The Obvious Reason Why Quantitative Easing Doesn't Work

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*Paul Gambles – the managing partner of MBMG Group – explains at CNBC, there is an **obvious** flaw in QE:*

> BoE's Quarterly Bulletin … states that a "common misconception is that the central bank determines the quantity of loans and deposits in the economy by controlling the quantity of central bank money — the so-called 'money multiplier' approach."
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> **This "misconception" is obviously shared by the world's policymakers, including the U.S. Federal Reserve, the Bank of Japan and the People's Bank of China, not to mention the Bank of England itself**, who have persisted with a policy of quantitative easing (QE).

Here's background on the flaw in the theory of the money multiplier.

Indeed, Ben Bernanke might have had hints about the flaw in the money multiplier theory back in *1988*.

Gambles continues:

> QE is seen by its adherents, such as former U.S. Federal Reserve Chairman Ben Bernanke, as both the panacea to heal the post-global financial crisis world and also the factor whose absence was the main cause of the Great Depression. This is in line with their view that **central banks create currency for commercial banks to then lend on to borrowers** and that this stimulates both asset values and also consumption, which then underpin and fuel the various stages of the expected recovery, encouraging banks to create even more money by lending to both businesses and individuals as a virtuous cycle of expansion unfolds.
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> The theory sounds great.
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> However it has one tiny flaw. It's nonsense.
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> Professor Hyman Minsky was one of the first to recognize the flaw in those theories. He realized that in practise, in a credit-driven economy, the process is the other way round. The credit which underpins economic activity isn't created by a supply of large deposits which then enables banks to lend; instead it is the demand for credit by borrowers that creates loans from banks

> which are then paid to recipients who then deposit them into banks. Loans create deposits, not the other way round.

Here's background on the fact that loans create deposits, *not* the other way around.

But Gambles notes that central bankers are trying to salvage the reputation of QE as an economy-saver by relying on interest rates:

> In the BoE's latest quarterly bulletin, they conceded this point, recognizing that QE is indeed tantamount to pushing on a piece of string. The article tries to salvage some central banker dignity by claiming somewhat hopefully that the artificially lower interest rates caused by QE might have stimulated some loan demand.
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> However the elasticity or price sensitivity of demand for credit has long been understood to vary at different points in the economic cycle or, as Minsky recognized, **people and businesses are not inclined to borrow money during a downturn purely because it is made cheaper to do so. Consumers also need a feeling of job security and confidence in the economy before taking on additional borrowing commitments**.

Indeed, lowering interest rates through quantitative easing creates a trap.

Gambles explains that QE may actually hurt the economy:

> It may even be that QE has actually had a negative effect on employment, recovery and economic activity.
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> This is because the only notable effect QE is having is to raise asset prices. If the so-called wealth effect — of higher stock indices and property markets combined with lower interest rates — has failed to generate a sustained rebound in demand for private borrowing, then the higher asset values can start to depress economic activity. Just think of a property market where unclear job or income prospects make consumers nervous about borrowing but house prices keep going up. The higher prices may act as either a deterrent or a bar to market entry, such as when first time buyers are unable to afford to step onto the property ladder.
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> Dr Andrea Terzi, Professor of Economics at Franklin University Switzerland, also suggests that many in the banking and finance industry, who often have trouble with the way academics teach and discuss monetary policy, will find the new view much closer to their operational experience.

Given that former Fed chairman Bernanke, Treasury Secretary Geithner and chief economist Summer's*entire strategy* was to artificially prop up asset prices – including the stock market (and see this, this, this and this) – and so their eagerness to launch QE is not surprising.

Indeed, 3 academic studies found that quantitative easing doesn't work. The head of Japan's quantitative easing program agrees.

The Federal Reserve official responsible for implementing $1.25 *trillion* of quantitative easing has confirmed that QE is just a massive bailout for the rich:

> I can only say: I'm sorry, America. As a former Federal Reserve official, I was responsible for executing the centerpiece program of the Fed's first plunge into the bond-buying experiment known as quantitative easing. The central bank continues to spin QE as a tool for helping Main Street. But I've come to recognize the program for what it really is: the **greatest backdoor Wall Street bailout of all time**.
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> Trading for the first round of QE ended on March 31, 2010. The final results confirmed that, while there had been only trivial relief for Main Street, the U.S. central bank's bond purchases had been **an absolute coup for Wall Stree**t. The banks hadn't just benefited from the lower cost of making loans. They'd also enjoyed huge capital gains on the rising values of their securities holdings and fat commissions from brokering most of the Fed's QE transactions. Wall Street had experienced its most profitable year ever in 2009, and 2010 was starting off in much the same way.
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> You'd think the Fed would have finally stopped to question the wisdom of QE. Think again. Only a few months later—after a 14% drop in the U.S. stock market and renewed weakening in the banking sector—the Fed announced a new round of bond buying: QE2. Germany's finance minister, Wolfgang Schäuble, immediately called the decision "clueless."
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> That was when I realized **the Fed had lost any remaining ability to think independently from Wall Street**.

And see this.

Indeed, economists note that QE helps the rich … but not the average American.

The president of the Federal Reserve Bank of Dallas said that Fed's Fisher said that "QE was a massive gift intended to boost wealth."

And Japanese quantitative easing expert Richard Koo said:

> In a sense, **quantitative easing is meant to benefit the wealthy**. After all, it can contribute to GDP only by making those with assets feel wealthier and encouraging them to consume more.

In fact, that's all QE does … benefit the rich.

QE is one of the main causes of inequality (and see this and this). Many economists have said that QE quantitative easing benefits the rich, and hurts the little guy. And economists now admit that runaway inequality cripples the economy. So QE indirectly hurts the economy by fueling runaway inequality.

Additionally, a loss of trust destroys the economy. 55% of Americans say that "The economic and political systems in the country are *stacked against* people like me". Americans making $90,000 or less don't like Federal Reserve policies. QE might therefore further undermine trust – and hurt the economy – since it so obviously skews the playing field.

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