What Impact Will Monetary Easing Have on U.S. & Global Economies?

On February 3, 2011, the Center on Japanese Economy and Business (CJEB) at Columbia Business School co-organized a lecture with the Japan Society, "What Impact Will Monetary Easing Have on U.S. & Global Economies?" The event featured Brian Foran, Managing Director, Senior Analyst covering Regional Banks and Credit Cards sectors for Equity Research at Nomura Securities International, Inc. (NSI); Alicia Ogawa, Senior Advisor at CJEB; David Resler, Managing Director and U.S. Chief Economist at NSI; and Gillian Tett, U.S. Managing Editor at the Financial Times.

The panel focused on addressing three main questions: did the U.S. Federal Reserve's second round of quantitative easing policies (QE2) work, did QE2 have a "Japanese-style" outcome, and what will QE2 do for the United States's and the world's economies?

Resler began the discussion by noting that QE2 was implemented to prevent a deflationary environment from growing in the United States and to avoid a double-dip recession. He remarked that the U.S. Federal Reserve's concerns were warranted since the U.S. core CPI reached a historically low point in October 2010, a month before QE2 started. The last three Federal Reserve Chairmen have also decided that taking control of expenditures is the best method of dealing with the U.S. deficit. However, Resler asserted that the United States must also look toward generating more revenues rather than simply reducing spending and/or increasing taxes. At the same time, he noted that the United States is experiencing a state of political uncertainty. The rise of the Tea Party emphasizes an underlying concern that the United States is failing to deal with its long term economic problems (e.g. a growing deficit, rising population, etc.). Therefore, Resler believes that the United States should slowly adjust to a "new world economic order" rather than tackle its deeper issues in the short run.

Ogawa expressed concern that the U.S. situation had many parallels with Japan. Deflation has been relatively persistent in Japan for the past 15 years. The Bank of Japan (BOJ) was widely criticized, as the U.S. Federal Reserve is now, for doing "too little, too late" with their quantitative easing policies. Ogawa asserted that, even though the BOJ has been bold in experimenting with new monetary policies (i.e. an aggressive stock buying program), Japan's financial system is still broken. Banks continue to lend to non-performing "zombie" companies rather than to innovative new firms. As in the United States, Japanese banks have deleveraged by cutting employee salaries and engaging in lay-offs. This has created a new class of non-fulltime employees which will hinder the countries' productivity in the long run, considering both nations' aging populations. Ogawa anticipates that serious issues could arise in the United States and Japan's economic futures including rampant deflation, fiscal policies investing in elderly services rather than education for the young, and disaffection among the younger generations. She believes that both the United States and Japan share the difficulty of exiting quantitative easing policies. Moreover, they are both struggling to maintain independence between their central banks and their governments.

Foran delved into specific forecasts for the U.S. economy under QE2. Specifically, QE2 will be bad for bank margins, good for housing values, and good for consumer cash flow. However, it will be destructive to the net interest margins of banks as they are flooded with deposits, which will place pressure on asset yields. QE2 will also result in cheap housing, given the imbalanced housing market, and consumers will continue to pay down debt regardless of lower interest rates. While U.S. bank losses will be comparable to those of Japanese banks, Foran noted that U.S. banks will have twice as much capital and significantly higher earning power compared to Japanese banks. As a result, the United States's policy response will be more manageable than Japan's response.

Tett focused her portion of the discussion around the international reaction to QE2. She recently observed at The World Economic Forum that the rest of the world is trying to protect itself from QE2. Some Latin American countries have even called these protective policies "quantitative tightening." Tett asserted that, while QE2 has staved off another recession, its long-term success remains unclear. Some primary concerns include an emergence of exchange rate pressures caused by QE2 and predictions of rising inflationary pressure in the United States. She acknowledged that the United States is taking a "bold psychological gamble" by implementing QE2 and not attacking long-term underlying problems (e.g. the deficit). Furthermore, the Federal Reserve has been sending mixed signals to the government. While it has voiced concern that the government will try to ride the benefits of QE2 without tackling deeper problems, it continues to purchase Treasury bills and prop up the bond market. Thus, Tett believes that the success of QE2 is indeterminable and global uncertainty regarding the U.S. economy will continue to grow. Looking ahead, Tett believes that the United States should implement a combination of spending and tax measures. However, she acknowledged that the current state of the U.S. political system must change to encourage such cooperation.

This event was moderated by Sara Eisen, Anchor and Reporter for Bloomberg. It was co-sponsored by The Japan Society, The Women's Bond Club of New York, and Nomura Holding America Inc.