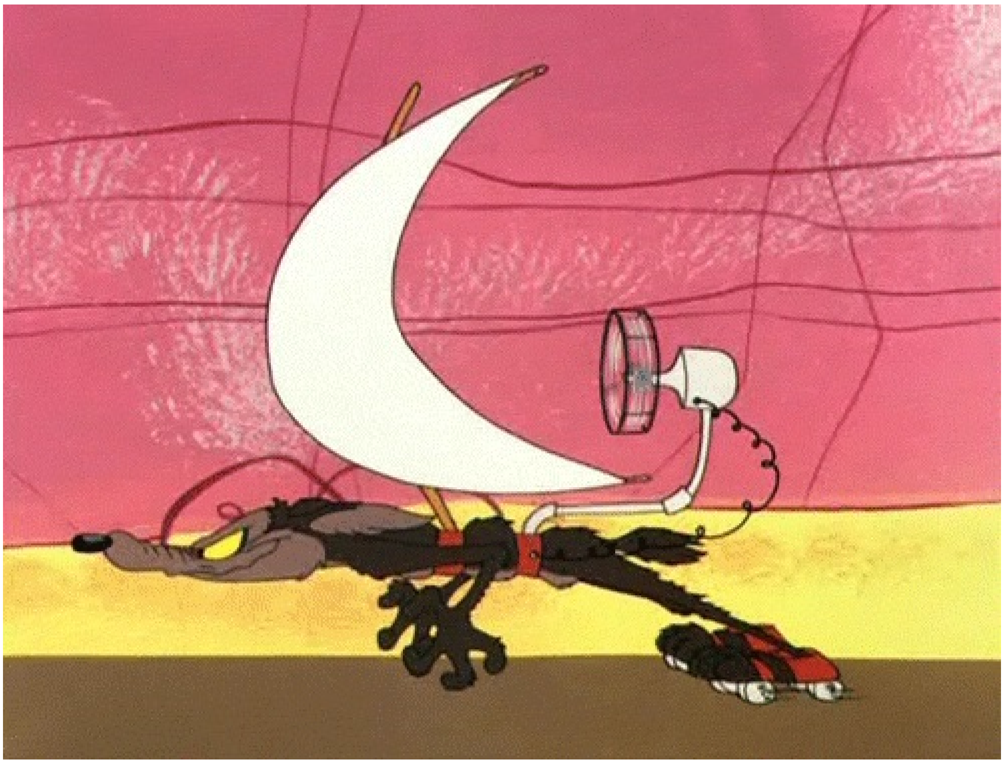
Quantitative Easing Explained. And Anti Social Economics.

Every so often the free market fails to sort itself out and the economy grows more slowly than it should, according to the economists, bankers and investors. Measures need to be taken to spur economic growth so that it can run at its potential again. Having lowered interest rates to zero or close to zero with less than spectacular results on economic growth, central banks turned to unconventional monetary policy, also known as quantitative easing. Purists define QE as the expansion of the central bank's balance sheet through the purchase of assets funded by, well, funded by the creation of money, a talent and right exclusive to central banks. Basically, governments borrow by issuing bonds, which to a point private investors become leery off due to the usually parlous state of the finances of governments wont to engage in such innovative practices. At this point the country's central bank buys these bonds thus lending to its own government. The government. Fine distinctions have been made about whether central banks are lending to their own governments, which is seen rightly as debt monetization, and buying bonds in the secondary market from private investors thus injecting money into the economy which it is hoped will circulate and stimulate demand. The reality is that the private investors holding government bonds are hardly borrowing from the central bank by selling them their bonds, and experience has shown that the money thus injected gets saved or hoarded somewhere, usually back on the said central bank's balance sheet. The velocity of money falls almost precisely to compensate for the liquidity injection and demand and output hardly budge. There is a physical analogy in all this.

Now that 8 years of QE have failed to produce the spectacular recoveries in economic growth expected, governments are beginning to toy with the idea of fiscal easing. The problem with fiscal easing is that it involves a government spending to boost the economy, in effect replacing private demand with government demand. Monetary easing it was hoped, would spur demand by placing money in the hands of businesses and households in the hope that it would spur demand but it's easier to lead a horse to water than to make it drink. Fiscal easing is a bit like leading your horse to water and then leading by example and taking great swigs yourself. There is no guarantee that the horse will drink. A case in point is Japan which has engaged in QE and fiscal easing and seem its national debt surge to 2.5X annual output. At the current G7 meeting in Japan you can sense the government once again tilting towards fiscal easing. In April 2017 there is a scheduled sales tax hike. The options before the government are to scrap the tax hike or to go ahead with it and sterilize it with a big fiscal package. There is a physical analogy in all this.



Experience has shown that you cannot borrow yourself into solvency try though some countries might, given that some investors have been happy to buy bonds at negative yields. It might not be long before someone voluntarily buys a bond with a negative coupon. Perhaps a central bank somewhere might want to lead by example. At some point the world will realize that you cannot move a boat by blowing into your own sail.

There are solutions which can work but the weight of the establishment and politics stand against them. And the weight of the establishment can mobilize academia, investment pundits and popular opinion against such solutions. Putting aside arguments for equitable wealth distribution aside, it doesn’t take much to observe that a dollar taken from a billionaire does not change their consumption levels much if at all, whereas this dollar transferred to a poor household will be spent almost completely, raising the velocity of money, the one variable which has confounded QE. The efficiency of this transfer, however, will be drowned out by the indignant accusations of it being blatantly socialist policy.