The Taper in the US

The taper. Isn't that a giant nocturnal pig? No, you're probably thinking of the tapir. The taper is a kind of monetary policy. It's the bland, one-word shorthand for the winding down of the biggest financial intervention in history: the U.S. Federal Reserve's five-year investment of more than $3 trillion (that's almost the size of the German economy) in bonds to prop up economic growth after the global free fall of 2008. There's plenty of controversy about whether buying bonds with money conjured from thin air saved the world or has fueled new bubbles. But there's been none about the perils the Fed faces in slowing the purchases down. To investors and central banks around the world, the taper is much scarier than pigs in the night.

The Situation

In December, the Fed's policy making committee announced that the time had come to taper, but just a bit. It said it would continue with the bond buying program, known as quantitative easing, or QE, but drop its monthly purchases to $75 billion from $85 billion. The program had been started by Fed Chairman Ben S. Bernanke, and the taper was announced at his last meeting. The task of managing the slowdown is falling on Janet Yellen, the economist chosen by President Barack Obama to succeed him. The Fed emphasized that the taper was only a "modest" one, and that its near-zero interest rates would continue. There had been anxiety over how global markets would react, since a hint by Bernanke in May about the taper's imminence led to a jump in mortgage rates. And in fact currencies and stock markets in emerging markets fell steeply in mid-January, as investors prepared for U.S. interest rates to rise. But the Fed stuck with its plan, reducing bond purchases to $65 billion in January as the domestic labor market continued to improve.

The Background

The idea behind QE is that you don't need a printing press to add money to an ailing economy. The Fed's usual method of fighting recessions is to push down the interest rates banks charge each other for overnight loans, which allows banks to offer cheaper loans to businesses. But the Fed cut that rate almost to zero during the financial crisis five years ago, and more was clearly needed. So the Fed began buying bonds in hopes of driving down long-term rates that are usually outside its control. It wasn't a new idea, but it had never been tried on such a massive scale. Since September 2012, the bank has been snapping up

$85 billion a month in Treasuries and mortgage-backed securities. Unlike earlier rounds, the Fed's purchase plan was described as open-ended, with officials saying it would continue until the labor market "improved substantially." The idea was that reducing them gradually — that is, tapering them off — would make clear that the central bank would continue to offer support for the economy, just at lower levels. But its problem soon became how to convince markets that a taper was different from an exit.

The Argument

Almost since the first QE purchase, critics have been warning that it would spur inflation. They've been wrong so far. Prices fell in October, putting the 12-month inflation rate at 1 percent, half of the 2 percent the Fed regards as healthy. Others pointed to increases in the stock and housing markets as incipient bubbles fueled by the Fed. There's also debate about how effective QE has been. Some economists see only a modest effect, coming mostly through lower mortgage rates. A former Fed official who executed the bond purchases, Andrew Huzar, charged that "while there had only been trivial relief for Main Street, the U.S. central bank's bond purchases had been an absolute coup for Wall Street." Yellen said that the pain for savers from low interest rates was more than offset by the help the policy has given to the labor market and the economy as a whole. At the same time, she acknowledged that QE "cannot continue forever." The Fed's action in December was not the end of the taper, but just the beginning of the end for QE.