Written by **William F. Jasper** on February 20, 2012

Now, More Than Ever, Time to Audit the Fed

QE3 or no QE3? For the past year — and especially over the past several months — central bankers, mortgage bankers, financial analysts, business leaders, politicians, and commentators have been engaged in a great debate over whether or not Ben Bernanke and the Federal Reserve will — and should — initiate a third round of "quantitative easing," or QE3. (Loosely, quantitative easing is a bankers' term for expanding the money supply.) The debate often rages over whether more "easing" would be "too" inflationary, and whether some inflation is acceptable if the tradeoff is a boost to employment and housing purchases.

Fed chairman Bernanke and other Federal Reserve officers have been making statements that are seemingly contradictory, fueling the controversy over if, and when, QE3 may launch. According to many astute observers, however, the debate is largely a diversion meant to conceal the fact that the Fed has already started QE3. Legendary commodities trader Jim Rogers, who is a regular guest on many financial programs, says that "QE3 is already here." The M2 money supply numbers show, he says, "They [the Fed] are in there buying already. "

Considering that literally *trillions* of dollars are at stake, not to mention the potential collapse of the dollar and global financial mayhem, QE3 is no trifling matter, and worthy of real and rigorous investigation, not rigged debate. There are now more than $1.47 trillion in funds from QE1 and QE2 parked in banks as "excess reserves" that could unleash a tidal wave of hyperinflation if they were released into the economy.

What Is Quantitative Easing?

Although it has been with us now for several years, "quantitative easing" is not a term that is generally understood by the common man, or even by many of the financial types who regularly use it. The term was introduced into the common economic jargon during the 2007-2008 global financial crisis to describe the process by which the world's central banks were buying up the toxic balance sheets of commercial banks. Or, it might be argued, it was introduced not to describe, but to *conceal and obfuscate* the corrupt transfer of assets between the commercial and central banks. The toxic balance sheets were loaded with malinvestments, especially in the housing sector, that had been encouraged by the central banks' easy money policies of the previous decade.

Investopedia provides this definition for "quantitative easing":

> A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

That's fairly straightforward and accurate. Investopedia goes on to explain that central banks "tend to use quantitative easing when interest rates have already been lowered to near 0% levels and have failed to produce the desired effect." "The major risk of quantitative easing," it notes, "is that, although more money is floating around, there is still a fixed amount of goods for sale. This will eventually lead to higher prices or inflation."

In November 2008 the Fed began its first round of quantitative easing (since dubbed QE1), buying up the mortgage-backed securities (MBS), thus bailing out the Wall Street banks that had unwisely loaded up on the bad loans. This was only an "emergency" measure, Bernanke insisted, and would be a temporary, short-term solution aimed at averting a banking collapse. The Fed had an "exit strategy," Bernanke assured everyone, that would enable the institution to unwind the huge credit mess and then clean up the Fed's balance sheet and return it to pre-crisis levels. Those predictions have proven to be about as honest and accurate as the promised "cakewalk" in-and-out invasions/occupations of Iraq and Afghanistan — which have turned into decade-long quagmires. The Fed's initial $500-$600 billion purchase of MBS debt from the banks and the government-sponsored enterprises (GSE) Fannie Mae, Freddie Mac, and Ginnie Mae was followed by the announcement in March 2009 that the Fed was initiating another $750 billion MBS buy-up binge. The Fed further announced that it was sinking another $100 billion into Fannie-Freddie-Ginnie and spending up to $300 billion for U.S. Treasury securities.

That concluded QE1, or at least what we have public knowledge of thus far. We don't really know the full extent of the Fed's QE1 since it has never been subjected to a full, honest audit, something that Congressman Ron Paul has been trying to force Congress to implement for many years. Many free-market economists warned that QE1 would fail to solve the crisis and would simply lead to additional calls for further "easing." That is precisely what has happened. One of those who opposed and exposed QE1 from the start is economist Dr. Philipp Bagus, an associate professor at Spain's Universidad Rey Juan Carlos and author of *The Tragedy of the Euro*.

Writing in the December 31, 2010 issue of Mises Daily online, Bagus noted:

> In the winter of 2010, no one is talking about reducing the Fed's balance sheet or about exit strategies anymore. On the contrary, the Fed has chosen the path of more inflation and dubbed this strategy "QE2." QE2 has a slightly different purpose than QE1. QE1 directly supported struggling banks by buying their problematic assets. QE2 supports the government.

"The inflationary policies of the Fed have been coupled with the Keynesian fiscal policies of the US government," Professor Bagus explained. "The US government engaged in deficit spending to bail out financial institutions and automakers, disrupting a fast liquidation of malinvestments and a smooth adaption of the structure of production to consumer wants." Bagus continues:

> QE2 is a direct response to this deficit spending, which obliges the government to issue more bonds. With QE2, the Fed supports the government by buying these bonds. The Fed thereby actively helps the government in its Keynesian policies, which disrupt recovery.... The banking system finances the government that in turn grants the privilege of fractional reserve banking and implicitly gives guarantees for banks' losses.

Bagus' essay for Mises Daily was presciently entitled, "Will There Be QE3, QE4, QE5...?" anticipating the ongoing Fed policy for continuous debauching of the dollar.

Contrary to the claims of Bernanke and the Fed's usual cheering sections on Wall Street, and in the media and academia, quantitative easing is inflationary in multiple ways. Bagus points out:

> First, base money (bank reserves) increases. When the Fed buys a government bond, it creates money that it transfers to the bank selling the bond. At the end of the operation, the bank has more bank reserves and the Fed owns the government bond.
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> Second, the quality of money tends to decrease. The average quality of assets that the Fed holds decreases when it buys government bonds. The percentage of gold of total assets that could be used in a monetary reform decreases, while the percentage of government bonds increases….
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> Third, prices will be higher than they would have been otherwise. Prices would probably have fallen substantially without QE1 and QE2….
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> Fourth, the exchange rate will be lower than it would have been otherwise. Market participants will value the dollar lower, given that the base-money supply increases and the dollar's quality decreases.

Bagus suggests we stop aiding and abetting the QE scheme, by calling it what it is. He offers a number of possible alternatives for the term "Quantitative Easing": "Quantitative Destruction II," "Crisis Prolongation III," "Currency Debasement I," "Bank Bailout I," "Government Bailout II," "Consumer Impoverishment" — or, simply, "Money Printing I and II."

Wall Street Loves QE

The big Wall Street firms love the Fed's QE policies and will undoubtedly cheer on QE4, QE5 … QE20, ad infinitum. Why? Because money created by QE flows into the stock market, bidding up stock prices. In March 2009, when QE1 got cooking, the Dow Jones was below 7,000 but quickly rose to 10,800. When QE1 expired and the Dow fell below 10,000 again, the push was on for QE2.

Goldman Sachs, the epitome of Wall Street insiders, is a big booster of QE3. In a Q&A Goldman Sachs issued in August 2011, following the Federal Reserve's Federal Open Market Committee (FOMC) meeting, the firm stated:

> Q: Will Fed officials ease monetary policy further?
> A: Yes, we think so….
> Q: Should Fed officials ease monetary policy further?
> A: Yes, we think so.

The folks at Goldman Sachs even indicate they hope that the Fed will inaugurate "much bigger," "more radical," and "extreme" versions of the QE program. The Goldman Sachs Q&A continues:

> There are three main ways in which the Fed could be more radical: (1) an extension of the QE program into markets other than Treasuries and agency MBS, e.g., private sector securities, (2) a much bigger QE program, up to the extreme version of a promise to buy as many securities as needed to hit a specific yield target…, and (3) an explicit or implicit change in the Fed's policy targets.

Goldman Sachs has been one of the biggest beneficiaries of the Fed's largess. And there is more than a mere hint of corruption and inappropriate conduct involved with the steady revolving door of top Goldman Sachs executives into top positions of the Fed and the U.S. Treasury. Much the same can be said for the execs at Citibank, JPMorgan Chase, and the other top-tier Wall Street banks, which have profited handsomely from the Fed's QE policies.

Where's the Inflation?

But if QE1 and QE2 are inflationary, as Ron Paul, Bagus, and others insist, why aren't we experiencing more inflation? After all, according to the Fed and the U.S. Bureau of Labor Statistics (BLS), annual inflation (by which they mean *price* inflation) has continued to hover around a *mere* three percent. Economists aligned with the Fed deem that "moderate" and acceptable. However, as we have noted in these pages before, many analysts and economists have taken the BLS to task for manipulating its Consumer Price Index (CPI) to drastically understate the true extent of price inflation and falsely peg the annual rate in the Fed's pre-ordained one-three percent acceptable range.

In order to accomplish this the BLS has dramatically changed its calculation methodologies twice, and jiggled them many other times. Significantly, it dropped home mortgages from its equation, coming up with a complicated and ever-changing owner-renter housing formula that masks much of the inflation. The CPI also excludes food and energy, two very volatile and not insignificant core components of every family's budget. These and many other sleight-of-hand statistical tricks allow the government's economic soothsayers to produce any outcome that may be deemed desirable to justify any current or proposed policy.

What is the real level of annual price inflation, then? No one knows precisely, but the evidence supports estimates that we are already in the double digits. Financial analyst John Williams at Government Shadow Statistics (shadowstats.com) is one of many experts presenting data supporting the claim that our true price inflation rate is already closer to 10 percent.

However, another answer to the inflation puzzle points to the gargantuan overhang of "excess reserves" that have not yet made their way into the system. "Excess reserves parked at the Fed have now risen to a record $1.47 trillion," notes the National Inflation Association (NIA), in a January 25, 2012 posting on its website. "Much of the $600 billion in newly printed money created by the Fed as part of QE2 has gone straight into the excess reserves and has not yet expanded the U.S. money supply."

The NIA reports:

> The Fed is currently paying 0.25% interest on these excess reserves, which is encouraging banks to keep these excess reserves parked at the Fed instead of making loans. The Fed is basically allowing banks to generate risk free profits doing nothing by paying out this 0.25% interest.

The NIA warns that "even if the Fed doesn't implement QE3, or decides to pause before launching QE3, the Fed can create tremendous price inflation simply by pushing these $1.47 trillion in excess reserves into the U.S. economy. This $1.47 trillion is high-powered money that could potentially multiply by ten times and increase the U.S. money supply by nearly $15 trillion."

These "parked" excess reserves hang by a thread like the proverbial Sword of Damocles above our heads. Monetary expert Terry Coxon, president of Passport Financial, Inc., warns that these reserves could unleash "inflation rates far beyond anything the U.S. has ever experienced." "The monetary base has more than doubled," noted Coxon in an interview last July with David Galland of Casey Research, "and without the Federal Reserve paying interest on the recently created boatload of reserves that is essentially keeping them immobilized in accounts at the Federal Reserve Bank in New York, the M1 money supply would more than double and we would have inflation rates that would make the worst days of inflation in Brazil and Argentina look tame."

Congressman Ron Paul has been sounding the warning about this deadly overhang from the get-go, which is why he has been censored, scorned, reviled, and smeared by the powers that be who aid and abet the Fed’s illicit and immoral policies.

Photo of Federal Reserve Board headquarters in Washington, D.C.