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## Monetary Policy: Quantitative Easing and Negative Interest Rates

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# Abstract

To: Prof Jacob Massoud

From: Mekdi Yilma

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Course: BUS 4980 Business Policy & Strategy

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## The Unconventional Monetary Policy

### Section 1: Brief Description of U.S. Economy and Monetary Policy Since the Early 2000s

- Understanding the small recession of 2001 and its causes
- Studying the oversupply of high tech during that period that resulted in the bursting of the Internet-bubble
- Grasping the concept of the drastic fall of the stock market in 2002

During this crisis, monetary policy reduced the interest rates and the U.S. gets out of the recession. However, the rate of growth was by no means high enough to sustain long-term economic development.

### Section 2: Description of the Mortgage Industry in 2004

In this period, we can observe the sale of housing units going up the roof while interest rates remaining low. Then, in June/July of the same year, the FED starts tightening. The Federal Fund Rate is the interest rate charged between banks overnight. Banks must hold a minimum required amount of cash so they can borrow from another bank. The FED determines this interest rate. If the FED raises this rate, regular interest rates in the market also increases. In 2004, the main economic growth sector was construction and real estate. Thus, long-term investors were highly affected by rising of the interest rates. In 2005-2006, mortgage backed securities explode. But, in the second quarter of 2005, the number of units constructed was lower than the previous year as a result of oversupply and interest rates. This was the indication of the downfall of the housing prices which later occurred in 2007.

### Section 3: The Aftermath of the 2008 Financial Crisis

- Discuss the demise of Lehman Brothers in Sep 2008 and AIG's bankruptcy occurring two days later
- Review of shadow banking particularly in relation to money market mutual funds, investment banking, and pension funds

### Section 4: Quantitative Easing

With quantitative easing mechanism, the central bank bought government securities. Banks received huge amount of support for mainly for two reasons

- 1) To further prevent the bankruptcy of the major five banks
- 2) To lend money to small businesses to revive the U.S. economy

This time around, quantitative easing did not work. Money that was given to the banks did not go to the real markets. It instead went into the stock market. Why? Because banks needed to recapitalize and as a result did not give money to small businesses or the money they gave was only to safe large companies. In this research paper, I will analyze the long-term impact of this action on the U.S. economy.

#### Section 5: Negative Interest Rates

During the last two/three years, European Central Banks and Japan Central Bank have started to adopt a negative interest rates. The theory behind this decision was when we have negative interest rates, it will push down the cost of borrowing, thus increasing the demand for loans. However, in practice, this showed a sign of desperation from the banks resulting for individuals to stash their money under their pillows. Hence, what are the implications of negative interest rates if the FED adopts them?