Is the Third Time a Charm for Quantitative Easing?

Analysts are warning that the Federal Reserve is gearing up for a third round of quantitative easing, which involves printing money and flooding the market with the inflated cash through the bond market. The Federal Reserve purchases bonds with printed money, which in turn leads to more inflation. Despite the lessons learned by the first two rounds of quantitative easing, the Federal Reserve is preparing for a third round.

Simon Maughn, co-head of European equities at MF Global, warns that the next round is on its way, and asserts that the United States will once again be a big purchaser.

"The bond market is going in one direction which is up— falling yields which is telling you quite clearly the direction of economic travel is downwards. Downgrades. QE3 (a third round of quantitative easing) is coming. The bond markets are all smarter than us, and that's exactly what the bond markets are telling me," explained Simon. "One more big injection of cash into the bond market should take you through at least the summer season into the beginning of the fourth quarter. That cash injection will have the normal inflationary knock-on impact, driving back up commodities, supporting industrial stocks, dragging the financials up with them…I think it's all about the monetary injection trade."

Despite the positive spin purported by Simon, *Business Insider* states that quantitative easing is bad for the economy for several reasons:

- QE will damage the value of the U.S. dollar
- As a result, it threatens the dollar as the World Reserve Currency
- QE causes inflation, which impacts already struggling American consumers
- Inflation is virtually a hidden tax on every American
- Inflationary spirals brought on by QE are often difficult to stop
- QE threatens to destabilize the global financial system
- QE is an "aggressive move in a world already on the verge of a currency war"
- QE makes it significantly more expensive for the U.S. government to borrow money

David Rosenberg of Gluskin-Sheff wrote of quantitative easing in 2010 following the first round of quantitative easing:

> This is a market completely based on hope. Throw fundamental investment principles out the window. It's now all about how the Fed can manage to inflate asset prices now that fiscal policy has tested its limits with the voting public. But where does this renewed faith in the Fed come

> from? Is this not the same Fed that took the funds rate from 5.5% to near- zero? The same Fed that tripled the size of its balance sheet in QE1? The same Fed that thought the housing and mortgage crisis would stay "contained" back in 2007? The same Fed that confused a credit contraction with a liquidity squeeze? The same Fed that believed, in the summer of 2007 when the crisis first broke that we would see 2.5- 3.0% real GDP growth in 2008?
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> The same Fed that was contemplating its exit strategy just a short six-months ago and believed it could start to shrink its balance sheet last spring? The same Fed that investors have so much faith in, and is the same Fed that passively tightened policy with a 25 basis point hike in the discount rate to 0.75% back on February 19th. The same Fed that just trimmed its forecast three times in the past four months, and is this not the same Fed that investors now have "faith" in? The question is, the "faith" to do what?

In 2009, the *Pragmatic Capitalist* warned of the impending failure of quantitative easing:

> Treasury yields have surged since the Fed officially began their quantitative easing program in the middle of March. Of course, the U.S. government believes they can eliminate a debt problem by creating more debt (brilliant, huh?). They're seeing the direct effects of their money printing strategy as investors around the globe pile out of U.S. treasuries as a result of the U.S. government's total disregard for its own currency. We've been saying it for a year – you can't solve a debt crisis with more debt. Consumer debt based de-leveraging recessions aren't your average recessions that can be solved with lower rates and a printing press. The Obama administration is playing a very dangerous game of chicken here with the bond market. I doubt the bond market will lose — as it rarely does.
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> Stocks are tanking as yields soar and commodity prices jump. Exactly what global consumers need: higher raw material prices, stagnant wages and more expensive money.

Unfortunately, when 10-year bonds fell below 3 percent for the first time since June 2010, it became clear that quantitative easing would likely witness a third round. Craig Steiner of Common Sense American Conservatism notes, "While certainly not an exact science — nor does past performance guarantee future results — it's interesting that since the financial crisis exploded in 2008, 10-year interest rates have dropped below 3 percent on two occasions. In each case, the Federal Reserve began a money-printing/quantitative easing plan four months later."

Meanwhile, economic commentators seem to have a particularly somber view of a third round of quantitative easing, questioning whether it will mark the final destruction of the U.S. economy. M&G's Jim Leaviss warns that QE3 could result in the total collapse of the U.S. dollar.

"The Federal Reserve will not contract its balance sheet anytime soon. The dollar will collapse if we get a third round of quantitative easing, but this is not something that concerns the Fed in the slightest," Leaviss said.

Some recommend that the Fed work with the inevitable weakness of the dollar that will result. *International Business Times* explains:

> Traders believing that QE3 will eventually occur may want to consider an ETF that would play on the dollar weakness that may result. An ETF, such as PowerShares DB Dollar Bearish Index (NYSE: UDN), may do well in an environment with a weakening dollar. Also, the precious metals—which have been volatile as of late—could do well if the Fed decides to undertake QE3.

> Traders might consider the SPDR Gold Trust (NYSE: GLD), which may rally should QE3 occur. The commodity currencies, such as the Canadian dollar and the Australian Dollar, may continue to do well if the Fed chooses to do another round of quantitative easing. An ETF like CurrencyShares Canadian Dollar Trust (NYSE: FXC) may be another option traders may wish to consider.

A third round of quantitative easing is sure to impact the already rising costs of products nationwide, most notably food. The *LA Times* reports this week that the cost of wheat is 70 percent higher than it was a year ago, while the price of corn has doubled in the past year.

Ironically, in March, the Federal Reserve indicated that it was unlikely to expand its quantitative easing program, asserting that the economy is on “firmer footing, and overall conditions in the labor market appear to be improving gradually.” The Fed also reported that “longer-term inflation expectations have remained stable and measures of underlying inflation have been subdued.”

As the Fed is now backtracking some of those assertions, Americans and nations across the globe continue to lose faith in the market and the Fed. It seems the only certainty Americans can count on is that they should be skeptical of any promises made by the Federal Reserve.