/morning-report/2012/06/21/)

The US FOMC decided to extend ‘Operation Twist’, broadly as expected by markets, saying it would buy $267bn worth of 6 to 30 year Treasury bonds while selling bonds with a maturity of 3 years or less. The FOMC noted the recent slowing in US employment and consumer spending and said it was ‘prepared to take further action as appropriate to promote a stronger economic recovery and sustained improvement in labour market conditions in a context of price stability’. This leaves the door open to QE3, which we have pencilled in for some time in Q3.

## General Economy High

### General

**Economy still growing**

**Board of Governors 6/20**/12 – (Board of Governors of the Federal Reserve, “Press Release”, http://www.federalreserve.gov/newsevents/press/monetary/20120620a.htm)

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects economic growth to remain moderate over coming quarters and then to pick up very gradually. Consequently, the Committee anticipates that the unemployment rate will decline only slowly toward levels that it judges to be consistent with its dual mandate. Furthermore, strains in global financial markets continue to pose significant downside risks to the economic outlook. The Committee anticipates that inflation over the medium term will run at or below the rate that it judges most consistent with its dual mandate.

#### Multiple Markets reflect strengthening economy

Regan and Nazareth 6/27 (Michael P. Regan and Rita Nazareth, writers for Bloomberg—a leading economic news source, June 27, 12, “Stocks Gain With Commodities On U.S. Data, China Bets”, http://www.bloomberg.com/news/2012-06-27/yen-gains-south-korean-stocks-drop-before-europe-crisis-summit.html)

Stocks (MXAP) rose, halting a four-day slump in Europe and Asia, and commodities surged as growth in U.S. home sales and durable-goods orders topped forecasts and speculation grew that China will add to economic stimulus. The euro weakened for a third day. Treasuries were little changed. The Standard & Poor’s 500 Index advanced 0.7 percent at 3:06 p.m. in New York. The Stoxx Europe 600 Index (SXXP) climbed 1.4 percent and the MSCI Asia Pacific Index rallied 0.7 percent. Oil climbed above $80 a barrel and corn headed for its biggest three-day gain since 1988. Spanish and Italian 10-year bonds fell as German Chancellor Angela Merkel reiterated opposition to joint euro-area debt. The euro lost 0.2 percent to $1.2463. The 1.1 percent increase in orders for durable goods eased concern that American manufacturing was faltering, while growth in pending home sales added to evidence the housing market was recovering. The China Securities Journal said the country may introduce “more proactive” policies to ensure stable growth in the world’s second-largest economy. European leaders prepared for a two-day summit starting tomorrow. “The economic data was encouraging,” said Walter Todd, who oversees about $940 million as chief investment officer of Greenwood Capital in Greenwood, South Carolina. “It’s important to see that because most recently we’ve had weaker data here and in China while Europe came back to the forefront. Any policy moves out of China would certainly be welcomed. In addition, it’s the end of the quarter and you tend to see some buying around that time.” Energy, health-care and utility companies led an advance in nine of the 10 main industries in the S&P 500 today. JPMorgan Chase & Co., Bank of America Corp. and Coca-Cola Co. climbed more than 1.6 percent for the biggest gains in the Dow Jones Industrial Average. Market Leaders Monsanto Co. (MON), the world’s largest seed company, climbed 4.5 percent as earnings exceeded analysts’ estimates. Bristol-Myers Squibb Co. added 1.6 percent after the maker of the blood thinner Plavix doubled the size of its share buyback program. Facebook Inc. dropped 3.1 percent after at least 17 firms started to cover the social-networking company, with an average analyst share-price estimate below its initial public offering price of $38 a share. An index of 11 homebuilders in S&P indexes surged 2.6 percent and touched the highest level in almost four years. The index of pending home resales climbed 5.9 percent to 101.1, matching a two-year high reached in March, after a 5.5 percent decline in April, figures from the National Association of Realtors showed. The median forecast of economists called for a 1.5 percent gain in May. Economic Data Bookings for U.S. durable goods increased for the first time in three months, the Commerce Department said. The median forecast of 76 economists surveyed by Bloomberg News called for a 0.5 percent gain. Excluding orders for transportation equipment, which can be volatile, bookings for goods meant to last at least three years advanced 0.4 percent. Today’s housing and durable-goods data helped assuage concern that the U.S. economic recovery was weakening. “The U.S. does look better than Europe, other places in the world, clearly,” Gregory Peters, chief cross-asset strategist at Morgan Stanley, told Bloomberg Television. “We’ve seen a lot of benefits from that, so a lot of flows into the U.S. But I think the story is that investors are hiding out in U.S. equities, U.S. risk markets, at a time when the U.S. economy is slowing, we’re facing the fiscal cliff, and earnings expectations are way too high.” Stock Skew Concern that Europe’s crisis will snuff out earnings growth sent the cost of protecting against losses in the S&P 500 to a five-year high. Puts protecting against a 10 percent decline in the benchmark gauge for American equities cost 1.73 times more than calls betting on a 10 percent gain, according to data on three-month contracts compiled by Bloomberg. The price relationship known as skew rose to 1.95 last week, the highest level since July 2007. The Federal Reserve reduced its estimate last week for expansion in gross domestic product and U.S. consumer confidence dropped for a fourth month in June. The S&P 500 lost 6.3 percent from the end of March through yesterday, leaving it poised for the first retreat in three quarters. Analysts forecast earnings declined 1.1 percent in the second quarter, the first decrease since 2009. European Shares The Stoxx 600 rebounded from a four-day retreat as banks and energy companies led gains. Lloyds Banking Group Plc and Barclays Plc rallied at least 1.9 percent. Barclays climbed even after it was fined 290 million pounds ($453.2 million) for submitting false London and euro interbank offered rates. Portugal Telecom SGPS SA climbed 3.1 percent after announcing a 200 million-euro ($250 million) share buyback. Glencore International Plc shares fell 1.5 percent after target Xstrata Plc’s second-largest shareholder asked for a higher bid. Spanish 10-year yields increased five basis points to 6.93 percent, while Italian 10-year rates added two points to 6.20 percent after earlier declining nine basis points. Germany’s Merkel shut the door to joint euro-area bonds as a means of lowering Spain’s borrowing costs, saying they are the “wrong way” to achieve the greater European integration needed to stem the debt crisis. Speaking three hours after Spanish Prime Minister Mariano Rajoy made a plea for help from tomorrow’s European summit, Merkel said that euro bonds, euro bills and debt redemption funds are unconstitutional in Germany and economically “wrong and counterproductive.” ‘Disorderly’ “At some point, the Germans are going to decide, ’do I take the credit risk of backstopping Italian and Spanish debt in exchange for some loss of national fiscal sovereignty by Italy and Spain?’” Nouriel Roubini, the co-founder and chairman of Roubini Global Economics, told Bloomberg Television’s “Surveillance.” “In which case, the euro zone has a chance to survive. Or otherwise this thing may become disorderly in the next few months.” Cocoa, lean hogs, sugar and corn rallied at least 1.6 percent to lead gains in 16 of 24 commodities tracked by the S&P GSCI Index, which climbed 0.8 percent for a fourth straight gain. The commodities gauge has rebounded after slumping to the lowest level since October 2010 on June 21. Natural gas trimmed earlier gains, trading up 0.3 percent after rallying as much as 6.5 percent. The fuel has surged 10 percent in five days. The National Weather Service predicted temperatures will be above normal east of the Rocky Mountains through July 9, spurring demand for the power-plant fuel as air- conditioning use increases. The MSCI Emerging Markets Index (MXEF) advanced 0.7 percent, poised for its steepest gain since June 19. The Hang Seng China Enterprises Index of mainland companies listed in Hong Kong advanced 0.7 percent. Benchmark gauges in Russian, Turkey, Indonesia, Thailand and the Philippines gained more than 1 percent.

### **Consumer confidence**

#### **Despite recent slip, consumer confidence still resilient**

Needham 6/26 (Vicki Needham, journalist for The Hill a congressional newspaper that publishes daily when Congress is in session, June 26, 2012, “Consumer confidence wanes again in June”, http://thehill.com/blogs/on-the-money/economy/234819-consumer-confidence-wanes-again-in-june)

Consumers' feelings about the economy continued their four-month slide in June despite falling gas prices.  Confidence fell to 62 percent in June, a drop from the 64.4 reading in May, The Conference Board said Tuesday. "Consumers were somewhat more positive about current conditions, but slightly more pessimistic about the short-term outlook," said Lynn Franco, director of Economic Indicators at The Conference Board in a statement.  "Income expectations, which had improved last month, declined in June," she said.  "If this trend continues, spending may be restrained in the short-term." Spending represents 70 percent of economic activity and is needed to boost the economic recovery. Consumers have been reluctant to pick up their pace of spending with the economy mired in uncertainty.  Concerns abound about the labor market, the slowly improving housing sector and the financial crisis tearing through Europe.  The index is well below the reading of 90 that indicates a healthy economy, a level that hasn't been hit since the recession started in December 2007.  Still, the overall index is much better than the 25.3 level hit in February 2009, the lowest in the survey's history.  Franco said the indexes suggest "there will be little change in the pace of economic activity in the near-term." Meanwhile, the present situation index increased to 46.6 from 44.9 last month, while the expectations gauge declined to 72.3 from 77.3. Consumers' assessment of current conditions improved slightly in June.  Those saying business conditions are "good" increased to 14.9 percent from 13.6 percent; however, those saying business conditions are "bad" increased to 35.1 percent from 34.7 percent.  Feelings about the job market remained mixed.  Those stating jobs are "hard to get" increased to 41.5 percent from 40.9 percent, while those claiming jobs are "plentiful" increased to 7.8 percent from 7.5 percent. Respondents anticipating more jobs in the months ahead declined to 14.1 percent from 15.4 percent, while those expecting fewer jobs also declined to 20.6 percent from 21.5.  The proportion of consumers expecting an increase in their incomes declined to 14.8 percent from 15.7 percent. The job market had picked up steam through the unseasonably warm winter but that pace slowed considerably through the spring.  The next jobs report for June is due out July 6.  Consumers also have grown less upbeat about the short-term outlook.  The percentage of consumers anticipating business conditions to improve over the next six months declined to 15.5 percent from 16.6, while those expecting business conditions will worsen increased to 16.2 percent from 12.9 percent.

### **Global Trade Confidence**

#### **Global Trade Confidence Up**

Frangos 6/26 (Alex Frangos, staff reporter in economics for the Wall Street Journal, “Global Trade Confidence Stable Despite Worries”, June 26, 2012, <http://blogs.wsj.com/economics/2012/06/26/global-trade-confidence-stable-despite-worries/>)

Given turmoil in Europe, slowdowns in China, India and Brazil, and lackluster growth in the U.S., one might expect trade-oriented businesses globally to be dour about the future. Well, not quite yet. HSBC’s Trade Confidence Index, a semiannual survey of exporters and importers in 20 countries, ticked up slightly in the latest reading published Tuesday. The overall reading was 113, little changed from the 112 score last October. A reading below 100 indicates a negative outlook; above 100 indicates a positive view. More than 70% of the companies surveyed expected trade volumes to stabilize or grow in the next six months. “Businesses are still continuing to trade. They are cautious, but we are still seeing growth,” said Noel Quinn, HSBC’s regional head of commercial banking, Asia Pacific, where he oversees lending to businesses across 17 countries. The survey of 5,800 businesses was conducted mostly in April and May and thus missed the full reverberations from Greece’s electoral stalemate and Spain’s bank bailout. And a clearer picture of China’s slowdown has emerged since the survey. Sentiment in China improved marginally in the survey, from a score of 100 to 105. The worst-performing market was Australia, which dipped four points into contraction territory with a score of 96. Sentiment in the U.S. improved 9 points from last year to 111 While there’s a lot wrong in the world, Mr. Quinn says it’s arguably not much worse than it was last October, when global stock markets were plunging, European banks were rapidly pulling back from overseas lending, and fears of a new recession in the U.S. were building. “If you think of how people viewed the economy last year, there was already significant concern over Europe,” he said. In the meantime, the European Central Bank’s LTRO, or Long-Term Refinancing Operation, provided a jolt of liquidity to the financial system. In Asia, regional and U.S. banks picked up the slack in lending for trade finance left by the withdrawal of European banks. And the U.S. economy, while still sluggish, performed somewhat better over the past six months, giving a boost to companies that sell to the U.S. “It’s not anything like what we experienced in 2008 and 2009,” said Mr. Quinn. “Businesses are cautious, but they haven’t stopped making decisions.” He said that businesses are enacting “fine-tuning adjustments” to business plans rather than making binary moves to cancel projects and investments, though he added: “I’m not trying to say everything is rosy.” To cope with slower growth, companies are placing smaller orders and ordering more frequently to prevent being stuck with inventory they can’t sell. In terms of longer-term capital projects such as infrastructure, Mr. Quinn cited places such as Bangladesh, Indonesia and Malaysia, where’s there’s “reasonable demand” for finance and “ample supply of liquidity to meet that demand” as bright spots.

### **AT: Europe**

#### **US economy is doing well despite the European situation**

Associated Press 6/27 (Associated press, world’s oldest and largest news gathering source made up of many news organizations, June27, 2012, “US stocks rise on stronger data about US housing, factories; European debt turmoil looms”, http://www.washingtonpost.com/business/markets/us-futures-waver-as-markets-weigh-healthy-us-data-against-eu/2012/06/27/gJQA5CKf6V\_story.html)

A rare double shot of good news about the U.S. economy sent stocks strongly higher Tuesday. The Dow Jones industrial average rose 82 points despite lingering fear about Europe’s debt turmoil. Americans signed more contracts to buy previously occupied homes in May, matching the fastest pace in two years, the National Association of Realtors said. The report was the latest signal that the housing market is improving in many regions following a slump of more than six years. Homebuilders soared. Lennar Corp. had reported earlier that its second-quarter profit rose as deliveries and new orders increased. Its stock jumped $1.80, or 7 percent, to $29.19, the biggest gain in the Standard & Poor’s 500 index. The ISE Homebuilders index rose 42 cents, or 4 percent, to $10.69. PulteGroup, D.R. Horton and Hovnanian Enterprises all rose sharply. Earlier, the government said that businesses placed more orders for long-lasting manufactured goods in May, suggesting that their confidence in the U.S. economy was not shaken by signs of weakness that emerged this spring. Core goods, a measure of business investment plans, also jumped. The reports offered a rare glimpse of good news about the U.S. economy, which continues to recover slowly despite three months of weak output and abysmal job growth. They “were really quite good,” said Dennis Gartman, an economist and editor of The Gartman Letter, a source of daily market commentary. “The economy is doing reasonably well and will continue to muddle on through,” Gartman said. The Dow rose 82 points to 12,617 as of noon Eastern. Coca-Cola rose $1.10 to $76.18 after the company said it would invest another $3 billion in India’s rapidly growing consumer market over the next eight years. The S&P 500 rose 10 points to 1,329. Its biggest loser by far was auto parts maker O’Reilly Automotive, which fell $17.60, or 19 percent, to $78.84. O’Reilly said its second-quarter earnings will be at the low end of its earlier estimates and sales will be weaker than previously expected. H&R Block leapt 40 cents, or 3 percent, to $15.49. The tax preparer company posted a lower fourth-quarter profit than analyst had expected, but the company gained valuable market share while cutting jobs and closing stores to focus on electronic tax filing. The Nasdaq composite average rose 22 points to 2,876. Markets remain wracked with concern about Europe as leaders there prepare for a two-day summit aimed at defusing their lingering debt crisis. German Chancellor Angela Merkel warned Wednesday that there would be no quick solution to the structural issues plaguing the continent. Europe will cause volatile stock trading in the coming weeks because the summit is unlikely to produce a lasting solution, Gartman said. He said the meeting is scheduled to be two days, but Italian Prime Minister Mario Monti promised to keep it going until Sunday if an agreement has not been reached. “I think he can keep them there until Sunday five weeks from now and there’s little chance they’ll agree,” Gartman said.

#### **U.S. economy has decoupled from Europe**

Wasik 5/21 (John Wasik, columnist for Reuters and author of The Cul-de-Sac Syndrome: Turning Around the Unsustainable American Dream., “What if Europe and U.S. decouple?”, http://www.reuters.com/article/2012/05/21/column-wasik-decouple-idUSL1E8GLAU020120521)

May 21 (Reuters) - What if, despite conventional wisdom, the United States and Eurozone economies "decoupled?" This suggests that no matter what happens in Greece, Spain and the rest of the beleaguered European nations, the U.S. economy wouldn't be linked to those woes and would continue its mild recovery relatively unimpaired. There's growing evidence to suggest that this has been happening and may manifest itself more in coming months. That means Europe and America could be more like two ships passing in the night rather than on a collision course. As most of Europe struggles with austerity programs, political shifts and debt woes, U.S. stocks have generally been staging a rebound. The MSCI All Country World Ex USA Index finished April 2.5 percent below the level of October 2009, "when foreign stocks established their relative strength peak against the U.S.," according to a May report from Leuthold Weeden Institutional Research. In contrast, the S&P 500 Index, a popular gauge for large U.S. stocks, moved up 29 percent over that period. That suggests Europe and the United States are not moving in lockstep. Why the inverse relationship in a global economy in which the fortunes of continents are often closely linked? The U.S. economy is modestly rebounding while Europe muddles through deleveraging. Stateside, industrial production, housing starts and overall economic activity are up, according to recent reports. Even housing starts were up almost 3 percent in April, according to the U.S. Commerce Department. Although this story is often buried when Europe and Facebook Inc devour business headlines, the S&P 500 beat all but eight countries in global performance measured by Leuthold Weeden. None of the countries that did better than the United States were in Europe. They were Thailand, the Philippines, Colombia, Indonesia, Chile, Sri Lanka, Malaysia and Korea - yet another reason to hold emerging markets as a hedge against Western debt dramas. One inverse proxy for U.S. economic health (and the dollar) has been the price of gold. Since 2007, gold prices have generally soared, acting as a fear index when U.S. economic news has been sour. But over the past year, the SPDR Gold Trust , an exchange-traded fund that tracks gold prices fairly closely, was off about 17 percent from its 52-week high through May 18. None of this means that the U.S-Europe decoupling will continue or that the United States will remain on its recovery course. Unemployment is still stubbornly high, and it will take years before the housing market is back to normal. Housing has typically been the truck that hauls the U.S. economy out of slumps, but it's been sputtering in the wake of the Great Recession. U.S. home prices were down 3.5 percent in February from a year earlier, according to the S&P/Case-Shiller 20-city composite index, and are at their lowest point since late 2002. Foreclosures are slowing, but continue to depress prices. Although foreclosures filings in April dipped to the lowest level since 2007, according to the data firm RealtyTrac, the company expects that number to rise to 6 million by 2014. PATIENCE REWARDED If you're a patient, long-term investor, there's no harm in betting on an eventual European recovery, although there's little optimism that it will happen soon. Many European-based companies are global players that are still worth owning. For example, the Vanguard MSCI Europe ETF holds power-houses like Royal Dutch Shell, Nestle and Novartis . Your stronger position, barring any mammoth surprises, may be a broad-based U.S. portfolio such as the iShares S&P 500 fund . Speaking of surprises, if you want to be cautious, your biggest fear at this point should be U.S. political risk. The White House and Republicans appear to be at loggerheads again over spending cuts and tax increases. If the two major parties begin playing a game of chicken over the U.S. debt ceiling toward the end of the year - repeating last year's puerile spitting match - U.S. stocks will get clobbered again. No matter how the political rhetoric trends now, though, it's sure to heat up as Congress faces down a "fiscal cliff" of the expiration of the Bush-era tax rates and more than $1 trillion in automatic budget cuts. If Congress does nothing by the end of the year, its inaction may scorch the decoupling theory as the frail U.S. economy could sink back into recession. If we were talking about tango dancing, it would be the equivalent of one partner slamming the other to the floor.

#### The US would prevent a European collapse

Maggs 6/20 (John Maggs, senior economics editor for the Kiplinger Letter—an economic news source, “Why America Won't Let the EU Fail”, June 20, 2012 https://www.kiplinger.com/columns/practical-economics/archives/america-would-help-bail-out-europe.html)

If Europe is threatened with a dire financial crisis, the United States will rush in with a helping hand, despite the insistence of President Obama and other U.S. leaders that taxpayer money would not be committed for this purpose. Europe would have to shoulder the heaviest load, but if those efforts proved inadequate, there is no doubt the U.S. would join. That’s because a collapse of Europe’s financial system would probably cause a worldwide economic downturn and plunge the U.S. into a deep recession. The aid, if needed, would flow mainly through the Federal Reserve, which has ample authority to lend trillions of dollars to such a rescue. Further assistance could include effective commitments from the U.S. Treasury through multilateral lenders such as the International Monetary Fund. Politics lies behind the official denials from Obama and Federal Reserve Chairman Ben Bernanke. Conservatives have been harshly critical of debt piled up by the Treasury and the Fed since late 2008, even though most economists say this spending and lending was needed to avert a U.S. depression. And the general public is both worried about government debt and suspicious of the Fed lending to foreigners. By publicly stating his opposition to U.S. help for Europe, Obama avoids a distracting debate about a euro crisis while he’s on the campaign trail. And though GOP presidential candidate Mitt Romney says he strongly opposes any U.S. funding of help for Europe, you can bet that as president, he too would allow it to flow to contain a global financial slump. Meanwhile, Bernanke measures his words carefully: He has told Congress he has “no intention” of approving a euro bailout, but has also said that Europe’s problems threaten “significant harm” to the U.S. economy and that the Fed “stands ready to do whatever is necessary to protect our financial system.” Bernanke fends off questions about help for Europe by claiming he doesn’t have the authority to act. But that’s not true. Long-held Fed emergency powers give it broad authority to lend unlimited amounts of money to governments or even private sector banks in the name of preserving financial stability. Although a vote of the Federal Reserve’s board is needed for some actions, Bernanke can act on his own to stabilize the U.S. dollar. The president can’t fire him before his term ends in 2014, and Congress’ only recourse would be to pass legislation curbing the Fed’s powers, which wouldn’t and couldn’t happen quickly or easily. The first tool Bernanke would likely use to help Europe doesn’t even require invoking emergency power: currency liquidity swaps. Under a 2007 agreement with the European Central Bank, renewed most recently last November, the Fed can lend unlimited amounts of money to the ECB by purchasing euros with dollars. While these are supposed to be short-term loans, repaid by selling euros later, there is no reason why the Fed could not hold euros indefinitely. Could such swaps be used for large loans to Europe? They already have. In 2008 and 2009, the Fed loaned over $500 billion to Europe, and after the euro crisis heated up again late last year, the outstanding balances of these swaps went from zero to over $100 billion in February. Dollar swaps could be crucial if a sharp escalation of the ECB’s lending for bailouts leads investors to flee the euro, driving down its value. Using this route, the Fed could lend billions or trillions, holding on to its euros for years. And American taxpayers would effectively be on the hook. If the euro governments and then the ECB were to default, the ensuing loss, felt in a plunge in the value of the dollar and in higher interest rates, would be the same as if Uncle Sam had sent the money in cash. Even an orderly repurchasing of those dollars later would affect U.S. rates in less noticeable ways. The bottom line is that the Fed’s actions would have an effect similar to a loan from the Treasury. Arresting a serious and ongoing crisis would probably require the Fed to take a further step, purchasing large amounts of euro-denominated debt -- something it has never done before. This would probably happen in concert with China and other nations and be billed as global response. Still, the political reaction in the U.S. would be severe, and elected leaders might not jump to the Fed’s defense. That wouldn’t stop Bernanke from taking this step, if he decided it was needed. He’s effectively a lame duck. Few people believe Bernanke wants to serve a third term, beyond January 31, 2014. Even if he did, Romney wouldn’t reappoint him, and if Obama is reelected, Republicans who have become harshly critical of Bernanke’s policies would block his nomination in the Senate. So he’s free to act on his conscience and would take the Fed into uncharted waters to stop a global crash. That’s just what he did in 2008. Back then, Congress and the White House stalemated over the idea of buying up mortgage debt, so the Fed did it instead, purchasing $1.2 trillion worth. It was a brave and crucial step in arresting the crisis, and it showed that one of the most important duties of a Fed chairman is to take risky and unpopular action to avert economic disaster, especially when no one else will.

#### No European Collapse—New Zealand pledged to give the IMF money for a Euro bailout

Levy 6/20 (Danya Levy, a political reporter for Fairfax Media—Australia and Asia’s leading news source, “MF commitment would cost NZ $4b”, June 20, 2012, http://www.stuff.co.nz/national/politics/7135935/IMF-commitment-would-cost-NZ-4b)

The Government would be forced to borrow almost $4 billion it has promised to the International Monetary Fund's new bailout fund for Europe but says if the money is called for, it will be repaid. Finance Minister Bill English said today he didn't expect the money would be needed because Europe had "significant resources" to solve its own debt problems, but said New Zealand had to contribute to the fund because it relied on borrowing from international markets. Overnight offers from countries around the world grew the IMF's fund to NZ$570b, the Wall Street Journal reported. It follows the G20 nations in April agreeing to boost the IMF's resources amid the Euro zone's worsening debt crisis. New Zealand yesterday pledged $1.26b as a stand-by loan facility, which along with an earlier pledge two years ago takes the money offered to almost $4b. English said the IMF had so far called up about $300m of that. "Any further calls would be the result of a collective decision in the IMF that action was needed," he told Radio New Zealand. Europe had to sort out its own political process because it had significant resources. "It just doesn't have a very good decision making process for using that resource. The IMF won't be marching in there to save Europe if the Europeans aren't making the efforts themselves to make sound decisions." However, the Government expected Europe would work their way through the debt crisis. It was important that New Zealand pledged money to the fund because it had one of the highest levels of debt to foreigners. "It would always be our first preference not to be doing this. (But) we have a significant proportion of our economy in international trade, more than Australia, so we have an interest in global stability which is why we participate." While New Zealand's gross debt would increase, it would also be considered an asset because it was lending that would be repaid. The pledge will have no impact on the Government's track to surplus.

China won’t let a European Collapse happen

Bloomberg News 12 (Bloomberg News, a leading economic and business news source worldwide, “China Pledges Sustained Euro Holdings With Plan To Invest In Bailout Funds”, February 15, 2012, http://www.bloomberg.com/news/2012-02-14/eu-s-van-rompuy-welcomes-china-s-interest-in-aiding-europe.html)

[China](http://topics.bloomberg.com/china/) pledged to invest in Europe’s bailout funds and sustain its holdings of euro assets, spurring gains in the currency and Asian stocks on optimism the region’s debt crisis will be overcome. “China will always adhere to the principle of holding assets of EU sovereign debt,” People’s Bank of China Governor Zhou Xiaochuan said in Beijing today. “We would participate in resolving the euro debt crisis,” he said, echoing comments by Premier [Wen Jiabao](http://topics.bloomberg.com/wen-jiabao/) yesterday. The remarks offer a carrot to European finance ministers, who are increasing pressure on [Greece](http://topics.bloomberg.com/greece/) to deliver budget cuts in exchange for a second bailout. At stake for China is helping to stabilize the economy of its largest export market amid a global slowdown that has curtailed growth in Chinese shipments abroad. “Wen and Zhou are giving the best support China can offer now, which is to send out positive messages such as promising not to cut euro assets and to buy European bonds to help bolster market confidence,” said Shen Jianguang, a Hong Kong-based economist at Mizuho Securities Asia Ltd. who previously worked at the [European Central Bank](http://topics.bloomberg.com/european-central-bank/). “How much and when China will buy will depend on its foreign-exchange investment strategy -- when they find the pricing and exchange rate favorable.” The MSCI Asia-Pacific Index of shares advanced 1.9 percent at 6:43 p.m. in [Tokyo](http://topics.bloomberg.com/tokyo/), heading for the biggest increase in a month. The euro strengthened 0.3 percent to $1.3168. ‘Sincere and Firm’ Zhou’s comments, made in a speech and question-and-answer session with students, came a day after Premier Wen Jiabao said the nation is willing to get “more deeply” involved in resolving Europe’s debt crisis, although the continent must send a clearer message to show how it’s working to strengthen its finances. “China’s willingness to support [Europe](http://topics.bloomberg.com/europe/) to cope with sovereign debt problems is sincere and firm,” Wen said at a joint press conference yesterday in Beijing with European Union President [Herman Van Rompuy](http://topics.bloomberg.com/herman-van-rompuy/). “China is ready to get more deeply involved in participating in solving the European debt issue.” [Van Rompuy](http://topics.bloomberg.com/van-rompuy/) said he welcomed the interest China has shown in investing in European sovereign bonds and the region’s rescue fund. Meantime, back in Europe, finance ministers are slated today for a teleconference call to prod Greece to do more to qualify for another bailout. Debt Crisis Spreading Even as Premier Wen and Zhou spoke of their support for Europe, the central bank warned today the region’s debt crisis will not be solved in the short term and is spreading throughout the euro area. The crisis could trigger systemic risks to the global economy, the PBOC said in a quarterly monetary policy report posted on its [website](http://www.pbc.gov.cn/), adding that major developed economies lack credible fiscal plans. The central bank didn’t specify when the report was prepared. China expects “those highly indebted countries to strengthen fiscal consolidation, cut deficits and reduce debt risks in light of their national conditions,” Wen said yesterday. “We hope the EU will soon reach internal consensus, make the political decision and send to the international community a clearer and a stronger message of policy responses.” Chinese officials are taking their message of support for Europe to the U.S. where Vice President [Xi Jinping](http://topics.bloomberg.com/xi-jinping/) is on a five- day visit. Right Time The two countries have been in “close policy communication” on the European debt crisis, Vice Finance Minister [Zhu Guangyao](http://topics.bloomberg.com/zhu-guangyao/) said at a briefing yesterday in [Washington](http://topics.bloomberg.com/washington/). “Both China and the U.S. hope that the financial stability and economic recovery will be restored in Europe at an early date,” he said. In Beijing, Governor Zhou said that while the five BRICS countries - [Brazil](http://topics.bloomberg.com/brazil/), Russia India, China and [South Africa](http://topics.bloomberg.com/south-africa/) - all hold a “very positive attitude” toward helping Europe, they have to wait for the right time and right opportunity to invest. China hopes for more “innovation” from Europe to provide more lucrative products that are “truly appealing” to Chinese investors, Zhou said, reiterating comments by Premier Wen. The nation has been wooed by European leaders to help fund the temporary European Financial Stability Facility and its permanent successor, the European Stability Mechanism. More Details China is considering funding options for the EFSF and the ESM through the [International Monetary Fund](http://topics.bloomberg.com/international-monetary-fund/), Wen said on Feb. 2 after meeting German Chancellor [Angela Merkel](http://topics.bloomberg.com/angela-merkel/) in Beijing. Officials previously said they needed more details on any plan to contribute funds. Zhou said today that China can channel its investments through three avenues. The central bank can participate through foreign-exchange reserves it manages and a second option is support from China Investment Corp., the country’s sovereign- wealth fund. The third source of help could come from financial institutions including [China Development Bank](http://topics.bloomberg.com/china-development-bank/) and Export-Import Bank of China, and other institutional investors including Chinese enterprises, Zhou said. China, which holds the world’s largest foreign-exchange reserves of $3.18 trillion, has previously signaled it wants to diversify the holdings away from U.S. dollar-denominated assets. The country doesn’t publicly disclose a breakdown of its [reserves](http://www.bloomberg.com/quote/CNGFOREX:IND). Maintain Investment The PBOC has “always had confidence in the euro’s outlook” and as China’s foreign-exchange reserves have increased, the nation has “adjusted and increased the proportion of investment in the euro,” Zhou said. Government leaders have “expressed clearly” through the Group of 20 nations that China will not reduce the proportion of its investment in euro assets during the global financial crisis and European debt crisis, Zhou said. Moody’s Investors Service cut the debt ratings of six European countries on Feb. 13, including Italy, [Spain](http://topics.bloomberg.com/spain/) and [Portugal](http://topics.bloomberg.com/portugal/), and said it may strip [France](http://topics.bloomberg.com/france/) and the U.K. of their top Aaa ratings, citing Europe’s debt crisis. Spain was downgraded to A3 from A1 on Feb. 13, Italy to A3 from A2 and Portugal to Ba3 from Ba2, all with negative outlooks. Slovakia, Slovenia and Malta also had their ratings lowered.

#### Japan will prevent a Eurozone collapse

Kajimoto 4/17 (Tetsushi Kajimoto, journalist for Reuters, April 17, 2012, “Japan vows $60 billion to boost IMF firepower”, http://www.reuters.com/article/2012/04/17/us-imf-japan-idUSBRE83G0CC20120417)

[Japan](http://www.reuters.com/places/japan) said on Tuesday it will provide $60 billion in loans to the International Monetary Fund, becoming the first non-European nation to commit money to boost the fund's financial firepower to contain the euro zone debt crisis.

Finance Minister Jun Azumi said Japan hoped Tokyo's contribution, which will be formally announced at a Group of 20 financial leaders' meeting later this week, will encourage other countries to follow suit.

Indeed, IMF Managing Director Christine Lagarde was quoted as saying she hoped to secure government agreements this week to raise the IMF's funds by more than $400 billion, about two-thirds of the amount the Fund had said in January it would need.

"I really hope this week we'll reach the critical mass of more than $400 billion. We are determined to do all we can," she was quoted as telling Italy's main financial newspaper Il Sole 24 Ore, though she also said finally sealing the funds might take a bit longer.

Japan's announcement comes ahead of the IMF and World Bank Spring Meeting and a G20 [finance](http://www.reuters.com/finance) leaders' gathering in Washington, which run from Friday to Sunday.

"Following a series of euro zone's policy responses, it is important to strengthen IMF funding and pave the way for ensuring an end to the crisis not only for the [euro zone](http://www.reuters.com/subjects/euro-zone) but also for Japan and Asian countries," Azumi told a regular news conference after a cabinet meeting.

"I am confident that many other countries will pledge contributions to the IMF," he said.

The IMF, which acts as a lender of last resort for governments, said in January it would need $600 billion in new resources to help "innocent bystanders" who might be affected by economic and financial spillovers from Europe.

Lagarde said last week the IMF might not need as much money as it had thought because economic risks had waned. G20 officials told Reuters the world's major economies were likely to agree to provide between $400 billion and $500 billion.

"I am grateful for Japan's leadership and strong commitment to multilateralism, and I call on the broader fund membership to follow Japan's lead," Lagarde said after Japan's pledge.

Japan's $60 billion pledge takes overall commitments to about $310 billion. Euro zone countries have committed about $200 billion and other European Union nations an additional $50 billion.

But the United States, heading towards a presidential election in November in which the country's hefty budget deficit is a key topic, has said it won't offer new funds.

Canada has insisted it is not interested in contributing to a fund to bail out Europe, which it says has enough of its own resources to deal with the crisis.

Other economies, including major emerging markets China, [Brazil](http://www.reuters.com/places/brazil) and Russia, have said they are willing to chip in but were looking to get more voting power in return. Azumi said he consulted with Chinese Vice Premier Wang Qishan on Monday and that there was no gap between the two countries on IMF funding.

Azumi acknowledged it would be difficult to secure commitments from all countries this week towards boosting the IMF's financial firepower and he underlined Japan's long-standing position that Europe needed to do more to combat the debt crisis.

"I don't think Europe has made enough efforts on their own," Azumi said. "I must urge them to beef up their firewall further. At the same time the world is in need of strengthening IMF lending, so Japan has been taking the lead in coordinating opinions with other countries concerned."

### Housing Market

#### The housing market is recovering rapidly

Crutsinger 6/27 (Martin Crutsinger, Associated Press economics writer and correspondent, “US new-home sales rose at fastest pace in 2 years”, June 27, 2012, http://www.dailyfinance.com/article/us-new-home-sales-rose-at-fastest-pace-in-2-years/444822/)

WASHINGTON -Americans bought new homes in May at the fastest pace in more than two years. The increase suggests a modest recovery is continuing in the U.S. housing market, despite weaker job growth. The Commerce Department said Monday that sales of new homes increased 7.6 percent in May from April to a seasonally adjusted annual rate of 369,000 homes. That's the best pace since April 2010, the last month that buyers could qualify for a federal home-buying tax credit. Even with the gains, the annual sales pace is less than half the 700,000 that economists consider to be healthy. Yet the increase follows other signs that show the housing market is slowly improving nearly five years after the bubble burst. Builders are gaining confidence in the market and starting to build more homes. Mortgage rates have plunged to the lowest levels on record, making home-buying more affordable. Prices remain low and have started to stabilize. And sales of previously occupied homes are much higher than the same time last year. Though new homes represent less than 20 percent of the housing market, they have an outsize impact on the economy. Each home built creates an average of three jobs for a year and generates about $90,000 in tax revenue, according to the National Association of Home Builders. One reason prices could rise is the supply of new homes for sale remains extremely low. Just 145,000 new homes were for sale in May. That's not much higher than the 144,000 available in April, which was the lowest supply on records dating back to 1963. At the current sales pace, it would take 4.7 months to exhaust the May supply. A six-month supply is generally considered healthy by economists. "With no excess inventory of unsold new homes, any sustained rebound in new home sales should quickly translate into firmer prices," said Steven Wood, chief economist at Insight Economics. The median price of a new home sold in May edged down 0.6 percent from the April to $234,500. But the median price was 5.6 percent higher than the same month one year ago. Builders are responding to the low supply. In May, they requested the most permits to start construction on homes and apartments in three and a half years. The gains in new homes sold were concentrated in two regions of the country last month. Sales surged 36.7 percent in the Northeast and 12.7 percent in the South. Sales fell 10.6 percent in the Midwest and were down 3.5 percent in the West. Sales of new homes are increasing despite a sluggish job market, which has slowed retail spending and business investment in computers and machinery. Some economists warned that the weaker job market has also started to affect some home sales. Sales of previously occupied homes fell in May to a seasonally adjusted sales rate of 4.55 million after nearly touching a two-year high in April. Still, re-sales have risen 9.6 percent from the same month last year. Hiring slowed sharply in April and May, raising concerns about the strength of the recovery. Employers have added an average of only 73,000 jobs a month in April and May. That's much lower than the average of 226,000 added in the first three months of this year. Copyright 2012 The Associated Press. All rights reserved. This material may not be published, broadcast, rewritten or redistributed.

# \*\*\*Links

## General

**Plan creates signal that the government is addicted to fiscal stimulus**

**Sumner 6/5**/12 - Professor of Economics at Bentley University, PhD in economics from the University of Chicago (Scott, The Money Illusion, “Where did Obama get the crazy idea that fiscal stimulus was the only option?”, http://www.themoneyillusion.com/?p=14722)

It’s these very “mixed signals” they lead most people to believe that the left is fixated on fiscal stimulus and has all but given up on monetary stimulus. That perception might be unfair, but if progressives want to change it they need to work much harder at communicating the importance of monetary stimulus. Because policymakers aren’t hearing the message, indeed it’s not even part of the debate. All we hear is austerity vs. fiscal stimulus; it’s as if there are no other choices. Does President Obama know monetary policy might determine his fate? Did he know that when he appointed 6 of the 7 current members of the Board of Governors? I think we all know the answer.

Some commenters tell me to “be nicer to Krugman and DeLong, they’re on your side.” I often say good things about their support for monetary stimulus. I call them insanely talented bloggers. But I also think fiscal stimulus is a dangerous distraction, so I’m going to monomaniacally push the need for monetary stimulus. Nothing else will work.

QE3 coming but fiscal stimulus prevents fed action

Grunwald 6/20/12 – TIME's senior national correspondent, Former New York Bureau Chief for the Washington Post (Michael, Time, “Stop Me If You’ve Heard This Before: Ben Bernanke Stays the Course”, http://swampland.time.com/2012/06/20/stop-me-if-youve-heard-this-before-ben-bernanke-stays-the-course/#ixzz1z1hxb5dH)

I’m having trouble thinking of something to say about Fed chairman Ben Bernanke deciding to stay the course that I haven’t said again and again and again. What was true more than two years ago remains true today: The economy could still use more monetary stimulus, but Bernanke doesn’t intend to provide it. The Fed’s decision today to continue Operation Twist through the end of the year but to refrain from any additional easing suggests that he still thinks the unemployment situation is a disaster, but he still doesn’t plan to do much about it, although there were signs he might grudgingly step on the gas a bit in the future to prevent further deterioration.

The Fed has a dual mandate of stabilizing inflation and maximizing employment, and it’s clearly failing the second part. So why is Bernanke so reluctant to act? For one thing, he thinks fiscal stimulus from Congress would be more effective than another round of quantitative easing, which is probably true, but Congress isn’t going to pass any more fiscal stimulus, so it’s kind of irrelevant. But Bernanke also thinks the potential benefits of pumping more money into an already liquid banking system would be modest and uncertain, while the potential risks of freaking out inflation-obsessed investors who already think of him as Zimbabwe Ben could be dramatic and real. Maybe he’s wrong, but that’s what he thinks.

If there’s another bad jobs report next month, he’ll probably be able to persuade his board to loosen policy a bit to avert disaster. He thinks his QE2 helped prevent deflation; maybe a QE3 would help prevent a double-dip recession. But he clearly doesn’t intend to act with the whatever-it-takes abandon that reinvented central banking and helped save the world from a second depression in 2008 and 2009. He clearly doesn’t consider 8% unemployment an emergency on par with, say, 5 percent inflation, even though some inflation could be helpful right about now.

Fiscal stimulus trades off with monetary stimulus

Salmon 6/20/12 – Financial blogging editor for Reuters (Felix, “Why Bernanke’s not doing more”, http://blogs.reuters.com/felix-salmon/2012/06/20/why-bernankes-not-doing-more/)

I don’t think there’s all that much difference, in reality, between the Ben Bernanke we saw at today’s post-FOMC press conference, on the one hand, and Mohamed El-Erian, criticizing Bernanke’s decision, on the other. Both of them say that Fed action at this point is a second-best solution to the economic problems facing the US: what we really need — and aren’t going to get — is fiscal, not monetary, stimulus.

Bernanke got quite a few questions today asking why he wasn’t being more aggressive; certainly extending Operation Twist by a few months is unlikely in and of itself to make much of a noticeable difference to anything. As Joe Weisenthal points out, if the market thought that Operation Twist would actually boost US growth, then the announcement should have sent long bond yields up; instead, then went down.

Fiscal stimulus causes the Federal Reserve to underestimate – that stops monetary stimulus

**Sumner 1/2**/12 - Professor of Economics at Bentley University, PhD in economics from the University of Chicago (Scott, An interview of Sumner hosted by Russ Roberts, Library of Economics and Liberty, “Sumner on Money and the Fed”, <http://www.econtalk.org/archives/2012/01/sumner_on_money.html>, 42nd minute)

I agree with your idea--I've always felt it's an interesting psychological insight--that the greatest living scholar of the Great Depression is Ben Bernanke. Nothing could be more embarrassing than for his legacy to be that he allowed it to happen under his watch. For one thing he's a great scholar of the Great Depression. For another, there's this famous conference where he, in the presence of Milton Friedman, who is not with us any longer and who I'd argue would be the number 1 scholar of all time, but fine, Ben Bernanke's second but now he's first because Milton's gone--but at that conference while Milton was still here, Ben Bernanke said: Don't worry, Milton, we won't let it happen again. Now, as you said earlier, maybe he's achieved that level. He did enough to avoid a Great Depression. He didn't do enough to avoid a Great Recession. But why would he even get this close? Why would he, when he saw that that $787, now $825 billion of stimulus wasn't doing very much, why would he counteract it? You are suggesting he counteracted it, and that's why it had no effect. Is that what you are saying? Yes. The way I would put this is: He didn't go out and say: Aha, I'm going to go out and counteract this now. If you asked him, he would deny counteracting it. No doubt. In his own mind he would not believe that he did that. But I believe that if you really think through the logical implications of what the Fed would have done in the absence of fiscal stimulus, that in essence it was sabotaged. I know that's a very counterintuitive and controversial statement, and almost nobody agrees with me. But I think that's because they are not thinking about the issue clearly enough. It's not that the Fed would ever set out to hurt the economy intentionally or anything of that sort. I happen to believe the Fed underestimated the amount of stimulus that was needed. If there had been no fiscal stimulus, their estimate of what was needed on the monetary side would have been substantially higher, and that's the logical point I'm making. Now, if you word it in a certain way, it sounds very appalling, like the Fed is sabotaging fiscal stimulus; and that's not it at all. But that's really kind of what it amounts to when you think about it logically. Let me give you an example of how the way we're thinking about these issues is so unlike the orthodox view. Can I take one minute to read a quotation--and I bet you cannot guess who said this, in 1999. This is about Japan.

## **Short-Term Stimulus Stops QE3**

**Fed waiting to implement QE3 – the plan’s short-term stimulus stops quantitative easing**

**Goldfarb and Whoriskey 6/21**/12 - Zachary Goldfarb is a staff writer covering the White House for the Washington Post and a graduate of the School of Public and International Affairs at Princeton, Peter Whoriskey is a staff writer for the Washington Post (Global Association of Risk Professionals, “Fed move highlights a lack of motion on jobs”, http://m.garp.org/home/news/NewsDetails.aspx?newsId=48555)

At its meeting Wednesday, the Fed also significantly reduced its estimate of economic growth, employment and inflation over the coming years, raising the odds of additional action to boost growth in coming months. Most senior officials at the Fed do not see any actions to withdraw support until at least late 2014.

By simply renewing Operation Twist, which was launched last year and was set to end this month, the Fed is sending the signal that it wants more time to see if the lull in hiring will abate.

"The Fed played it safe, taking out a little more insurance against downside growth risks, while positioning themselves to do more if Europe deteriorates or the labor market fails to pick up," JPMorgan Chase chief U.S. economist Michael Feroli said in a research note.

## **Gold DA?**

High gold prices are contingent on monetary easing

Bond 6/20/12 – (Jason, “Gold Prices Edge Lower”, http://fyxnews.com/smw/29407/Gold-Prices-Edge-Lower)

Gold prices edged lower in trading on Tuesday as investors remained cautious ahead of Federal Reserve’s monetary policy meeting. The two-day meeting concludes on Wednesday. Any hints of further monetary easing from the Federal Reserve could boost gold prices.

Gold slipped on Tuesday following seven straight sessions of gains. But, the precious metal could bounce back on Wednesday if the Fed hints at monetary easing. Economists expect the central bank to extend its Operation Twist program, which expires at the end of this month.

Speaking to Reuters, James Steel, Chief Commodity Analyst at HSBC, said that gold has shown itself to be very sensitive to shifts in expectations of U.S. monetary policy. Steel said that if the Fed states that it is prepared to easy policy further if the economy could weaken, this may be sufficient to support gold prices.

Lynette Tan, analyst at Phillip Futures at Singapore, told Reuters that ahead of the FOMC meeting, gold bugs will watch for signs of more quantitative easing or an extension of Operation Twist when it ends this month. Tan said that a failure to confirm more asset purchase or the like could see gold dropping again.

# \*\*\*Internal Links

## Markets React Quickly

Market reacts quickly to Federal reserve action

Little No Date – chief financial writer for a large mutual fund family, worked with a consulting firm that served large financial services companies (Ken, “Interest Rates and Stock Prices”, http://stocks.about.com/od/understandingstocks/a/061207intrates.htm)

The direction of interest rate movement is of primary importance to the stock market. Stock investors watch for signs from the economy and regulators that may suggest which way interest rates will move in the future.

These tips are not always reliable over the long term, but may give investors an idea where interest rates are headed in the short run.

The Federal Reserve Open Market Committee, more commonly known as the Fed, sets key interest rates and the market reacts quickly to any changes it imposes.

Stocks React

More importantly, the market reacts to how it thinks the Fed is going to act even months before it meets.

**Markets watch the Federal Reserve’s every move**

**Hayo et al 12** – Bernd Hayo is an economics professor at the University of Essen, Ali Kutan is Professor of Economics and Finance at Southern Illinois University, Matthias Neuenkirch is a professor of economics at Philipps University in Germany (Published in: Southern Economic Journal, “Federal Reserve Communications and Emerging Equity Markets”, Volume: 78, Issue: 3, January 2012, Proquest)

Our results have important implications for policymakers and investors. First, in addition to observing formal announcements, investors and policymakers need to pay attention to informal communication of U.S. monetary policy. Hayo, Kutan, and Neuenkirch (2010) present similar findings for mature European and Pacific equity markets, although their results suggest that mature equity markets are even more influenced by communication and to a lesser extent by monetary policy actions. Arguably, these well-developed markets have a more sophisticated understanding of monetary policy than do emerging equity markets and thus are more alert to the possibly subtler nuances of informal communication. Based on these results, we conjecture that as these emerging markets continue to evolve, informal communication will become increasingly important to them. The increased influence of central bank communication during the financial crisis seems to support this conjecture.

Second, the strong reactions during the financial crisis show how crucial central bank communication is in turbulent times. Financial markets closely monitor every speech and adjust their prices in reaction to a larger extent during a financial crisis than they do during "normal times."

Third, the finding that American stock markets react more strongly to news of policy shocks from the United States than do non-American stock markets suggests that the former countries have a higher risk of contagion via both formal and informal channels and that investors focusing on the American region face a lower degree of portfolio diversification opportunities.

Finally, in an extension of the analysis presented herein, we find that U.S. monetary policy news has a larger impact on returns than on the volatility of returns. This suggests that the Fed's actions generate primarily wealth effects rather than risk effects, as measured by the conditional variance of returns. 23 Thus, U.S. monetary policy announcements can significantly impact the wealth of investors in emerging economies, especially in the neighboring American economies. Prudent policymakers in these emerging markets should design policy strategies that effectively deal with the wealth and other effects of U.S. monetary policy actions and communications.

**Markets watch closely to signs of stimulus – the anticipation alone raises stocks**

**Dieterich 6/19**/12 – (Chris, Nasdaq, “U.S. Stocks Push Higher, Await Fed News”, http://www.nasdaq.com/article/us-stocks-add-to-gains-fomc-on-tap-20120619-01249)

--Stocks rise on hope for more Fed stimulus

--S&P 500, Nasdaq extend gains to a fourth session

--Housing starts slow in May; permits jump to highest since 2008

NEW YORK--Speculation that U.S. central bankers are set to unveil additional stimulus measures and the easing of tensions across Europe's financial markets lifted the S&P 500 to its the fourth gain in a row.

The Standard & Poor's 500-stock index rose 13.20 points, or 1%, to 1357.98 on Tuesday, its highest close in nearly five weeks.

The Dow Jones Industrial Average tacked on 95.51 points, or 0.8%, to 12837.33, closing just short of its fourth triple-digit gain in six sessions.

Materials stocks led Tuesday's rally, with United States Steel surging $1.74, or 9.5%, to $20.15. Financials followed closely behind after federal housing regulators said they were revising guidelines that could reduce lenders' risks of having to buy back soured mortgages.

Bank of America jumped 35 cents, or 4.5%, to 8.11, to lead the Dow's advance.

Microsoft, also a Dow component, jumped 86 cents, or 2.9%, to 30.70, after the software company unveiled its Surface tablet computer, which will compete with Apple's iPad. Apple's stock rose 1.63, or 0.3%, to 587.41.

The Nasdaq Composite rose 34.43 points, or 1.2%, to 2929.76. The technology-heavy index rose for the fourth session in a row, its longest streak of gains since February.

The Federal Reserve's policy-setting committee convened a two-day meeting on Tuesday. A series of statements and forecasts are scheduled to begin around midday Wednesday.

Tuesday's stock rally was based "generally on enthusiasm for, and hope that, the Fed might say something market- friendly tomorrow," said Steve Sosnick, equity risk manager for Timber Hill, the market-making unit of Interactive Brokers.

Investors will be watching closely for hints that the central bank is preparing again to stimulate the U.S. economy, perhaps through additional purchases of government securities, or a variation of an existing program set up to extend maturities of the central bank's bond holdings.

## **AT: Plan Solves Private Investment**

#### No private investment in the short term – only after public investment

Leeper et al. 09 (ERIC M. LEEPER, TODD B. WALKER, AND SHU-CHUN S. YANG, Leeper—professor of macroeconomics at Univeristy of Minnesota, Walker—economics professor at Indiana university, Yang-- economist in the Research Department of the IMF, 2009, “Government investment and fiscal stimulus in the short and long runs”, http://www.princeton.edu/economics/seminar-schedule-by-prog/macro-s09/monetary-fiscal-policy-co/schedule/additional-participant-pa/GovtInvest.pdf)

Implementation delays alter the short-run dynamics substantially, especially for consumption, labor, and output. Under the usual assumption of no delays (or one quarter to build), the responses are similar to those in the simple model [figure 2]: consumption and private investment fall but output and labor rise immediately. Investment adjustment costs generate a hump-shaped decline in investment because adjustment costs punish rapid changes. Private investment does not rise until more than three years after the shock.

When there are implementation delays, private investment does not rise until much later: after more than four years with one-year delay and seven years with three-year delay. The peak decline is also larger than in the case without delays. Implementation delays imply a slower build-up of public capital, and, therefore, a slower increase in the marginal product of private inputs. Because it takes less time to build private capital, agents postpone investment until the public capital stock is built up.

While investment responses differ only quantitatively when there are implementation delays, consumption, labor, and output differ qualitatively in their short-run dynamics. As in the simple model, the driving force for an immediate increase in labor without delay is the crowding-out effect or negative wealth effect. Under implementation delays, the government absorbs a fewer goods initially and the crowding out effect is smaller in the short run. On the other hand, since the total increase in government investment is the same across the three delay periods, the positive wealth effect from higher future public capital operates in each case. Less crowding out, coupled with the same positive wealth effect, generates a slight decline in employment and a slight increase in consumption in the short run, in contrast to the case without delays.

With implementation delays, labor also declines in the short run because the marginal product of labor rises only gradually as public capital gets installed. With longer implementation delays, the rebound in investment and labor is also slower. Consequently, with a three-year delay, output does not begin to rise until almost two years after the shock; with a one-year delay, output does not rise until two quarters after the shock.

When \_G = 0.05, the qualitative patterns of all variables follow closely to those with \_G = 0.1 [second column of figure 3]. Under \_G = 0.05, the initial decline in labor and output under delayed implementation is, however, negligible. As public capital is less productive, the positive wealth effect induced from more productive public capital is also smaller. When \_G = 0.05 and N = 4 or N = 12, this positive wealth effect is almost canceled out entirely by the crowding-out effect, leaving little impact on consumption, labor, and output for the initial two to three quarters. Since public capital is less productive, the subsequent increase of private investment and labor is also smaller because the productivity of private inputs rises more modestly.

Although various spending rates have little influence on the responses at longer horizons, the above analysis shows that an implementation delay is qualitatively and quantitatively important for short-run dynamics. Contrary to the results when there is no implementation delay—that an increase in government investment is expansionary and raises employment immediately—we find that implementation delays imply that productive government investment can have little effect or even a negative effect on labor and output in the short run. This period can be as brief as a couple of quarters or as long as a couple of years. In addition, the short-run decline in private investment can be larger and longer compared to the case without implementation delays. Implementation delays are an important factor to evaluate the short-term effects of government investment.

More debt requires increased tax rates – that kills private investment

Leeper et al. 09 (ERIC M. LEEPER, TODD B. WALKER, AND SHU-CHUN S. YANG, Leeper—professor of macroeconomics at Univeristy of Minnesota, Walker—economics professor at Indiana university, Yang-- economist in the Research Department of the IMF, 2009, “Government investment and fiscal stimulus in the short and long runs”, http://www.princeton.edu/economics/seminar-schedule-by-prog/macro-s09/monetary-fiscal-policy-co/schedule/additional-participant-pa/GovtInvest.pdf)

3.3. Fiscal Adjustments. Another important consideration for determining the effects of government investment, particularly in the long run, are the ultimate sources of fiscal financing. Up to this point, we exploited the Ricardian equivalence of the models when government spending is financed by non-distorting taxes. Of course, stimulus packages like the American Recovery and Reinvestment Act finance higher government spending by selling government debt. We examine four alternative schemes for financing and eventually retiring the expansion in new debt: adjustments to future lump-sum taxes, unproductive government spending, capital taxes, and labor taxes.

Fiscal adjustment parameters follow the values in table 2. Figure 4 plots responses when \_G = 0.1 for each of the four financing schemes.20 As the figure makes evident, the choice of financing instrument matters a great deal for the effects in the long run. Fiscal adjustments through distorting financing methods create another channel that influences the impacts of government investment. Raising income tax rates or reducing government consumption offsets some of the growth effects from higher productive public capital. The net effect over longer horizons can be expansionary or contractionary. Among the four methods of financing, regardless of the length of implementation delays, government investment is most expansionary when non-distorting transfers are reduced, and it is least expansionary—in fact, contractionary— when government raises the tax rate on capital income. As shown in the path of private investment (the third column), raising the marginal tax rate on capital income generates strong negative impacts on private investment. These negative effects can dominate the positive impacts from more productive public capital. Lower private investment also reduces the marginal product of labor, driving down employment. Combining these two factors, output falls below its initial level five to seven years after the initial government investment shock and stays persistently low before returning to the steady state.

Increasing the tax rate on labor income to stabilize debt reduces the after-tax return on labor, which drives down labor inputs and output relative to the case with transfer reductions. A reduction in (unproductive) government consumption, lowers the amount of resource government absorbs from the economy and offsets some of the crowding out effects from the increase in government investment. As a result, labor falls more and consumption rises relative to the case with transfer reductions. Lower labor in turn reduces some of the growth effect from the productive government investment.

# \*\*\*Impacts

## QE Solves the Economy

Krugman agrees – monetary stimulus needed now

Krugman 6/21/12 – Professor of Economics and International Affairs at Princeton University, Nobel Memorial Prize in Economic Sciences in 2008 (Paul, NY Times, “Brief Notes From Hiding”, http://krugman.blogs.nytimes.com/2012/06/21/brief-notes-from-hiding/)

The intimidated Fed: The minimal action — extending Operation Twist — wasn’t just inadequate, it was shameful. The Fed has a dual mandate, employment and price stability. Its own projections show high unemployment persisting for years and years, inflation running below its target — and realistically its inflation projections are too high while its unemployment projections are too low. There is no rational argument I can see for not going all out with monetary stimulus.

Even the possibility of further monetary stimulus boosts stocks

Johnston and Siret 6/20/12 – They are journalists for The Times (Chris and Mal, The Times, “Markets lacklustre ahead of Fed decision”, LexisNexis)

Investors are on tenterhooks awaiting the outcome of the US Fed's policy meeting on Wednesday, hoping it will extend its long-term bond-buying programme to stimulate the economy, which has helped shore up metals prices and the Aussie dollar.

The benchmark S&P/ASX 200 index was up 7.2 points at 4,130.5 at 0448 GMT, but down from a high of 4,159.3.

New Zealand's benchmark NZX 50 index fell 30 points to 3,450.3, led down by a 5.7 percent drop in Fisher & Paykel Healthcare as it traded without rights to its dividend.

The media sector got a lift when Rupert Murdoch's News Corp offered A$1.97 billion for Consolidated Media to expand in pay TV, sending shares of the target up 11 percent to just below the A$3.50 a share value of the bid.

News Corp's shares also rose 0.7 percent to A$20.17 after it announced the bid for Consolidated Media and a restructure of its local operations, flagging yet-to-be determined job cuts.

Rival Fairfax Media, which announced a radical overhaul of its newspapers this week, including axing 1,900 jobs, rose 1.7 percent, while broadcaster Southern Cross Austereo jumped 4.2 percent to A$1.255.

0530 Tokyo stocks rose 0.77 percent amid hopes that the US central bank will usher in further easing measures to stimulate the world's biggest economy.

The Nikkei 225 index at the Tokyo Stock Exchange gained 66.28 points to 8,722.15 while the broader Topix index of all first-section issues rose 1.29 percent, or 9.50 points, to 744.19.

The gains came after the Dow Jones Industrial Average ended 0.75 percent higher and European bourses posted gains, following a moderately successful Spanish bond auction and on speculation about more Fed stimulus.

"The view actually seems quite balanced on the Fed acting sooner versus later," said CLSA equity strategist Nicholas Smith.

Tatsunori Kawai, chief strategist at kabu.com Securities, said "hopes for more easing are certainly a factor stoking enthusiasm for equities globally."

0510 Hong Kong stocks rose 0.44 percent in the morning session on hopes for a fresh round of stimulus by the US Federal Reserve to boost the economy.

The benchmark Hang Seng Index climbed 85.82 points to 19,502.49 on turnover of HK$18.76 billion ($2.42 billion).

0420 Asia markets rose through the morning as hopes for a fresh round of stimulus to revitalize the US economy buoyed sentiment across global markets.

Japan's Nikkei Stock Average added 0.8 percent, South Korea's Kospi put on 0.3 percent, and Australia's S&P/ASX 200 index gained 0.6 percent.

In China, Hong Kong's Hang Seng Index added 0.5 percent and the Shanghai Composite edged up 0.1 percent.

Upbeat US housing data and the prospect of more monetary easing by the Federal Reserve helped to drive Wall Street stocks to five-week highs Tuesday.

Strategists at Barclays Capital expect the Federal Reserve to extend Operation Twist "by a few more months ... as the market would be disappointed with lack of more aggressive actions by the Fed."

#### Quantitative Easing reduces unemployment

Ito 6/27 (Aki Ito, economic reporter for Bloomberg, June, 27, 2012, “Evans Says Fed Needs to Do More Than Operation Twist”, <http://www.businessweek.com/news/2012-06-27/evans-says-fed-needs-to-do-more-than-operation-twist>)

Federal Reserve Bank of Chicago President Charles Evans said the U.S. central bank didn’t provide enough stimulus last week and called for new easing including more asset purchases to spur economic growth. “We should be doing more accommodation than what was adopted under the Twist,” he said in Chicago today, referring to the Fed’s June 20 decision to expand its Operation Twist program extending the maturity of bonds on its balance sheet. While the move “has small effects,” Evans said, “its larger effect is that it indicates the Fed is continuing to think more accommodation is important and worthwhile.” Faced with slower job growth and a deepening debt crisis in Europe, the Federal Open Market Committee expanded its maturity- extension program by $267 billion through the end of the year. Chairman Ben S. Bernanke said at a press conference the Fed is prepared to do more without gains in employment. “Right off the bat, I’d be willing to do more on the basis of the current data,” Evans, 54, said to reporters at the Chicago Fed. He doesn’t vote on policy this year. The Chicago Fed president has been among the most vocal advocates for additional easing among central bank officials. Last year he was the only member of the FOMC to dissent in favor of increasing stimulus. Evans today reiterated his call for policy makers to commit to holding the main interest rate near zero until the unemployment rate falls below 7 percent or inflation rises above 3 percent. He said this would be his first priority, adding that “in the current environment, any amount of additional accommodation is welcome.” Forecast Growth Fed officials lowered their forecast for growth and employment after meeting on June 19-20, projecting a jobless rate of at least 7.5 percent by the end of 2013. The central bank is ready to do more to bolster growth and promote “sustained gains in labor market conditions,” the FOMC said. Bernanke said after the meeting that additional asset purchases are among the steps the Fed would consider. St. Louis Fed President James Bullard said on June 22 that another round of quantitative easing would face a “pretty high hurdle.” “I’d be willing to support more asset purchases, MBS, in order to provide more accommodation,” Evans said, referring to mortgage-backed securities. “The labor market situation has been completely unsatisfactory.” The Fed has bought $2.3 trillion of securities in two rounds of so-called quantitative easing aimed at reducing borrowing costs, spurring economic growth and reviving the job market. Mixed Outlook Reports since the Fed meeting have painted a mixed outlook for the economy, with the Philadelphia Fed’s manufacturing index for June tumbling to the lowest level since August. Still, orders for durable goods in May rose for the first time since February and pending home sales rebounded, data showed today. Stocks rose today as the housing and durable goods data alleviated concerns of a weakening U.S. expansion. The Standard & Poor’s 500 Index increased 1 percent to 1,333.04 as of 12:55 p.m. in New York. Concern over financial turmoil in Europe is weighing on the economic outlook as Cyprus this week became the fifth euro member state to request a bailout. European Union leaders are meeting in a two-day summit that begins tomorrow. “Given the downside risks that we’re facing, if there were any substantial downside shocks that we’re hit with over the next six to 12 months, the economy’s not in the best place” to weather those shocks, Evans said. He said he expects annual economic growth of 2 percent to 2.5 percent during the next two years, compared with an earlier forecast of 2.5 percent to 3 percent growth. Evans has been the district bank’s president since 2007. He represents a region that includes Iowa and most of Illinois, Indiana, Michigan and Wisconsin.

#### Quantitative Easing works – solves market expections

O’Brien 6/5 (Matthew O'Brien, associate editor at The Atlantic covering business and economics, “Save Us, Ben Bernanke, You're Our Only Hope”, June 5, 2012, http://www.theatlantic.com/business/archive/2012/06/save-us-ben-bernanke-youre-our-only-hope/258037/)

This may not be our darkest hour, but the disappointing [May jobs report](http://www.theatlantic.com/business/archive/2012/06/the-job-market-crashes-to-earth/257972/) showed the U.S. economy once again slowing towards stall speed. It's not just the anemic 69,000 jobs the economy added last month. More disconcerting were the sharp downward revisions to previous months. It looks like we could be in for an unwelcome rerun of the [summer doldrums](http://www.theatlantic.com/business/archive/2012/06/the-us-economy-isnt-just-a-man-made-disaster-film-its-an-epic-trilogy/258081/) we have gotten to know all too well in 2010 and 2011. Markets have a bad feeling about this. It isn't just about the deteriorating U.S. outlook. Europe and China are turning to the dark side of growth too. The euro is continuing its game of Schrödinger's currency: At any moment it is both saved and doomed. Right now, it's looking more and more doomed. Then there's the [slowdown](http://www.theatlantic.com/business/archive/2012/05/smack-the-brics-hit-a-wall-of-their-own-making/257448/) in China -- along with India and Brazil. These economies powered global growth during the dark days of 2008 and 2009, but seem certifiably wobbly now. The Fed is our last hope -- and there isn't another. Republicans in Congress continue to block further fiscal stimulus, despite [historically low](http://www.theatlantic.com/business/archive/2012/05/its-a-record-us-treasury-yields-hit-a-220-year-low/257948/) borrowing costs and a clear need for better [infrastructure](http://www.theatlantic.com/business/archive/2012/06/its-a-tragedy-were-not-spending-more-on-infrastructure/258042/). So that leaves Ben Bernanke & Co. as the last and only line of defense. But with short-term interest rates at zero, how much more can the Fed do? What would more quantitative easing accomplish -- and what does that even mean? In a galaxy far, far away, there wouldn't be any question about whether the Fed could kickstart more growth. That galaxy is called Israel, or Sweden, or Switzerland. Even with zero interest rates, a central bank can increase growth thanks to three things: expectations, expectations, and expectations. Oh, and expectations. But we're getting ahead of ourselves. Let's step back and first consider why critics say the Fed is "out of ammo". Then, we'll explain why that's wrong -- by referring to the ur-text of monetary policy: the script of *Star Wars*. Really. IT'S A (LIQUIDITY) TRAP! A long time ago -- in 2008, to be exact -- monetary policy seemed simple. Central banks raised short-term interest rates when the economy got too hot, and lowered them when it got too cool. The way they did this was simple too. They sold short-term bonds to banks when they wanted to raise rates, and bought short-term bonds from banks when they wanted to lower rates. Central banks got so good at this that the business cycle seemed tamed. Unemployment was low, inflation was lower, and recessions were rare. Economists gave themselves a pat on the back for this self-proclaimed Great Moderation. That was before the dark times. Before Lehman. Then this tidy little world came crashing down. The shock from the financial crisis was so big that even a zero percent interest rate wasn't enough to turn the economy around. It still isn't. The Fed looks stuck. It can't push nominal rates below zero. What more can it do? The Fed has tried a new strategy. It has bought long-term bonds. In other words, bonds that still have nonzero interest rates. The idea behind this unconventional easing is the same as for conventional easing: To push up growth by pushing down interest rates -- just on different bonds. These different bonds have mostly been longer-dated Treasures, as well as mortgage-backed securities and agency debt from Fannie Mae and Freddie Mac. Taken together, this rather misunderstood bond-buying goes by the rather unfortunate name of "quantitative easing". From a certain point of view, quantitative easing is money-printing. From another, it's just an asset swap. Let's think about what this means. Or rather, let's think about where the money for quantitative easing comes from. The magic of central of banking is that the money comes from nowhere. Or whatever the digital equivalent of nowhere is. Remember: Each bank holds a reserve account with the Fed that must meet a certain minimum balance. When the Fed buys longer-dated Treasuries from a bank, it simply creates money and credits the bank's reserve account with this newly-created money. Banks usually only keep the minimum amount in their reserve accounts -- until now, that is. The chart below shows how so-called excess reserves have grown since 2008. Lots of people don't like this. They worry that this increasing pile of reserves will mean increasing inflation when banks eventually lend them out. Or that this is really just another backdoor bank bailout. Or that this shows that quantitative easing doesn't work. Let's consider these in turn. First, the Fed has a number of tools to prevent excess reserves from being lent out too quickly. It's actually using one right now, although it really shouldn't be. It pays interest on these reserves. That's right: It pays banks not to lend. So relax, Zimbabwe is not in our future. Second, the Fed doesn't give banks this money for free. The banks give up bonds in return. It's swapping one asset for another. And third, just because so many reserves aren't lent out doesn't mean that quantitative easing accomplishes nothing. If nothing else, it signals that the Fed will not passively watch inflation fall too low. That message matters. THESE AREN'T THE RATES YOU'RE LOOKING FOR "These aren't the droids you're looking for." That's what Obi-Wan Kenobi famously tells a trio of less-than-with-it baddies in *Star Wars* when -- spoiler alert! -- they actually were the droids they were looking for. But thanks to the Force, Kenobi convinces them otherwise. That's a Jedi mind trick -- and it's a pretty decent model for how central banks can manipulate expectations. Thanks to the printing press, the Fed can create a self-fulfilling reality. Even with interest rates at zero. Central banks have a strong influence on market expectations. Actually, they have as strong an influence as they want to have. Sometimes they use quantitative easing to communicate what they want. Sometimes they use their words. And that's where monetary policy basically becomes a Jedi mind trick. The true nature of central banking isn't about interest rates. It's about making and keeping promises. And that brings me to a confession. I lied earlier. Central banks don't *really* buy or sell short-term bonds when they lower or raise short-term interest rates. They don't need to. The market takes care of it. If the Fed announces a target and markets believe the Fed is serious about hitting that target, the Fed doesn't need to do much else. Markets don't want to bet against someone who can conjure up an infinite amount of money -- so they go along with the Fed. Don't underestimate the power of expectations. It might sound a like a hokey religion, but it's not. Consider Switzerland. Thanks to the euro's endless flirtation with financial oblivion, investors have piled into the Swiss franc as a safe haven. That sounds good, but a massively overvalued currency is not good. It pushes inflation down to dangerously low levels, and makes exports uncompetitive. So the Swiss National Bank (SNB) has responded by devaluing its currency -- setting a ceiling on its value at 1.2 Swiss francs to 1 euro. In other words, the SNB has promised to print money until its money is worth what it wants it to be worth. It's quantitative easing with a target. And, as [Evan Soltas](http://esoltas.blogspot.com/2012/05/power-of-promises.html) pointed out, the beauty of this target is that the SNB hasn't even had to print money lately, because markets believe it now. Markets have moved the exchange rate to where the SNB wants it. I FIND YOUR LACK OF A TARGET DISTURBING I've seen a lot of strange stuff, but nothing quite as strange as the Fed's reluctance to declare a target recently. Rather than announce a target, the Fed announces *how much* quantitative easing it will do. This is planning for failure. Quantitative easing without a target is more quantitative and less easing. Without an open-ended commitment that shocks expectations, the Fed has to buy more bonds to get less of a result. It's the opposite of what the SNB has done. Many economists have labored to bring us this knowledge -- including a professor named Ben Bernanke -- and yet the Fed mostly ignores it. I say mostly, because the Fed has said that it expects to keep short-term interest rates near zero through late 2014. But this sounds more radical than it is in reality. It's not a credible promise because it's not even a promise. It's what the Fed *expects* will happen. So what would be a good way to shift expectations? Let's start with what isn't a good way. Interest rates can deceive you. Don't trust them. Because most people think the point of quantitative easing is to push down long-term interest rates, they think that any time long-term interest rates fall that it's a form of "stealth quantitative easing". [Not so](http://www.businessinsider.com/morgan-stanley-financial-conditions-index-2012-6). Consider the chart below from [Bloomberg](http://www.bloomberg.com/quote/USGGBE01:IND/chart) that shows one-year inflation expectations. Inflation expectations have jumped whenever the Fed has eased. That's not surprising. That's the point of Fed easing. What might be surprising is that sometimes long-term interest rates have fallen when inflation expectations have fallen. In other words, targeting interest rates alone can be misleading. A far better target would be the variable that the Fed ultimately cares about: the total size of the economy. Unfortunately, that kind of regime change is too radical for the Fed now. A second-best policy would be targeting the second-best variables: inflation and unemployment. Chicago Fed president [Charles Evans](http://www.chicagofed.org/webpages/publications/speeches/2011/09_07_dual_mandate.cfm) has proposed such a rule, saying the Fed should commit to keeping rates at zero as long as core inflation is below 3 percent or unemployment is above 7 percent. Even better would be to promise to keep doing quantitative easing until the economy hits one of those targets. EASE OR EASE NOT: THERE IS NO TRY. The ability to manipulate interest rates is insignificant next to the power of expectations. The latter is never out of ammo, because the Fed can always promise to turn on the printing press and buy stuff until people get the message. It's not magic, but it's the closet thing we have to it. The only reason the Fed has failed so far is that it hasn't been determined to succeed. It's tentatively tried things instead. Switzerland shows that there is another path. Use the force, Ben. Use the force of inflation expectations.

#### Quantitative easing good – it’s better than nothing

Vigna 6/15 (Paul Vigna, economic reporter for the Wall Street Journal, “How Much Good Will QE3 Be?”, <http://blogs.wsj.com/marketbeat/2012/06/15/how-much-good-will-qe3-be/>, June 15, 2012)

Stocks are rising again, even ahead of a nerve-wracking Greek election that could spell a whole new chapter of the European crisis. By now, you all know the reason: central banks.

The ECB’s Mario Draghi [dropped a loud hint](http://online.wsj.com/article/SB10001424052702303734204577467923364831432.html?mod=WSJ_hp_LEFTWhatsNewsCollection) this morning, saying the bank  was ready to continue its “crucial role” of providing liquidity to sound banks (given the state of European banks, the adjective “sound” is not superfluous.)

The market rally this whole month has been largely predicated on the idea that some central bank, the Fed or the ECB, or maybe half a dozen of them in concert, will step into any breach. For the markets, all they need to hear is “coordinated central-bank action” and they’re slamming into the buy keys. For the real world, it may not mean so much.

BofA Merrill Lynch analyst Michael Hanson said another QE program from the Fed might not be a big fundamental positive. But not acting might be a big fundamental negative:

Does it really matter? Given how low long-term rates are today, and how much the Fed has already done, is additional easing likely to have any benefits at all? We suspect the answer is yes, although the impact may be quite muted. In light of current market sentiment, not acting might have an even bigger (adverse) impact.

Conveniently, the Fed has a meeting coming this week, a two-day affair concluding Wednesday with the FOMC statement on rates. Hanson says the odds of the Fed announcing some kind of “balance-sheet move” at that meeting are about one in three.

What’s more likely is a dovish statement from the central bank that paves the way for a new program. BofA Merrill expects QE3 by the late summer or early fall.

#### Quantitative easing key to prevent economic crash - key to keep markets moving

Stepniak 5/24 (Brittany Stepniak, editor for Wealth Wire.--reports on the most up-to-date precious metals research, oil developments, economic predictions, and stock market volatility--also a contributing writer for Green Chip Stocks, “Faber: Market Will Crash Without "Massive" QE3”, <http://www.wealthwire.com/news/equities/3243>, May 24, 2012)

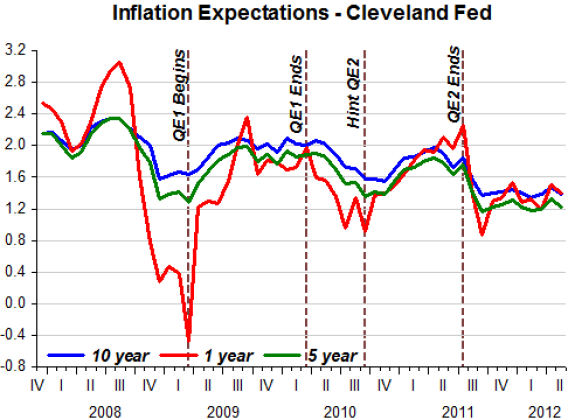
Always notorious for predicting any impending doom on the horizon, economic expert Marc Faber says we may experience a [market crash mimicking that of 1987](http://wallstreetpit.com/91958-markets-will-crash-like-in-1987-if-stocks-rally-without-qe3-marc-faber) in the second half of 2012. In fact, Faber believes we need “massive QE3” in order for markets to continue moving upwards with strong momentum without crashing after hitting 1422. In the meantime, Faber says corporations are likely to report “good” earnings, but they will certainly not exceed any expectations. Faber elaborates: “A crash, like in 1987…because the market would become technically very weak. I would expect the market making a new high. If it happens, it would be a new high with very few stocks pushing up and the majority of stocks have already rolled over. The earnings outlook is not particularly good because most economies in the world are slowing down. People focus on Greece but Greece is completely irrelevant. What is relevant are two countries — China and India — 2.5 billion people combined. They are a huge market for goods and these economies are slowing down massively at the present time.”  In regards to the S&P 500, Faber thinks we have already seen the high this year – unless, of course, a huge dose of QE3 is injected into society. Faber does expect that the Fed will issue further stimulus, but says it depends on asset markets. According to Dr. Faber, QE3 will become a more probable scenario if the S&P drops another 100-150 points. Additionally, Faber was not bashful at all in expressing his disdain with many government officials in the U.S. and especially the bureaucrats in Brussels. Faber asserts that the lack of fiscal discipline and frivolous spending is destroying Europe. Although Faber is not particularly fond of America's bureaucrats, he thinks the look like “geniuses” when compared to Europe's.  Commenting on the euro crisis, Faber suggests that Europe not only kick-out not only Greece from the euro-zone, but also Spain, Italy, and even France. Repeated bailouts provide a band-aid patch to mask the wound, but they don't cure the infection. Avoiding the real culprit of the problem could lead to an all out economic catastrophe for Europe and the United States of America. Faber says the public has been “brainwashed” into thinking that the real catastrophe will ensue if the above listed countries are kicked out of the euro-zone. Quite simply put, Faber says that couldn't be further from reality.

**Quantitative Easing solves – clear correlation with inflation expectations – here is a graph**

**Yglesias 5/16**/12 – business and economics correspondent (Matthew, Slate, “The Two Charts That Show We Need QE3”, http://www.slate.com/blogs/moneybox/2012/05/16/qe3\_needed\_in\_two\_charts.html)

Would a third round of quantitative easing boost the economy? You bet it would. The evidence?

Marcus Nunes shows that the Fed's QE programs are effective tools for shifting inflation expectations:



## Stock Markets Impact

**Stock market will crash absent QE3**

**Liu and Gretler 5/10**/12 – Bloomberg reporters (Betty and Corrine, Bloomberg, “Faber Sees ’87-Type Crash If U.S. Stocks Rise Without QE3”, http://www.bloomberg.com/news/2012-05-10/faber-sees-crash-like-in-1987-if-u-s-stocks-climb-higher.html)

U.S. stocks may plunge in the second half of the year “like in 1987” if the Standard & Poor’s 500 Index (SPX) climbs without further stimulus from the Federal Reserve, said Marc Faber, whose prediction of a February selloff in global equities never materialized.

“I think the market will have difficulties to move up strongly unless we have a massive QE3,” Faber, who manages $300 million at Marc Faber Ltd., told Betty Liu on Bloomberg Television’s “In the Loop” from Zurich today, referring to a third round of large-scale asset purchases by the Fed. “If it moves and makes a high above 1,422, the second half of the year could witness a crash, like in 1987.”

The Dow Jones Industrial Average plunged 23 percent on Oct. 19, 1987 in the biggest crash since 1914, triggering losses in stock-market values around the world. The Standard & Poor’s 500 Index plummeted 20 percent. The Dow still closed 2.3 percent higher in 1987, and the S&P 500 advanced 2 percent.

“If the market makes a new high, it will be a new high with very few stocks pushing up and the majority of stocks having already rolled over,” Faber said. “The earnings outlook is not particularly good because most economies in the world are slowing down.”

Stock market crash kills the economy

Low 8 – Economists (Lawrence, “Does Stock Market Crash Often Followed By A Recession (or Depression)”, http://econsguide.blogspot.com/2008/10/does-stock-market-crash-always-followed.html)

Does Stock Market Crash Often Followed By A Recession (or Depression)?

Yes,

(1) Falling wealth. In most countries, people generally store their wealth in property market & stock market. With market crash, it means consumers’ wealth is wiped off & this could undermine their willingness to spend into the economy & this leads to fall in consumption. Fall in AD will cause real GDP to fall.

However the situation could be unique in UK, as most Britons store their wealth in property market. People there even view shares as speculative investment. This means when share prices go up, people do not spend more & when share prices go down, they do not cut their spending. It’s also worth to note that only small % of populations have significant savings in shares. At the moment, wealth crisis in UK wasn’t stemmed from falling stock index, but rather a series of falling house prices which has to do with high default rate of subprime mortgage loan

(2) Falling investment. In the period of falling share prices, firms may find difficulty in raising capital through the issuance of shares. Therefore this may prompt them to defer or cancel an investment project causing a fall in AD. Real GDP will decline & this causes negative economic growth

(3) Fall in confidence. This depends on how long & how severe is the crash. Most notably was the October 1929, Great Depression where share prices suffer from such a large fall & is prolonged that it causes a general decline in economic confidence & collapse of financial institutions. Consumers cut their spending & firms continue to hold back their investments, causing a large scale of unemployment & fall in economic growth. These effects were magnified by a negative multiplier effect, when things happen in a cycle

**Stock market plunge offsets benefits from fiscal stimulus**

**Farmer 12** – Chair of the Economics Department at UCLA (Roger, “The stock market crash of 2008 caused the Great Recession: Theory and evidence”, Published in Journal of Economic Dynamics & Control, http://econweb.umd.edu/~davis/eventpapers/FarmerStock.pdf)

7.1. The stock market crash of 2008 caused the Great Recession

I believe that there is an alternative more credible explanation of the connection between stock market wealth and unemployment in which an apparent liquidity crisis is a symptom, rather than the cause of the recession. That explanation involves the shift from a high employment to a low employment equilibrium as households and ﬁrms re-evaluated their beliefs about the value of U.S. wealth.

To make the case that a drop in stock market wealth can cause an increase in the unemployment rate, there must be a plausible transmission mechanism from one to the other. In my work, that mechanism operates through aggregate demand.

Keynesians draw attention to Okun’s law; a relationship between detrended real GDP and the unemployment rate. Fig. 10 depicts Okun’s law for post-war data. It plots GDP measured in wage units and the log of a logistic transform of the unemployment rate for the period from 1953q1 to 2011q1.

In Farmer’s model economics, Okun’s law holds in the data because movements in the unemployment rate are caused by movements in aggregate demand. It is the empirical counterpart of the aggregate supply curve in Fig. 9. To construct an explanation of the causes of unemployment, we must build a theory of how each of the components of aggregate demand moves over time.

In a closed economy, GDP consists of consumption, investment and government purchases. 12 Although there is some evidence of a high frequency correlation between the stock market and investment, particularly in the two most recent recessions, investment ﬂuctuations are not responsible for permanent shifts in the unemployment rate. Investment, measured in wage units, is a stationary series (Farmer, 2010

7.2. Beliefs drive aggregate demand

In my work, conﬁdence, represented by Eq. (16), is an independent driving force of business cycles. I call Eq. (16) a belief function: it describes the way that households and ﬁrms form expectations of the future. 13 The belief function is a fundamental that has the same methodological status as preferences, technology and endowments. As agents revise their beliefs, shocks to those beliefs inﬂuence the real value of wealth. A large negative shock to beliefs results in a large drop in wealth that causes households and ﬁrms to reduce their consumption expenditures. The drop in stock market wealth also inﬂuences investors who will not purchase new factories and machines if they believe that the value of their existing capital may fall further.

Beliefs are highly persistent and it is this persistence that accounts for extended periods of high unemployment like the Great Depression and the Great Recession. After a stock market crash, households reduce their consumption expenditure. The associated fall in aggregate demand causes businesses to layoff workers and that generates a further wealth effect as newly unemployed households experience a fall in the value of their expected future earnings. There is a multiplier effect, similar to the Keynesian multiplier, but it operates through wealth and not through income.

### Hurts Economy

Crash causes economic slowdown

Amadeo 8 - 20 years senior-level experience in economic analysis and business strategy working for major international corporations, M.S., Sloan School of Business at MIT (Kim, “Could a Stock Market Crash Cause a Recession?”, http://useconomy.about.com/od/stockmarketcomponents/f/stock\_recession.htm)

Answer: Since stocks are a piece of ownership in a company, the stock market reflects investors' confidence in the future earnings of all these companies. Since corporate earnings are dependent on the health of the U.S. economy, the stock market is also an indicator for the U.S. economy itself.

What does it mean when the stock market crashes, as it did the week beginning October 5 2008, when the Dow fell from over 10,000 to below 8,500, a 15% decline in one week. It can mean a sudden loss of confidence in both the market and the underlying economy.

If confidence is not restored, it could contribute further to recession, as happened in 2000. That’s because declining stock values means less wealth for consumers, whose purchases drive 70% of the economy. (See "What Are the Components of GDP?"). It also means less financing for new businesses, since the sale of stocks is one way that companies can get the funds needed to grow. (SeeHow Do Stocks and Stock Investing Affect the U.S. Economy?")

Last, but certainly not least, a declining stock market could eventually lead to a slowdown in the global economy. That is because the U.S. economy provides 20% of the world’s output. (See "The Power of the U.S. Economy")

# \*\*\*Aff Cards

## Uniqueness

#### QE 3 won’t happen – the election and the economy is doing fine

Liu 6/24 (George Liu, the Chief Financial/Economics Columnist of The Daily Political Review--a Monitored Contributor for FOREXPROS--a Seeking Alpha Certified Contributor--as well as a paid blogger for The Motley Fool Blog Network.--also currently serve on the Board of Directors for Ureka Co, “Will The Federal Reserve Unleash QE3 Soon?”, June 24, 2012, http://seekingalpha.com/article/679821-will-the-federal-reserve-unleash-qe3-soon?source=google\_news)

The investment community has been abuzz lately with commotion over what actions the Federal Reserve will take to attempt to spur slowing domestic economic growth. More specifically, the investment community has been anticipating a third round of quantitative easing, the policy of outright purchasing securities on the open market in hopes of increasing the money supply to stimulate the economy through increased lending and liquidity. Thus far, the Federal Reserve has been reluctant to initiate a new round of quantitative easing. The Federal Reserve board met this Wednesday and the results were somewhat anticlimactic. After deliberation, the committee decided to settle with renewing Operation Twist, which was due to expire later this month. Operation Twist involves the Federal Reserve selling medium-term bonds and using the proceeds to buy longer-term ones, which in turn "should put downward pressure on longer-term interest rates and help to make broader financial conditions more accommodative." With the Federal Reserve declining to unleash another round of quantitative easing this past meeting, investors are continuing to wonder if it will do so in the near future. However, without significant deterioration in the global economy, the Federal Reserve would be reluctant to do so anytime soon. St. Louis Fed Bank President James Bullard has stated that Federal Reserve policymakers would need to see "a pretty high hurdle" before unleashing QE3. So far, this "pretty high hurdle" is nowhere to be seen. Domestic economic data is definitely weak. Goldman Sachs recently decided to recommend shorting the S&P 500, partly due to weak economic data coming from the Philadelphia Federal Reserve. The Federal Reserve also has had to cut projections for domestic GDP growth to 1.9%-2.4% compared to the 2.4%-2.9% gain predicted in April. However, the economy is still, despite a slowing recovery, growing at a point the Federal Reserve deems acceptable. The PMI Manufacturing Index came in at 52.9 for June, which is, although below consensus estimates, solidly above 50 (meaning there is overall growth). The Conference Board Leading Economic Index was also up slightly in May, which reflects that the U.S. economy is growing modestly. Moreover, the Federal Reserve's newly established 2-percent inflation goal is also a potential problem if quantitative easing is initiated, as increasing the money supply to the U.S. economy will also increase inflation. Recent developments in Europe have been somewhat positive. New Democracy has set up a coalition government in Greece and the troika have signaled that they were willing to renegotiate parts of the Greek bailout, although it remains to be seen if the new Greek government can succeed where the previous Greek government failed. Moreover, Spain came out yesterday announcing that the audits of its banking system has concluded that, in a worst case scenario, Spain's banking industry would require 62 billion euros, which is on the low end of previous estimates by the IMF and is well within the 100 billion euros the Eurogroup set aside for a Spanish bailout. Moreover, Italy, France, Spain and Germany recently agreed to push European leaders to sign off on a 130 billion euro plan aimed at increasing growth in Europe's beleaguered economies. Finally, the Federal Reserve has also been plagued by politics, or more specifically, a desire to stay apolitical. Election season is heating up and the Federal Reserve doesn't want to get caught in the political crossfire. Instead, Federal Reserve policymakers want to keep the Federal Reserve nonpartisan; thus, any major action, such as quantitative easing, the bank takes will definitely be scrutinized by some through political lenses. Capital Economics, a research firm, has noted that, historically, the central bank does not change its monetary policies ahead of presidential elections. Overall, barring drastically negative developments in the domestic and international economies, don't expect the Federal Reserve to initiate quantitative easing anytime soon. Disclosure: I have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

## Link

**The plan amplifies QE3**

**Gagnon 11** – a visiting associate director at the Division of Monetary Affairs at the US Federal Reserve Board, PhD in economics from Stanford (Joe, Interview, 6/14/11, “Interview with Joe Gagnon on Quantitative Easing, its Criticisms and the Argument for QE3”, http://rortybomb.wordpress.com/2011/06/14/interview-with-joe-gagnon-on-quantitative-easing-its-criticisms-and-the-argument-for-qe3/)

Are the effects of QE3 amplified by a short-term stimulus in the form of infrastructure spending and employee tax cuts?

Absolutely. The end of the payroll tax cut, the winding down of the stimulus spending, and the termination of extended unemployment benefits are conspiring to create a large fiscal drag on the economy in 2012. I would recommend extending or even enlarging the payroll tax cut for 2012 and renewing extended unemployment benefits for at least 12 months. QE3 can help to ensure these actions have the best possible effect.

As for infrastructure spending, I think it needs to be analyzed in two categories. First, anything that can really be built (and not just planned) in 2012 could be viewed as near-term stimulus in place of (or in addition to) a payroll tax cut. Second, longer-term infrastructure projects (many of which I support) need to be based on long-term needs and in the context of a long-term fiscal plan to stabilize our national debt, not the near-term state of the recovery. The dividing line between the near term and the long term is probably 2013, with spending in 2013 still contributing usefully to near-term recovery.

## Impacts

### QE3 Fails

**No economic benefits to QE3 – excess reserves too large**

**Becker 6/10**/12 – Professor of the Graduate School of Business at The University of Chicago (Gary, “Is Further Quantitative Easing by the Fed Warranted?”, http://www.becker-posner-blog.com/2012/06/is-further-quantitative-easing-by-the-fed-warranted-becker.html)

The slow recovery of the US economy, and the much worse situation in Europe, is putting great pressure on the Fed to try to provide another monetary “stimulus”. I urge the Fed to resist this pressure mainly because further Fed easing under present circumstance will do little stimulating.

The Fed tries to stimulate economic activity through open market operations; that is, by buying assets, such as treasury bills, US government bonds, and debt issued by the private sector. These actions directly lower interest rates, and a little more indirectly also raise the reserves of banks. Through a variety of aggressive open market operations since the financial crisis began in 2008, the Fed has accumulated several trillion dollars of assets. In part due to these actions, interest rates on treasury bills are close to zero, and the excess reserves of American banks have increased to a mind-boggling level of almost $1.5 trillion.

The Fed cannot do much more to lower interest rates. Not only are short term rates close to zero, but long term rates are also quite low-interest rates on 5 year US government bonds are currently only a few percent. The Fed in what is called “Operation Twist” could try to further lower long term interest rates relative to the negligible rate on treasury bills by buying long term bonds. This might reduce further the spread in interest rates (that is, flatten the interest yield curve), but this effect is limited by a fundamental economic equilibrium condition. Long term interest rates tend to be an average of current and expected short term rates since more investors would shift into short term rates when long term rates are below this average; conversely, investors shift into long term rates when these are above the average of current and expected future short term rates.

Even with zero interest rates, advocates of a further “quantitative easing” (QE3) argue that the Fed’s purchase of government bonds and other assets would still increase reserves of banks, and that increased reserves will encourage further bank lending to businesses and households. The problem with this argument in the present situation is that, as indicated earlier, banks already hold huge levels of excess reserves. If banks are not lending more when they already have so many excess reserves, why would a further growth in these reserves increase lending by much, especially when interest rates are very low and the Fed pays interest on bank reserves- the current interest rate on reserves is 0.25%.

Even supporters of further Fed easing admit that QE2 had little effect on the economy (see, for example, the article in today’s New York Times by Christina Romer, former Chair of the Council of Economic Advisers). I submit that the reason for this is that QE2 mainly raised already large bank reserves to still larger levels without giving banks much incentive to increase their lending. For this reason, additional quantitative easing will likely also do little to help the economy.

Quantitative Easing hurts the economy – 3 reasons

Dellape 3/7/12 (J, March 7, 2012, “Would a 3rd Round of Quantitative Easing be a Charm?”, http://hanseconomics.com/2012/03/07/would-a-3rd-round-of-quantitative-easing-be-a-charm/)

But Mr. O’Brien is wrong. Below, I will attempt to clearly explain what quantitative easing is and three simple reasons why it is undesirable and downright harmful for economic recovery. Quantitative easing simply refers to when a central bank (the Federal Reserve in America’s case) continues to inject new reserves into the banking system when interest rates are already at or near 0%. The Fed injects these new reserves by buying government securities (T-bills and bonds) from banks. This is formally called “open market purchases” by the Fed. The purchasing of these bonds pushes the Fed Funds rate (the rate at which bank’s charge one another for overnight loans) lower, encouraging a greater amount of lending between banks and ultimately from banks to borrowers. Keeping credit flowing from banks has been priority #1 for Bernanke, hence the all-time low we have seen in the Fed Funds rate during his term. The Fed Funds rate has been equal to or less than .2% since December 2008. This policy by itself involves a great amount of bond purchases by the Fed. Quantitative easing implies that even after the Fed has purchased enough government securities to push the Fed Funds rate to basically 0%, it injects even more money into the banking system. The ultimate objective of the policy is to keep credit flowing from banks as well as inspire greater confidence in the health of the economy. Why it Would not be a Charm Reason #1: The Nature of Credit Expansion Unfortunately, this policy rests on the belief that immense amounts of credit expansion will lead to economic recovery. Sound economics shows this to be the farthest thing from the truth. When the Fed decides to print more money and inject it into the banking industry, it actually fosters economic volatility rather than curbs it. Austrian Business Cycle Theory, explained [here](http://hanseconomics.com/2011/12/30/did-the-economist-present-a-true-reflection-of-austrian-theory/), shows that credit expansion by central banks creates an artificial boom in economic activity. Investment and consumption are stimulated temporarily and therefore it seems like the economy is healthier than it was before. However, those people investing on the market are not using resources that have been saved by other market participants. Rather, the Fed has printed the money being exchanged out of thin air. The injection of this money into the economy changes the structure of production in an unsustainable way. This is precisely because the changes are not the result of decisions made by market participants. Resources have not been saved by individuals to support the new structure of production. Eventually, the boom turns to bust when the preferences of individuals reassert themselves and we are left with a state of economic affairs which is inferior to the one before credit expansion. Reason #2: Inflation Quantitative easing inflates and therefore depreciates the value of the US dollar. The chart below shows the massive increase in the monetary base in the past four years. The blue line represents the increase in the total monetary base while the red line represents the increase in money held by banks which they do not have to hold. If they chose to, they could lend out their excess reserves. Quantitative easing encourages banks to lend out more of this money. As this money enters into the economy, we have good reason to believe that we will see price inflation. This inflation will only make it more difficult for businesses to calculate revenues and expenses and employ the very people who will have to pay more for goods and services. Reason #3 QE Discourages Real Savings Lastly, and just as importantly, quantitative easing makes it less appealing for people to save and invest their resources. The voluntary saving and investing of real resources by individuals is the path to sustainable improvements in living standards. People will be more willing to save and invest if they earn a higher rate of return on their investment and less willing at a lower rate of return. The following chart shows how the Fed’s expansionary policy has discouraged savings. Because the Fed has injected so much cash into the banking system, banks have literally more than enough of it. Therefore banks have little incentive to provide much of a return at all on their customers’ savings accounts. This explains why anyone who has saved their money in a 6 month cd with a bank in the past 2 years has earned no more than a pitiful 0.5% in interest. While not an exhaustive list, I strongly believe the points made above provide more than enough reason to believe that further quantitative easing will not bring about real economic recovery and only serve to further damage an already injured US economy.

#### **Quantitative easing bad – only benefits the rich and empirically fails**

Olen 5/1 (John, May, 01, 2012, “Quantitative Easing is Counterproductive”, http://economyincrisis.org/content/quantitative-easing-hurts-average-workers)

With U.S. GDP growth cooling off to 2.2 percent last quarter, there is renewed talk of another round of quantitative easing. Market makers are hoping for a third round (QE3), but the first two attempts have degraded the dollar and hurt the average American while once again enriching the powerful companies. For all intents and purposes, quantitative easing creates money out of thin air. While in the past the printing of new money was used to increase the money supply, today quantitative easing allows the injection of huge sums of money into the economy with just the click of a mouse. Essentially what happens in quantitative easing is the Federal Reserve purchases financial assets (treasuries, mortgage-backed securities etc.) to increase its balance sheet, and as a result the institutions they buy them from have a larger amount of liquidity. This liquidity should theoretically allow the banks to provide more loans to businesses and individuals, and those loans should stimulate and grow the economy. The key to the whole process is that the money the Federal Reserve uses to purchase the initial assets is created just for that purpose. The major problem is that while the Federal Reserve is creating this money that helps banks, the process actually hurts everyone else. A study by Dhaval Joshi, of BCA Research, showed that quantitative easing increased share prices and profits, but wages saw no positive effect. “Real wages–adjusted for inflation–have fallen in both the U.S. and UK, where QE has been a key tool for boosting growth. In Germany, meanwhile, where there has been no quantitative easing, real wages have risen” the study notes. Wealthy owners and stockholders have profited from this injection of new money because their income is tied to investment, but there has been no beneficial multiplier effect that has transferred those gains onto the average person who depends on wages for their livelihood. Small businesses, one of the main drivers of economic activity and employment in this country, are still having trouble getting the necessary credit to stay in business. What quantitative easing has done is increase food and commodity prices after both QE1 and QE2, placing an even larger burden on workers with stagnant wages or fixed incomes. The attempts at recovery during this economic downturn have been almost entirely aimed at top earners and large institutions, many of which were responsible for the downturn to begin with. Another round of quantitative easing would only serve those interests farther, and placating the financial sector has clearly not been beneficial for the average citizen so far.

## Inflation Turn

**QE3 causes inflation**

**Becker 6/10**/12 – Professor of the Graduate School of Business at The University of Chicago (Gary, “Is Further Quantitative Easing by the Fed Warranted?”, http://www.becker-posner-blog.com/2012/06/is-further-quantitative-easing-by-the-fed-warranted-becker.html)

Some advocates of further easing admit this, but claim there is virtually no downside, and that even a small gain is valuable in an economy that is doing poorly. I disagree with this argument because there is a downside to further easing, and this downside would more than negate the small gains to the economy.

I am not arguing that additional easing and the growth of bank reserves will pose a significant short-term inflation risk. The economy still has a lot of slack, and inflation is low. However, once banks start lending at the scale necessary to pull the American economy out of its doldrums, the money supply is likely to grow rapidly, which will increase the rate of inflation, perhaps to dangerously high levels.

**Inflation kills economic growth**

**FRBSF** **11** – (Federal Reserve Bank of San Francisco, “About the Fed”, 4/21/11 (The date the website was last modified), http://www.frbsf.org/publications/federalreserve/monetary/goals.html)

What's so bad about higher inflation?

High inflation is bad because it can hinder economic growth, and for a lot of reasons. For one thing, it makes it harder to tell what a change in the price of a particular product means. For example, a firm that is offered higher prices for its products can have trouble telling how much of the price change is due to stronger demand for its products and how much reflects the economy-wide rise in prices.

Moreover, when inflation is high, it also tends to vary a lot, and that makes people uncertain about what inflation will be in the future. That uncertainty can hinder economic growth in a couple of ways—it adds an inflation risk premium to long-term interest rates, and it complicates further the planning and contracting by businesses and households that are so essential to capital formation.

That's not all. Because many aspects of the tax system are not indexed to inflation, high inflation distorts economic decisions by arbitrarily increasing or decreasing after-tax rates of return to different kinds of economic activities. In addition, it leads people to spend time and resources hedging against inflation instead of pursuing more productive activities.

Another problem is that a surprise inflation tends to redistribute wealth. For example, when loans have fixed rates, a surprise inflation redistributes wealth from lenders to borrowers, because inflation lowers the real burden of making a stream of payments whose nominal value is fixed.

### Inflation Turn – Ext.

**Too much monetary stimulus take away all benefits and causes inflation**

**FRBSF** **11** – (Federal Reserve Bank of San Francisco, “About the Fed”, 4/21/11 (The date the website was last modified), http://www.frbsf.org/publications/federalreserve/monetary/goals.html)

If the Fed can stimulate the economy out of a recession, why doesn't it stimulate the economy all the time?

Persistent attempts to expand the economy beyond its long-run growth path will press capacity constraints and lead to higher and higher inflation, without producing lower unemployment or higher output in the long run. In other words, not only are there no long-term gains from persistently pursuing expansionary policies, but there's also a price—higher inflation.

**And we’ve had too much Federal Reserve stimulus**

**Einhorn 5/3**/12 – President of Greenlight Capital, an investment advisor (David, “The Fed's Jelly Donut Policy”, http://www.huffingtonpost.com/david-einhorn/fed-interest-rates\_b\_1472509.html)

A Jelly Donut is a yummy mid-afternoon energy boost.

Two Jelly Donuts are an indulgent breakfast.

Three Jelly Donuts may induce a tummy ache.

Six Jelly Donuts -- that's an eating disorder.

Twelve Jelly Donuts is fraternity pledge hazing.

My point is that you can have too much of a good thing and overdoses are destructive. Chairman Bernanke is presently force-feeding us what seems like the 36th Jelly Donut of easy money and wondering why it isn't giving us energy or making us feel better. Instead of a robust recovery, the economy continues to be sluggish. Last year, when asked why his measures weren't working, he suggested it was "bad luck."

### AT: Fed can Control Inflation

**Political influence prevents actions to stop inflation**

**Becker 6/10**/12 – Professor of the Graduate School of Business at The University of Chicago (Gary, “Is Further Quantitative Easing by the Fed Warranted?”, http://www.becker-posner-blog.com/2012/06/is-further-quantitative-easing-by-the-fed-warranted-becker.html)

The major question is as much a political as economic one: will the Fed adopt these policies when that would risk slowing the recovery, and possibly create another recession? Congress and the President, no matter which political party controls these branches of government, would exert powerful political pressure on the Fed to use these weapons sparingly. Perhaps a strong Fed chairman would act, despite this pressure not to rock the boat. However, I do not believe this is a risk worth taking, particularly when further monetary easing would have at best small positive effects on the economy.