Quantitative Easing Was a Bust; Let's Try Higher Wages Instead

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Why is the economy still in the doldrums after 6 years of zero rates and three rounds of Quantitative Easing?

It's because consumers aren't consuming and there's too much debt. You see, despite the Fed's wacko theories about pumping liquidity into the financial system to make investors feel wealthier, people actually have to buy things to generate growth. And the truth is, consumers have reduced their spending because wages are flat, incomes are falling and many of them are still hanging on by the skin of their teeth. So consumption has been unusually weak. Economist Stephen Roach made a good point in an article at Project Syndicate. He said, "In the 22 quarters since early 2008, real personal-consumption expenditure, which accounts for about 70% of US GDP, has grown at an average annual rate of just 1.1%, easily the weakest period of consumer demand in the post-World War II era." (It's also a) "massive slowdown from the pre-crisis pace of 3.6% annual real consumption growth from 1996 to 2007." ("Occupy QE", Stephen S. Roach, Project Syndicate)

So how is the economy supposed to grow if people aren't buying things?

It can't.

Now according to the Fed, the best way to fix the problem is to make money cheaper (so more people borrow and spend) and to pump $4 trillion in liquidity into the financial system so stock prices soar. The point of this crazy experiment is to further enrich big time speculators so they spend more money and, thus, rev up the economy. It's called the "wealth effect" and the Fed actually believes this trickle down nonsense will work if given enough time. But, the fact is, QE hasn't worked, doesn't work, and won't work. Because it doesn't address the fundamental problem: How to get more money to the people who will spend it and grow the economy. That's the issue.

Zero rates can help because they lower the cost of borrowing. But lower rates don't work if there's no demand for funds, that is, if no one is borrowing. And what economists have found out is that, after a major financial crash, where households have seen much of their wealth vanish overnight, people are not as eager to borrow as they were before. This is easy to understand. If you're in a hole, you stop digging. The average Joe can't operate like a Wall Street banker who thinks, "I'll just keep borrowing until I get out of debt." No. Ordinary working people can't do that. They have to reduce their spending until they get their heads above water again.

This is why the credit expansion has been so weak since the recession ended in 2009. Yes, there have been exceptions, like subprime auto loans and student loans which have skyrocketed in the last few years, (and many of which are headed for default) but as a whole the demand for credit has remained weak.

Once again, this is entirely predictable. When people find themselves deep in the red, (like after a financial meltdown) they don't borrow as much. It's that simple. So it doesn't matter if rates are low or not, the demand for credit is going to remain weak until household balance sheets are repaired and consumers feel comfortable borrowing again.

So if low rates don't lead to a credit expansion, then what good are they?

Not much good at all, in fact, they're extremely damaging. Time and time again we've seen how low rates encourage all kinds of risky behavior, because when money is cheap and easily available, it fuels massive speculation that creates asset bubbles. For example, the stock buyback craze is entirely attributable to the Fed's zero rates, and it's precipitated a huge bubble in stock prices. Get a load of this from Zero Hedge:

> "In 2014, the constituents of the S&P 500 on a net basis bought back ~$430Bn worth of common stock and spent a further ~$375Bn on dividend payouts. The total capital returned to shareholders was only slightly less than the annual earnings reported. On the fixed income front, the investment grade corporate bond market saw a record $577Bn of net issuance in 2014. While the equity and bond universes don't overlap 100%, we think these numbers convey a simple yet important story. US corporations have essentially been issuing record levels of debt and using a significant chunk of their earnings and cash reserves to buy back record levels of common stock." ("Buyback Bonanza, Margin Madness Behind US Equity Rally", Zero Hedge)

What does this mean in English? It means the giant corporations aren't even thinking about the future of their companies any more. They're not building more capacity or hiring more workers or expanding R&D. They're taking every dime they can get their greasy mitts on and goosing stock prices so they can stuff their pockets full of cabbage and walk away like King Charlie. This is the effect of low rates. This is what happens when speculators get hold of cheap money. It throws the whole system out-of-whack.

Consider this: If the Fed sets rates at zero, and the rate of inflation is 1.5 percent; then for every dollar the Fed lends out, they get $.98 cents back in return. Does that sound like a good deal to you, dear reader?

Zero rates mean that the Fed is subsiding bubblemaking and inducing speculators to take risks that are inherently destructive to the system. This isn't a reasonable way to spur growth or stimulate the economy. It's the well-worn path to financial crisis.

Keep in mind, the Fed's policies come at a high price too. As we said earlier, the Fed's balance sheet has ballooned to over $4 trillion dollars. So ask yourself this: How do the service payments on that $4 trillion debt impact economic growth?

Obviously, the service payments drain resources away from the real economy. Let's use an example: Joe Blow decides he doesn't want to live in his ramshackle $500 per month basement hovel on Capital Hill anymore, so he moves to a beautiful two bedroom apartment in Madison Park overlooking Lake Washington for a whopping $2,200 per month. So, now Mr. Blow has $1,700 less per month to spend on nights-on-the-town or exotic LARPing adventures in Port Orchard with his computer-geek friends. What impact will Joe's new arrangement have on the economy?

It will hurt the economy because less spending means less growth. And that same rule applies to the corporations that borrowed money to repurchase their own shares. The billions in debt servicing will be diverted away from the real economy where it would have done some good. This is why the big Wall Street banks should have been euthanized following the Crash of '08, so their debts could have been wiped out instead of transferred to the Fed's balance sheet where they are a constant drag on growth.

The global economy faces so many headwinds at present that it's hard to know where to begin. China's real estate bubble has popped, capital flight has put emerging markets into a nosedive, commodities prices have plunged triggering fears of deflation, the economic data is increasingly bleak, and the Fed's plan to "normalize" rates has sent stocks gyrating like never before.

Even so, economic policy should focus on the things that increase growth, boost demand and lead to a more evenly-shared prosperity. Full employment and solid wages gains should be on top of the list. Those are the foundation blocks for a strong economy that can withstand the ups-and-downs of an erratic business cycle or the periodic battering of financial crises.

We tried QE, now let's try higher wages.

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