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Negative Rates, Plunging Yields and a "Fix" for the Economy

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Theme: Global Economy

Global Research, June 17, 2016

CounterPunch

On Tuesday, the 10-year German bund slipped into the bizarro-world of negative rates where lenders actually pay the government to borrow their money. Aside from turning capitalism on its head, negative rates illustrate the muddled thinking of central bankers who continue to believe they can spur growth by reducing the cost of cash. Regrettably, the evidence suggests otherwise. At present, there is more than $10 trillion of government sovereign debt with negative rates, but no sign of a credit expansion anywhere. Also, global GDP has slowed to a crawl indicating that negative rates are not having any meaningful impact on growth. So if negative rates are really as great as central bankers seem to think, it certainly doesn't show up in the data. Here's how the editors of the Wall Street Journal summed it up:

> "Negative interest rates reflect a lack of confidence in options for private investment. They also discourage savings that can be invested in profitable ventures. A negative 10-year bond is less a sign of monetary wizardry than of economic policy failure." ("Money for Nothing", Wall Street Journal)

Bingo. Negative rates merely underscore the fact that policymakers are clueless when it comes to fixing the economy. They're a sign of desperation.

In the last two weeks, long-term bond yields have been falling at a record pace. The looming prospect of a "Brexit" (that the UK will vote to leave the EU in an upcoming June 23 referendum) has investors piling into risk-free government debt like mad. The downward pressure on yields has pushed the price of US Treasuries and German bund through the roof while signs of stress have lifted the "fear gauge" (VIX) back into the red zone. Here's brief recap from Bloomberg:

> "Today's bond market is defying just about every comparison known to man.
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> Never before have traders paid so much to own trillions of dollars in debt and gotten so little in return. Jack Malvey, one of the most-respected figures in the bond market, went back as far as 1871 and couldn't find a time when global yields were even close to today's lows. Bill Gross went even further, tweeting that they're now the lowest in "500 years of recorded history."
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> Lackluster global growth, negative interest rates and extraordinary buying from central banks have all kept government debt in demand, even as yields on more than $8 trillion of the bonds dip below zero."….
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> The odds of the U.S. entering a recession over the next year is now the highest

> since the current expansion began seven years ago, according to JPMorgan Chase & Co. The Organisation for Economic Cooperation and Development also warned this month the global economy is slipping into a self-fulfilling "low-growth trap." What's more, Britain's vote on whether to leave the European Union this month has been a major source of market jitters." ("Most Expensive Bond Market in History Has Come Unhinged. Or Not", Bloomberg)

There are a number of factors effecting bond yields: Fear, that a Brexit could lead to more market turbulence and perhaps another financial crisis. Pessimism, that the outlook for growth will stay dim for the foreseeable future keeping the demand for credit weak.. And lack of confidence, that policymakers will be able to reach their target inflation rate of 2 percent as long as wages and personal consumption remain flat. All of these have fueled the flight to safety that has put pressure on yields. But the primary cause of the droopy yields is central bank meddling, particularly QE, which has dramatically distorted prices by reducing the supply of USTs by more than $2.5 trillion in the US alone. David Stockman gives a good rundown of what's really going on in an incendiary post titled "Bubble News From The Nosebleed Section". Here's a clip:

> "…One of the enduring myths of Bubble Finance is that bond yields have plunged to the zero bound and below because of "lowflation" and slumping global growth. Supposedly, the market is "pricing-in" the specter of deflation. No it isn't. Their insuperable arrogance to the contrary notwithstanding, the central banks have not abolished the law of supply and demand.
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> What they have done, instead, is jam their big fat thumbs on the market's pricing equation, thereby adding massive girth to the demand side of the ledger by sheer dint of running their printing pressers white hot. Indeed, what got "priced-in" to the great global bond bubble is $19 trillion worth of central bank bond purchases since the mid-1990s that were funded with cash conjured from thin air."
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> ("Bubble News From The Nosebleed Section", David Stockman's Contra Corner)

Central banks have never intervened in the operation of the markets to the extent they have in the last seven years. The amount of liquidity they've poured into the system has so thoroughly distorted prices that its no longer possible to make reasonable judgments based on past performance or outdated models. It's a brave new world and even the Fed is uncertain of how to proceed. Take, for example, the Fed's stated goal of "normalizing" rates. Think about what that means. It is a tacit admission that the that the Fed's seven-year intervention has screwed things up so badly that it will take a monumental effort to restore the markets to their original condition. Needless to say, whenever Yellen mentions "normalization" stocks fall off a cliff as traders wisely figure the Fed is thinking about raising rates. Here's Bloomberg again:

> "Last year, inflation in developed economies slowed to 0.4 percent and is forecast to reach just 1 percent in 2016 — half the 2 percent rate most major central banks target, data compiled by Bloomberg show."

So what Bloomberg and the other elitist media would like us to believe is that these highly-educated economists and financial gurus at the central banks still can't figure out how to generate simple inflation. Is that what we're supposed to believe?

Nonsense. If Obama rehired the 500,000 public sector employees who got their pink slips during the recession, then we'd have positive inflation in no-time-flat. But the bigwigs don't want that. They don't want full employment or higher wages or workers to a bigger share in the gains in production. What they want, is a permanently-hobbled economy that barley grows at 2 percent so they can continue to borrow cheaply in the bond market and use the proceeds to buy back their own shares or issue dividends with the money they just stole from Mom and Pop investors. That's what they really want. And that's why Krugman and Summers and the other Ivy League toadies concocted their wacko "secular stagnation" theory. Its an attempt to create an economic justification for continuing the same policies into perpetuity.

So what can be done? Is there a way to turn this train around and put the economy back on the road to recovery?

Sure. While the political issues are pretty thorny, the economic ones are fairly straightforward. What's needed is more bigger deficits, more fiscal stimulus and more government spending. That's the ticket. Here's a clip from an article in VOX that sums it up perfectly:

> "But if the exact cause of the bond boom is a little unclear, the right course of action is really pretty obvious: If the international financial community wants to lend money this cheaply, governments should borrow money and put it to good use. Ideally that would mean spending it on infrastructure projects that are large, expensive, and useful — the kind of thing that will pay dividends for decades to come but that under ordinary times you might shy away from taking on…..
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> The opportunity to borrow this cheaply (probably) won't last forever, and countries that boost their deficits will (probably) have to reverse course, but while it lasts everyone could be enjoying a better life instead of pointless austerity." ("Financial markets are begging the US, Europe, and Japan to run bigger deficits", VOX)

That's great advice, and there's no reason not to follow up on it. The author is right, these rates aren't going to last forever. We might as well put them to good use by putting people back to work, raising wages, shoring up the defunct welfare system, rebuilding dilapidated bridges and roads, expanding green energy programs, increasing funding for education, health care, retirement etc. These are all programs that get money circulating through the system fast. They boost growth, raise living standards, and build a better society.

Fixing the economy is the easy part. It's the politics that are tough.

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