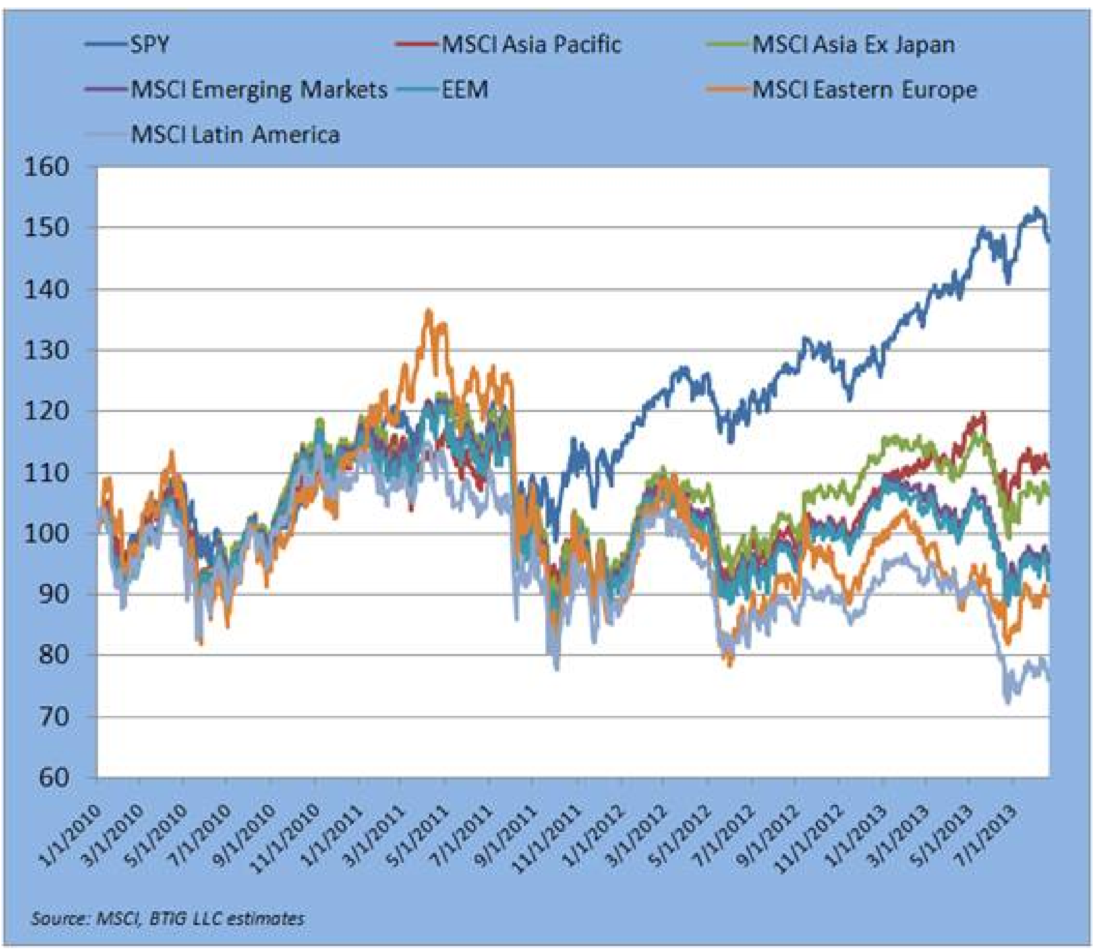
What Has QE Actually Accomplished?

John Mauldin | August 20, 2013

The market is obsessed with "tapering." The assumption is that all the "juice" in the economy is somehow the product of the Federal Reserve's actions. The headline on the front page of the *Wall Street Journal* today reads "Fear of Fed Retreat Roils India." I suppose one has to come up with some kind of reason to explain the convergence of emerging equity markets and those of the US. My friend Dan Greenhaus over at BTIG sent out this ugly graph (if you are an emerging-market investor) this morning:



Source: MSCI, BTIG LLC estimates

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As I've highlighted over the last few months, I'm pretty well convinced that there is something more fundamental going on. And that even bigger changes may be coming in the near future. This week we look at two pithy analyses of the likely effectiveness of Fed tapering and what it might portend.

The first article is from (of all places) the San Francisco Federal Reserve, where Janet Yellen used to be the president, prior to her appointment to the Federal Reserve Board of Governors. Authored by Vasco Cúrdia and Andrea Ferrero, the paper is called "How Stimulatory Are Large-Scale Asset Purchases?" When you read this, remember, you have here Federal Reserve system economists writing publicly about the policy of the Federal Reserve. There is a certain diplomatic politeness required in such papers. What Cúrdia and Ferrero are really saying is that the latest round of QE, massive as it has been, has not had all that much effect on the economy, and that other factors should be taken into account. I'm sure this thesis is somewhat controversial, and I look forward to seeing what QE proponents like David Zervos over at Jefferies have to say about it.

Cúrdia and Ferrero write:

> The Federal Reserve's large-scale purchases of long-term Treasury securities most likely provided a moderate boost to economic growth and inflation. Importantly, the effects appear to depend greatly on the Fed's guidance that short-term interest rates would remain low for an extended period. Indeed, estimates from a macroeconomic model suggest that such interest rate forward guidance probably has greater effects than signals about the amount of assets purchased.

This piece makes a great set-up to an essay published just yesterday by my friend and "Camp Kotok" fishing buddy Bob Eisenbeis, vice chairman & chief monetary economist at Cumberland Advisors. Bob points out that there is going to be a great deal of turnover in the Federal Reserve Board of Governors in the coming year, leading to a lot of discussion and a probable walking back of the QE asset-purchase process. Bob continues:

> So what does this mean for investors? There clearly is a disconnect between theory and evidence, and it is currently impacting the FOMC's intended policy. This, together with the personal/political considerations surrounding the composition of the Board of Governors, its leadership, and the makeup of the voting presidents, makes divining what is likely to happen even more difficult. One thing seems rather clear at this point, and that is that other factors besides "incoming data" will be in play, which will only serve to increase volatility and place a premium on hedging by investors.

In reading the speeches of the various FOMC participants, it seems to me there is growing concern over the size and continuation of the current asset-purchase model. Now, with the analysis from Cúrdia and Ferrero and the follow-on commentary from Eisenbeis, there is even data questioning its efficacy. Given the volatility that has clearly been introduced into the market, I think you're going to see a real effort to begin to reduce the size of QE. The interesting thing is that if the San

Francisco Fed paper is right, the effects of tapering shouldn't be all that large, and the far more important question concerns the level of interest rates. And on that topic the consensus seems to be clear: we are going to have low rates for a very long period of time. Indeed, it is that low-rate regime that we should be paying far more attention to than to tapering. I think you will find this week's *Outside the Box* interesting and provocative summer reading.

I am back in Dallas, where we are having what is the mildest August that I can remember in my almost 64 years in Texas. Sitting outside at a restaurant or by the pool in the evening is quite pleasant. This follows one of the mildest winters that I can remember. If this becomes typical Dallas weather in the new, global warming era, our biggest problem will be dealing with tax refugees from San Diego seeking more favorable tax and weatherclimates.

Last week I finished a major project while I was in Montana. I feel as if I have got a 900-pound gorilla off my back. Now I can now focus on the 50 20-pound monkeys that have lined up in the last few months, waiting their turn. But small monkeys are easy—I can dispatch a few of those every day. As long as I can get rid of more of them than get in line, I can end the day with a sense of accomplishment. Meanwhile the apartment construction is now entering the fun phase where we can see things really happening, and I get to play amateur designer while being supervised by professionals. Yesterday we met with the young gentleman who will be handling media and connectivity for the apartment. Everything is now tied together—TVs, computers, lighting, air conditioning and heating, security cameras, door locks, sound and music—into one server/controller, organized by iPad minis and accessible anywhere in the world from my iPad. If it has an electronic connection, it is going into the home network.

There is a young gentleman in our family who has now gone to work for Sony. He sat in on the initial meeting about the home network and talked to us about where Sony (and their competitors) will be in five years. He emphasized that our wiring needs will be very different then and that we need to plan for the changes today. He and the media guy walk through the place like two kids in a candy store, talking about what can be done. So we are wiring the place for products that don't even exist yet. Somehow that appeals to the amateur futurist in me. And we will be installing more than a few Sony products, without even benefiting from the yen depreciation that I think we will see in the next several years.

You're watching the world change rapidly around him analyst,

John Mauldin, Editor
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