

Why the Taper Will Come

“Continuing assessment of the efficacy and costs of asset purchases might lead the Committee to decide at some point to change the mix of its policy tools while maintaining a high degree of accommodation.”

-Minutes of Federal Open Market Committee
October 29-30, 2013

The above text is the most important aspect of the most recent Federal Open Market Committee (FOMC) meeting that took place between October 29 and 30. The text is in no way novel as the sustainability of this economic stimulus program has always been of concern, and thus examining its long term benefits and consequences continues to be the focus of Federal Reserve officials. However, moving past analyzing the efficacy or cost of the program, it is the end of the above quote that is most telling. And that is that the misconception by the financial media of tapering Quantitative Easing meaning that the Fed is attempting to make their policy less accommodative. In fact to the contrary, it is not that their goal is to be less accommodative, but change the medium in which it is delivered.

In most recent months the newest term to be thrown around in the tool basket of Fed policy approaches is forward guidance. Essentially, it is a central bank utilizing their ability to vocally influence markets by casting their projections on economic activity or policy interest rates. The most recent projections have the Fed maintaining their emergency low federal funds rate at a quarter of a percent or 25 basis points until the beginning of 2016. Similar to quantitative easing, where the fed acted as a backstop for the threat of illiquidity in financial markets, and acted to suppress long term interest rates (something not typically within the conventional capability of central bankers), which gave investors' confidence not only in the

present, but also into the future. Forward guidance gives a similar message, and that is that policy will continue to be highly accommodative; we are just witnessing it in a different form.

The problem that we are learning with a program like quantitative easing is that it has seemed to run its course. Where the anticipation was that the fed would inject massive amounts of liquidity into the financial system, and in turn banks and other financial institutions would go out and lend and spur investment fell short. What predominantly occurred was these financial institutions sitting on massive amounts of capital earned a minimal interest rate parking funds with the Fed and without ever incurring any real risk. James Bullard, President of the St. Louis Fed and who is arguably one of the most creative thinkers with the US central bank even took to discuss the idea of a negative policy rate this week to create an incentive to lend those funds. And it's because the mere idea of printing money is no longer sufficient as the policy becomes ineffective without the printed money changing hands.

And this is simply why the Fed's taper, as has been argued in past newsletters, is inevitable. It's not to be confused with the aspect of an improving economy as we are yet to witness that. It is the fact that this trick has gotten stale, and the Fed's looking for another manner in which to accommodate. When Ben Bernanke began what was originally referred to as QEIII, every analyst warned of the central bank running out of policy bullets as the effects not on the stock markets, but the economy seem to be wearing off. What we very well could be witnessing is the actuality that QE has run its course. No question it served its purpose, and with a dysfunctional federal government we can hope for some form of support from the US central bank, but at the moment, the fed looks to be out of ammo.

All investments contain risks and may lose value. This material is the opinion of its author(s) and is not the opinion of Border Gold Corp. This material is shared for informational purposes only. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission. Border Gold Corp. (BGC) is a privately owned company located near Vancouver, BC. ©2013, BGC.