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The Fed Has Not Stopped Trying to Stimulate the Economy

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Justin Wolfers

The most important thing to understand about the Federal Reserve's decision Wednesday is that it has decided to keep the monetary policy dial set to "stimulate."

Indeed, by conventional measures, monetary policy is currently dialed in to as expansive a setting as it ever has been — not only in this recovery, but arguably in the history of the nation.

Let's start with the Fed's standard tool, the federal funds rate, which is set to remain at essentially zero percent, as it has been since late 2008. While we may now be used to it, this was almost unimaginable a generation ago.

When the Fed ran out of room to further lower short-term interest rates, it embarked on a program of buying long-term securities to push down long-term interest rates. This program of quantitative easing has led to the Fed today holding an unprecedented $4.5 trillion worth of assets.

This number is important, because the Fed believes that it is the total stock of the securities it holds that influences long-term interest rates, not the flow of new purchases. (This perspective is sometimes called the "stock view," and while it has been endorsed by many Fed economists, some market players remain unconvinced. I am not persuaded by their counterarguments.) Because the Fed plans to continue to hold these assets, you should expect long-term interest rates to remain low, making it cheaper for businesses and families to borrow.

Of course, the aspect of Wednesday's Federal Reserve decision that has captured the most attention is its decision to stop purchasing further long-term securities. But don't confuse this with a monetary tightening. It's hanging on to the stock of securities it currently holds, and the Fed's preferred "stock view" says that this is what matters for keeping longer-term interest rates low.

By this view, the Fed's decision to end its bond-buying program does not mark the end of its efforts to stimulate the economy. Rather, it is no longer going to keep shifting the monetary dial to yet another more stimulative notch at each meeting. The level of monetary accommodation will remain at a historical high, even if it is no longer expanding.

Over recent years, policy makers have also worked to lower long-term interest rates by shaping expectations about future monetary policy decisions, in a process known as forward guidance. Today's statement continues this policy, repeating recent guidance that the Fed expects interest rates to remain low for "a considerable time."

Of course, the fact that the degree of monetary stimulus the economy is receiving is historically high does not mean that it is sufficient. It is now nearly seven years since the recession hit, and unemployment remains high, even as inflation has continued to run below the Fed's target. It is a sad indictment of our macroeconomic policy makers — both fiscal and monetary — that it has taken this long to fashion an adequate response.

But for all the hubbub about the decision to end quantitative easing, realize that the degree of monetary support the economy is receiving tomorrow will be no smaller than it was receiving yesterday.

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