

Business

FINANCIAL POST

Fed bashing raises fear of policy inaction

US\$600B plan to buy bonds may hit dollar: critics

By Janet Whitman, Financial Post November 16, 2010

NEW YORK - Ben Bernanke doesn't seem to be making many friends these days.

After getting an earful last week from top officials from other countries over his efforts to boost the U.S. economy by printing more money, the chairman of the U.S. Federal Reserve is coming under a fresh attack from a lengthy list of former Republican government officials, right-leaning economists and analysts who wrote him a letter blasting the program as "neither warranted nor helpful."

The group said the plan to print money to buy US\$600-billion in additional U.S. Treasury bonds -- known as "quantitative easing" in Fed speak -- could further erode the value of the U.S. dollar and increase the odds of inflation, while doing nothing to help improve the country's nearly 10% unemployment rate.

Criticism of the Fed has been common since its creation back in 1914, but this time around the disparagement is threatening to take on a more political tone, which could make it tougher for Mr. Bernanke and other board members at the central bank to reach agreement on what to do about monetary policy.

Allan Meltzer, a Fed historian and professor at Carnegie Mellon University in Pittsburgh, said the attacks are well deserved, adding that the latest move to pump money into the financial system is simply another in a long list of examples of the Fed overreacting to short-term events.

"Pressure is going to come for change with some effort to rein in the extent to which the Fed can print money," Prof. Meltzer said. "Back in the 1950s, many people believed that the Fed was not very important, but people don't believe that anymore."

Adding fuel to the likelihood of greater scrutiny of the U.S. Central Bank are recent gains by the conservative Tea Party and Republicans -- including the election to the U.S.

Senate of Rand Paul, an outspoken critic of Mr. Bernanke, and whose father, libertarian U.S. Congressman Ron Paul, wrote the book End the Fed.

Not everyone was critical of the Fed's US\$600-billion, second round of quantitative easing, known as QE2, however.

After the open letter bashing the Fed appeared in the Wall Street Journal and the New York Times, Paul McCaulley, a managing director at PIMCO, the world's largest bond firm, leapt to Mr. Bernanke's defense.

"It brings me great angst to observe professional critics -- many of them acquaintances and friends of mine--rhetorically beating Fed Chairman Ben Bernanke about the head and shoulders for launching QE2," he wrote in a note on the California firm's website." At the same time, the fact that Sarah Palin has joined the chorus brings me great joy. If what Ben is doing offends both the learned and the unlearned, then he is clearly acting unconventionally relative to orthodoxy. And this is good, very good."

Vincent Reinhart, a former Fed monetary-affairs director who is a resident scholar at right-leaning think-tank the American Enterprise Institute in Washington, D.C., said Mr. Bernanke may have felt little choice but to act because the U.S. government, laden with a huge debt burden, can do little to help revive the economy.

"In this case, the economic policy team is in disarray. It can't do fiscal stimulus, the tax code is a mess and the legacy mortgage problem hasn't been dealt with," he said.

Meanwhile, the Fed simply might decide to pull the US\$600-billion spend on its own, amid signs consumer spending is holding up and business investments and exports are heading higher.

"If they proceed with their agenda to purchase an additional \$600-billion in securities at a time when economic activity is accelerating, the Fed dramatically increases the risk of unmooring inflation expectations at some point," said **Bernard Baumohl**, chief global economist at the Economic Outlook Group.

"That could be disastrous for the economy. Instead of lowering rates on medium-and long-term bonds, which is the Fed's goal, going ahead with QE2 may inadvertently cause the opposite to happen as bond holders all rush for the exits as the sell-off threatens to pummel bond prices."

jwhitman@nationalpost.com

© Copyright (c) National Post