Pioneer Bank & Trust
Trust & Investments
Local.

704 7th Ave, PO Box 729
Belle Fourche, SD 57717-0729
Phone (605) 892-3494
Fax (605) 892-2115

2001 W Omaha St, PO Box 9189
Rapid City, SD 57709-9189
Phone (605) 341-2265
Fax (605) 341-7425

140 E Jackson Blvd, PO Box 10
Spearfish, SD 57783-0010
Phone (605) 642-2725
Fax (605) 642-1736

QE3 ends

In late October the Fed announced the end of the third installment of Quantitative Easing, a program of buying government bonds begun in September 2012. Initially set at purchases of $40 billion per month of mortgage-backed securities to bolster the housing market, by December 2012 the program expanded to include an additional $45 billion monthly of Treasury bonds. The purchases were intended to shrink the supply of Treasury debt, which would be expected to increase its price, keeping a lid on longer-term interest rates.

Before the financial crisis hit, the Fed's balance sheet was about $1 trillion, and now it has grown to about $4.5 trillion. About $1.5 trillion is attributable to this third installment of quantitative easing.

Critics warned that the Fed's action could spark renewed inflation. That has not happened. They also feared that the dollar would be devalued, but instead it has increased in value. In its announcement the Fed stated that short-term interest rates would be kept near zero for a "considerable time." Most observers interpret that to mean until mid-2015. However, this time the Fed leavened the intention with the observation that improvement in the labor markets or an uptick in inflation could bring higher interest rates sooner. Similarly, should deflation set in or labor markets deteriorate, an interest rate hike likely would be deferred.

QE3 did not stimulate rapid economic growth, as this recovery has been among the slowest on record. The Fed's defenders suggest that without QE3 economic conditions would have been far more dire, and the recovery might well have collapsed back into recession. That debate will go on for years.

Twice before, when the Fed has indicated that the bond-buying program would be ended, a reversal of policy was needed when the economy began to sag. The early stock market reaction this time was more positive. Indeed, the day following the announcement the Dow Jones Industrial Average set an intraday record high.

In the near term, inflation in the U.S. looks to be held in check by lower energy prices, a development that will ripple through the economy, leaving prosperity in its wake. Around the globe, economies continue to perform below expectations. In contrast, the Commerce Department announced in late October that the U.S. economy had grown at a healthy 3.5% annual rate in the third quarter of the year.

Although the Fed has stopped adding to its balance sheet, it will continue to buy bonds to replace those that mature in its portfolio. At some unknown future date, the Fed's holdings gradually will be reduced, when it stops replacing bonds as they mature. By that time, we can hope, our economy will be growing strongly and sustainably.

(November 2014)