https://www.unionleader.com/news/business/money_sense/marc-a-heberts-money-ense-understanding-the-fed-s-recent-actions/article_9c40a94f-0610-57a8-ac38-e4d1b7c0c793.html

Marc A. Hebert's 'Money $ense': Understanding the Fed's recent actions

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During these difficult times, there have been many actions taken to support the U.S. economy.

One of the agencies that many probably don't realize is active during this time is the Federal Reserve, which is the U.S. central bank.

The Federal Open Market Committee (FOMC), which makes many of the Fed's key decisions, has made a promise to buy Treasury securities and agency mortgage-backed securities in the amount necessary to support the economy. The FOMC is also trying to prevent disruptions in the financial markets.

In addition, the Fed is purchasing corporate as well as state and local government bonds and providing loans to the private sector. It will buy corporate bonds from U.S. companies.

It should be noted these bonds will still have to be repaid. Just because the Fed is buying a corporate bond doesn't mean the repayment has been forgiven. This isn't a corporate bailout. The Fed's goal is to provide liquidity and facilitate borrowing for corporations as well as setting the stage for economic recovery.

By purchasing Treasury securities, the money supply is increased throughout the broader economy. The purchase of mortgage-backed securities aids the mortgage market. Along with setting interest rates, the Fed aims to promote employment and maintain prices. This is its "dual mandate." All of this has a familiar name: quantitative easing or QE for short. The goal of this is to increase liquidity in the economy.

The purchases are done through banks within the Federal Reserve System. Purchases are done by adding dollar amounts to the individual bank's balance sheet. Now the bank has more money to lend. Also, when the Treasury or mortgage agency issues bonds, the Fed is ready to buy. This is one way that the Treasury finances its stimulus programs such as those passed under the CARES Act.

By holding these securities, the Fed will earn interest. Any net interest the Fed earns is returned to the Treasury. This equates to interest-free loans on treasuries. The principal is paid when the bonds matures. Essentially, the bonds become part of the national debt. When they mature and the principal is due, the Treasury issues new bonds, and the debt payment is just kicked down the road.

Given that the Fed can create money endlessly, why doesn't it always do so?

There is endless need for the government to spend and for other lending. The reason it uses this tool only in select circumstances is inflation. Too much money in the economy will raise the price of goods and services as consumers compete with each other to purchase available goods.

An example of this happened after World War II and during the 1970s. During these times, there was a low interest rate environment and money was pumped into the economy by the Fed. This resulted in high inflation rates.

The situation today could be different from those eras. The inflation rate has been low for over a decade now. In the current situation, consumer spending has been severely impacted, and people just aren't spending like they did before the pandemic.

It seems unlikely, at least in the near term, that inflation will rise.

What happens over the long term might be a different story. The Fed will attempt to increase the money supply just enough to ease the crisis. This action can be seen in the amount of Treasury security purchases.

During the last weeks of March, purchases were at a peak of $75 billion per day! By mid-June, this level fell down to around $4 billion daily. Further adjustment will be made as needed in the coming months.

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