USA TODAY MONEY

# Fed halts $4T stimulus campaign

How the Wilshire 5000 index, the broadest measure of the entire stock market, has reacted since 2008 when Federal Reserve Chairman Ben Bernanke launched quantitative easing (QE) to push more money into the economy during the 2008 financial crisis and Great Recession:

**Key announcements by the Fed's policymaking arm, the Federal Open Market Committee (FOMC) and changes in Wilshire 5000 during QEs:**




**Sources** Wilshire Associates, RBS Securities, research.stlouisfed.org; federalreserve.gov

ANNE CAREY, JAE YANG, GEORGE PETRAS, FRANK POMPA AND KARL GELLES, USA TODAY

## WHY QE IS IMPORTANT

If you've bought a home or gotten a job in the past five years, the Fed's quantitative easing program may have touched your life.

Normally, the Fed regulates the economy by raising or lowering short-term interest rates. If the economy is growing too fast, it nudges its key fed funds rate up. If it's slowing, it lowers it.

In 2008, the Fed had already pushed rates to zero. To stimulate the economy, it began quantitative easing — buying long-term Treasury and mortgage-backed securities to lower long-term interest rates. Doing so, the Fed reasoned, would push long-term rates down. (In the upside-down bond world, lower supply means lower yields, and vice versa.) Those lower yields would push down mortgage rates and let homeowners refinance, putting money in their pockets. It would also push up stocks, making people feel wealthier.

Where did the money to buy those securities come from? The Fed itself, which can increase or decrease the money supply. When the Fed sells those securities — or they mature — that money will slide back out of the monetary system. All other things being equal, that would push up interest rates. But many of the Fed's holdings won't mature until 2017 or longer.

# Easy come, easy go: Beginning of the end

**John Waggoner**
USA TODAY

### Fed issues upbeat appraisal

Notes that economy's growing, jobs are improving, 1B

Quantitative easing has died for the third time, but easy money lives.

"We're writing the eulogy on the most extreme Federal Reserve intervention in history," says Guy LeBas, chief fixed income strategist at Janney Montgomery Scott. But interest rates will remain low for years to come, he says.

The Federal Reserve's job of keeping the economy humming was extraordinarily difficult during the 2007-09 financial crisis. The housing market collapsed; banks and investors stopped lending; the stock market endured its worst fall since the Great Depression; unemployment soared.

The Fed's diagnosis: Deflation, not inflation, was putting the economy in grave danger. The central bank pushed the key short-term fed funds rate to zero, which would let businesses and consumers borrow at cheaper rates.

But that still wasn't enough to get the economy out of the intensive-care unit. So the Fed began buying long-term securities — Treasury bonds and mortgage-backed securities — to push long-term rates lower.

The Fed essentially created the money to buy the bonds, expanding the U.S. money supply. And by taking those bonds off the market, the Fed pushed long-term rates lower — especially mortgage rates.

After three rounds of bond buying, the Fed has ended the program, at least for now. "It's an inflection point," LeBas says. "The Fed is still providing support, just less of it."

What will the post-QE era look like?

▶ **Low short-term rates.** A neutral position for the fed funds rate is about 4%, says Kevin Cummins, economist at Harris Private Bank. "We're not going to see that for quite awhile," he says. The bank thinks the Fed funds rate will hit 1.25% to 1.5% by the end of 2015, and may not hit 4% until after 2016.

▶ **Low long-term rates.** Deflation in Europe and Japan, as well as sluggish loan demand in the U.S., could keep long-term rates low for a long time.

▶ **Higher dollar.** For investors, this means that stocks will still look better than bonds or money market funds for some time, assuming corporate earnings continue to be robust.

# A pat on the back for Yellen — but lots of hurdles ahead

**Darrell Delamaide**
Special for USA TODAY

**WASHINGTON** The successful end of the Federal Reserve's monetary stimulus program is an important milestone on the road back to financial normalcy, but there are still some treacherous hurdles ahead.

The fact that the actual decision announced Wednesday caused scarcely a ripple in the markets is a tribute to Fed Chair Janet Yellen's growing ability to manage investor expectations — a communications exercise that Fed officials call "forward guidance."

The Fed has learned to communicate better in the school of hard knocks. When it first announced last year it was going to start "tapering" its bond purchases from the $85 billion a month they had maintained since December 2012, investors were caught unaware and there was a market sell-off that came to be known as the "taper tantrum."

The next challenge is to communicate when policymakers will start to raise interest rates. Most Fed watchers expect the Fed won't start raising rates, expressed in the target rate for the money it lends banks overnight, until the second half of next year.

This benchmark rate has been at virtually zero since December 2008, as part of the Fed's response to the financial crisis.

Economic recovery has been relatively weak and erratic, however, so most Fed policymakers are reluctant to consider an increase in interest rates until economic growth, and particularly improvement in the employment situation, shows signs of sustainable improvement.

Fed officials do not expect conditions to return to normal until well into 2017. At that point, Fed officials would like to see the economy growing robustly, unemployment to be near 5% after reabsorbing more people back into the labor market and inflation stable at 2%.

To achieve that without major market disruption, they will have to successfully pick the time to start raising rates, clearly signal to investors when that will be and by how much, decide when to start reducing their balance sheet by not reinvesting principal, and introduce new tools for managing interest rates in today's changed environment.

It's a tall order and will require the Fed to maintain a delicate balance between too little and too much monetary accommodation while managing investor expectations.

**Darrell Delamaide has reported on business for Dow Jones, Barron's, Bloomberg News service and others.**