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QE central bankers deserve a medal for saving society

The QE experiment has worked on one level for those countries that did it, but may have destabilized the global financial system yet further and stored up future trouble

What Mervyn King's QE programme did was distribute the costs of crisis evenly between creditors and debtors Photo: Andrew Crowley

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The final word on quantitative easing will have to wait for historians. As the US Federal Reserve winds down QE3 we can at least conclude that the experiment was a huge success for those countries that acted quickly and with decisive force.

Yet that is not the ultimate test. The sophisticated critique - to be distinguished from hyperinflation warnings and "hard money" bluster - is that QE contaminated the rest of the world in complicated ways and may have stored up a greater crisis for the future.

What we can conclude is that extreme QE enabled the US to weather the most drastic fiscal tightening since demobilisation after the Korean War, without falling back into recession. Much the same was true for Britain.

The Fed's $3.7 trillion of bond purchases did not drive up debt ratios, as often claimed. It reduced them.

Flow of Funds data show that total non-financial debt has dropped from a peak near 260pc of GDP in 2009 and since stabilised at 237pc of GDP. Public debt did jump, matched by falls in household and corporate debt ratios.

On cue, federal debt is now falling as well. The deficit is down to 2.8pc of GDP, low enough to erode the debt ratio in a growing economy through the magic of the denominator effect.

This is not a "pure" economic experiment, of course. There are other variables: the shale boom and the manufacturing renaissance in chemicals and plastics that it has spawned; quick action by the US authorities to clean up the banking system. Yet it is indicative.

By contrast, the eurozone carried out its fiscal austerity without monetary stimulus to cushion the shock, lurching from crisis to crisis as a result. The region has yet to reclaim it former levels of output, a worse outcome than during the Great Depression by a wide margin. Not even the 1840s were this bad. You have to go back to the Thirty Years War in the 17th century to trump the economic devastation of EMU.

The eurozone's public debt ratios have rocketed, yet unlike America there has no been no drop in private debt to compensate.

The latest Eurostat data are staggering. They show that Italy's debt has jumped by 5.5pc of GDP to 133.8pc over the past year despite a primary surplus, purely because of EMU contractionary policies. The eurozone has bent every sinew to cut debt, and ended up in a worse predicament, exactly as Britain did under its infamous deflation policies in the 1920s.

At the end of it all, Euroland is again on the cusp of a triple-dip recession, with unemployment stuck at 11.5pc. It faces devastating hysteresis effects in southern Europe, where a large chunk of those under 30 have never had a permanent job. Leaving aside the social destruction, this will reduce the economic growth of these countries for two decades or more. It overwhelms the alleged benefits of EMU-imposed reforms.

The contrast with the US is so stark that there can be little argument. The US suffered broadly the same economic shock in 2008 and had a similar jobless rate in the white heat of the crisis. Its unemployment rate has since tumbled to 5.9pc. Lay-offs have dropped to a 14-year low. There is even an acute shortage of truck drivers, now able to command $40,000 a year.

Britain's workforce has reached fresh records above 30m. Some are highly-educated refugees from the EMU victim states, a loss to them, a boon to us.

The British recovery may be unhealthy in many ways - not least the current

account deficit - but it is surely better for the long-term prospects of this country than the cosmic gloom gripping the Maastricht bloc.
It is true that Japan is struggling despite the most radical QE blitz ever attempted in a large economy - roughly $70bn a month since Shinzo Abe took power, and began to shake Japan out of its fatalism - but it had a bigger mountain to climb, and it has in fact weathered the shock of its sales tax rise this year. Those who say QE has failed in Japan are premature, and offer no counterfactual argument. Clearly the status quo ante was a path to ruin.
You can argue that zero rates robbed savers, and that QE robbed them a fraction more, but let it never be forgotten that the state rescued the banking system across much of the industrial world in 2008. If governments had let banks collapse - and 4,000 went under across the US in the early 1930s - savers would have lost their shirts. They were in fact bailed out by the taxpayers, and little gratitude some show for it.
What QE has done is to distribute the costs of crisis evenly between creditors and debtors, a matter of natural justice. Eurozone policies are by contrast an enforcement mechanism for creditors alone. Debtors in Spain have been reduced to servitude by a combination of medieval debt laws and the "internal devaluation" imposed by the EMU regime.
We will never know whether extreme monetary stimulus averted social and political breakdown, a slide into beer-hall thuggery and street militias, but would you ever wish to put the matter to a test? So let us give due credit to the heroes of our time - Ben Bernanke, Mervyn King and those who stood by them against the mob of howling critics.
And yet, there is a problem. The Bank for International Settlements and others such as India's central bank governor Raghuram Rajan argue that QE is in essence a beggar-thy-neighbour ploy that shifts the burden onto others in a "Pareto sub-optimal" for the world as a whole.
They argue it led to a flood of liquidity into emerging economies and that they were not able to neutralise the effects. Most of the world has now been drawn into an all-engulfing debt trap that has left the international system more vulnerable than ever.
Debt has risen by 20 percentage points to a record 175pc of GDP in emerging markets, with China already around 250pc, according to Standard Chartered. These are unprecedented levels for countries without mature financial markets and deep layers of wealth. Morgan Stanley calculates that gross global leverage has risen from $105 trillion to $150 trillion since 2007. The BIS says the world is on a hair-trigger, at risk of "violent" effects if there is slightest loss of liquidity.

This may soon be out to the test since it is not only the Fed that is tightening, tapering QE3 from $85bn a month to zero since the start of the year. By a quirk of fate, China's central bank has stopped accumulating foreign bonds as well, for its own reasons. Let us hope they are talking to each other.
The Chinese central bank became a net seller of Treasuries, Bunds, Gilts and French bonds in the third quarter. This is a major change of strategy. It was buying $35bn a month earlier this year, before premier Li Keqiang announced that excess reserves had become an inflationary "burden". This shift is not exactly "reverse QE" but is analogous.
The world must deal with a double shock from the two monetary superpowers. Investors had hoped that the European Central Bank would pick up the baton in a seamless transition. This has not yet happened, and may not happen on any worthwhile scale for a long time given the "German problem".
The ECB's balance sheet has contracted by €150bn to just over €2 trillion since Frankfurt first unveiled its "QE-Lite" more than four months ago. The ECB bought €1.7bn of securities last week but this is a toe in the water.
It is too early to judge whether even the Anglosphere can really throw away its QE crutches. The risk of a relapse is obvious as the commodity nexus flashes global stress warnings. We may need QE4 after all.
If so, let us inject the stimulus directly into veins of the economy money next time, using it to build roads, houses and an infrastructure fit for the 21st century. Experts call that "fiscal dominance", a dirty concept, a slippery slope towards to monetary financing of deficits. To which the condign reply in a global deflationary trap with chronic lack of demand is, all the better.