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More Treachery at the Fed?

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No one expects the Fed to announce a rate-hike at the end of the today's FOMC meeting, but that doesn't mean there won't be a few surprises. The problem is that the recovery has stalled and the Fed can't decide whether we've just hit a "soft patch" or if it's something more serious. If it is more serious, then the Fed will need a contingency plan for kick-starting the economy. So, what's it going to be; another round of Quantitative Easing (QE), rate caps on short-term Treasuries or something else altogether? That's what the financial media will want to know, and only Fed chairman Ben Bernanke knows the answers.

But before we get to that, let's look at the economy. First quarter growth has been revised to an anemic 1.8 percent and economists are currently shaving their estimates for Q2. Some think that the high number of "black swan" events (Tsunami in Japan, debt problems in the eurozone) are mainly responsible for the poor growth, but that doesn't explain the sharp downturn in hiring, manufacturing, housing and consumer confidence. The US is experiencing a dropoff in demand at the worst possible time, just as Obama's $800 billion fiscal stimulus and Bernanke's $600 billion monetary stimulus are running out of gas. That means even less support for an economy that can barley stand upright as it is. Here's an excerpt from an article by Nouriel Roubini with a rundown on the economy:

"…there are good reasons to believe that we are experiencing a more persistent slump…. the factors slowing US growth are chronic. These include slow but persistent private and public-sector deleveraging; rising oil prices; weak job creation; another downturn in the housing market; severe fiscal problems at the state and local level; and an unsustainable deficit and debt burden at the federal level….

If what is happening now turns out to be something worse than a temporary soft patch, the market correction will continue further, thus weakening growth as the negative wealth effects of falling equity markets reduce private spending." ("That Stalling Feeling", Nouriel roubini, Project Syndicate)

More and more mainstream economists have joined Roubini in thinking that recent sluggishness is more than a soft patch. They think we may be headed for a double dip recession. Surprisingly, former chief economic advisor to the president, Lawrence Summers, has joined the Cassandras and is warning of stiffer headwinds just ahead. Here's a clip from Summers recent op-ed in the Financial Times:

"…the US is now half way to a lost economic decade…..the problem in a period of high unemployment, as now, is a lack of business demand for employees not any lack of desire to work is all but self-evident… When demand is constraining an economy, there is little to be gained from increasing potential supply. …

What, then, is to be done? This is no time for … traditional political agendas.

… The fiscal debate must accept that the greatest threat to our creditworthiness is a sustained period of slow growth. Discussions about medium-term austerity need to be coupled with a focus on near-term growth….

Substantial withdrawal of fiscal stimulus at the end of 2011 would be premature. Stimulus should be continued and indeed expanded by providing the payroll tax cut to employers as well as employees…

We averted Depression in 2008/2009 by acting decisively. Now we can avert a lost decade by recognizing economic reality." ("How to avoid stumbling into our own lost decade", Lawrence Summers, Financial Times)

Consider the irony of Summers–who designed Obama's $800 billion stimulus package and rejected the warnings of other prominent economists who said the stimulus was "too small"–recanting in the FT and pleading for a second round. Pretty shameless, eh? But the point is the leading economic indicators are pointed down, hiring has slowed to a crawl, household spending and personal consumption have tapered off, wages remain flat, and lending is barley staying even. In other words, the Fed's efforts to stimulate demand have failed. The economy is in another funk.

So, what is Bernanke going to say at today's meeting?

Ahhh, that's where the surprise comes in, but there was a clue in an article last week on Bloomberg News. Here's an excerpt from the article:

"Federal Reserve officials are discussing whether to adopt an explicit target for inflation, a strategy long advocated by Chairman Ben S. Bernanke …. An inflation target could help quiet critics of record monetary stimulus and anchor public expectations for consumer prices should the Fed in coming months try to spur the recovery by keeping interest rates close to zero for longer.

"My sense is that this may be a done deal, though not one likely to be implemented soon, and perhaps not until economic conditions return to closer to normal," said Laurence Meyer, senior managing director and co-founder of Macroeconomic Advisers LLC and a former Fed governor.

"The chairman is obviously for it, and it is hard to find anybody on the FOMC who now is really opposed to it." ("Fed Officials Said to Discuss Adopting Inflation Target Backed by Bernanke", Bloomberg)

So, an inflation target is a "done deal"? Really? But what does that mean?

Once the Fed sets an "explicit inflation target", then (if the CPI is below the target and rates are already at zero, as they are today) the Fed can buy as many bonds as they please until their goal is reached. If that sounds a lot like Quantitative Easing; it's because it's the same thing. (Although this time it will probably involve rate caps on medium-term Treasuries) Is that what Bernanke is doing; announcing a third round of his controversial bond purchasing program without using the same name?

It sure looks like it. In fact, any mention today of “inflation targeting” at today’s FOMC meeting should be taken as a sign that Bernanke is planning another bond buying binge, despite the fact that the only people who really benefited from the program have been investors who’ve seen stock prices skyrocket from the money that’s shifted out of bonds into equities. All the gains from QE2 went to Wall Street.

As for inflation targeting, Bernanke is not just an advocate of the policy, he’s its biggest booster. He’s even written a book on the topic titled “Inflation Targeting: Lessons from the International Experience” with co-authors Thomas Laubach, Frederic S. Mishkin, and Adam S. Posen in 2001. There’s every reason to suspect that the neoliberal credo that Bernanke espouses in his book helped shoehorn him into the top-spot at the Central Bank. It certainly had nothing to do with his abyssal track record.

So, what’s so bad about an explicit inflation target anyway? Haven’t other countries used the policy effectively?

Yes, they have. But other countries (particularly in the EU) also have labor laws and a social safety net which tend to protect workers from the abuses of errant monetary policy. Not so in the US. If Bernanke executes his plan, high unemployment and slow growth will become a permanent feature of life in America. Here’s an excerpt from an article by Nobel prize winning economist Joseph Stiglitz mulling over the effects of inflation targeting in other countries:

“Today, inflation targeting is being put to the test — and it will almost certainly fail. Developing countries currently face higher rates of inflation, not because of poorer macro-management, but because oil and food prices are soaring, and these items represent a much larger share of the average household budget than in rich countries….Inflation in these countries is, for the most part, imported. Raising interest rates won’t have much effect on the international price of grains or fuel…” (“What’s wrong with inflation targeting?”, Joseph Stiglitz, Project Syndicate)

But Stiglitz is talking about “developing countries”. Does that same rule apply to the US?

Yes, it does. If the Fed achieves its target rate, then Bernanke will raise short-term rates regardless of the effects on growth or employment. That’s what inflation targeting is all about; it’s a hat-tip to investors that the Fed will preserve their wealth at all costs, even if the broader economy has to be sacrificed. Here’s a clip from an article by economist Dean Baker who draws the same conclusion as Stiglitz:

“Inflation targeting has led to an enormous economic and human disaster, likely costing the world more than $10tn in lost output and leaving tens of millions of people unemployed. If this experience is not enough to discredit a policy, it is difficult to imagine any possible set of events in the world that could lead the inflation targeters to change their minds….

….the central bankers and others directing policy place the interests of the financial sector at the center of their concerns.” (“Guess which policy your central bank will pursue”, Dean Baker, Guardian)

Get the picture? Inflation targeting is neoliberalism writ large, no different than “structural adjustment”, “debt consolidation”, “privatization of public assets” etc. It’s another subsidy for speculators while ordinary working people get kicked to the curb.

Here's one last blurb from economist James Galbraith who's even more skeptical of inflation targeting than Stiglitz or Baker. This excerpt is from Galbraith's blistering critique of Bernanke's book titled "The Inflation Obsession: Flying in the Face of the Facts":

"….Inflation targeting in all cases coincided with high unemployment, and its main effect was to excuse central bankers from addressing this crisis…..("The Inflation Obsession: Flying in the Face of the Facts", James k. Galbraith, Foreign Affairs)

That's it in a nutshell. Bernanke wants to absolve himself of any responsibility to enact policies that will create "full employment". He'd rather shrug off the Fed's dual mandate ("price stability and full employment") and focus on inflation alone. That means that soaring unemployment and slow growth will be the norm for years to come.

There's a reason why Stiglitz, Baker and Galbraith all oppose inflation targeting. It's bad policy.

Mike Whitney *is one of the featured authors in the bestselling new book from Global Research,* The Global Economic Crisis: The Great Depression of the XXI Century *(Michel Chossudovsky and Andrew Gavin Marshall, Editors):*

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