

US UNCONVENTIONAL MONETARY POLICY AND ITS IMPACT ON US INCOME

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ABSTRACT

Starting in November 2008 and until October 2014, the Fed used the policy of quantitative easing to increase the amount of non-borrowed reserves in the banking system with an objective to lowering the bank lending rate, thereby raising the aggregate demand and ultimately boosting the US GDP. In this paper, therefore, we investigate the impact of Fed's such policy on US GDP. So, our model variables are US GDP (GDP) and the quantity of non-borrowed reserves created by the Fed (NBR). We estimate a vector error correction model (VECM) on the data ranging from 1980 to 2012. Our study finds that, while the Fed's quantitative easing policy positively affect the US GDP in the short run, it has no impact in the long run.

Keywords: *quantitative easing, non-borrowed reserves, aggregate demand, GDP, VECM, short-run impact, long-run impact, etc.*

1. INTRODUCTION

In an attempt to take the economy out of recession or stimulate a sluggish economy, the Federal Reserve (Fed) takes one or more of the several tools in its arsenal, such as, lowering its lending rate, lowering the required reserves financial and deposit accepting institutions must hold against their checkable deposits, and buying Treasury securities.

But when the lending rate and required reserve ratio are already too low and cannot be lowered further and financial institutions are reluctant to sell their holding of Treasury securities, the only way the Fed can pump in liquidity in the financial system is by taking resort to quantitative easing (QE), which involves buying troubled assets and, thereby, pumping liquidity into the financial system.

| Date | Quantitative Easing Measure |
|---------------|---|
| Nov. 25, 2008 | The Fed announced the purchase of the direct obligations of housing-related government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, and the Federal Home Loan Banks—and mortgage-backed securities (MBS) backed by Fannie Mae, Freddie Mac, and Ginnie Mae up to \$100 billion in GSE direct obligations and up to \$500 billion in MBS. |
| Mar. 16, 2009 | The Fed expands agency based MBS program to \$1.25 trillion and its buying of longer-term Treasury securities up to \$300 billion. |
| Mar. 31, 2010 | Quantitative Easing-1 terminated, under which the Fed purchased \$1.5trillion in bonds, including \$1.2 trillion in US Agency debt and MBS and \$300 billion in US Treasuries. |
| Nov. 3, 2010 | The Fed announced its intention to purchase a further \$600 billion of longer-term Treasury securities by the end of the second quarter of 2011, at the pace of about \$75 billion per month. |
| Nov. 4, 2010 | The Fed announced its intention to buy an additional \$600 billion of longer-term Treasury securities by mid-2011 |