The Market School

Scit Uti Foro

THE FED, INFLATION AND NOT-SO-HEROIC LEADERSHIP

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There's a new Fed Chairperson coming to town. Who will wear the badge: Yellen? Summers? Kohn? It doesn't matter. They share the same faith in pouring enough buckets of cheap credit to drown the US economy, for which everyone apparently believes the Fed is solely responsible. Crazy, but I thought supply and demand were better drivers of economies than helicopters tossing free money at banks who don't lend. The last time I saw Larry Summers, he was speaking (for a fee) at an investor conference held by a private money lending fund in NYC whose very success was based on the post 08 failure of banks to make loans due to a derivatives crisis that Mr. Summers helped author. A month before, I sat at another NYC event listening to Greenspan. He was complaining about lose money in Europe, but never mentioned the spigot he opened that lead to our housing bubble and the 9 million souls who dropped from the US workforce when it burst. But Greenspan, like Summers, was clever—he ducked out of town before the bad news arrived. Bernanke is just as charmed, and will likely ride out of the Federal Reserve on a white horse before a real reckoning arrives. Those buckets of FED liquidity may be hiding safely behind rates still to rise and bubbles still to pop, but when the reality of that money slowly enters the real economy and psychology, inflation is coming.

In fact, it's already here. The CPI scale is fiction, and though it reports unusually low rates (less than 2%), more accurate scales measure the real inflation numbers at +10%. (See August 2013 white paper). The dollar value at 2006 is now worth 88 cents in today's money. In short: our currency is getting sicker (which is what happens when central banks control the price of credit via astronomical money creation). I have written ad nausea on the dangers of too much doping—too much free money. It can take us to Armstrong highs, with inevitable Armstrong lows. The Fed---led QE 1---through infinity, Operation Twist, ZIRP etc. are all pain---maskers, not pain solvers. You simply cannot toss all that money (Trillions) into a market without diluting a currency and distorting prices any more than you can add gallons of water to glasses of lemonade without diluting the flavor. But again, why no reported inflation? Well, monetary expansion can only create inflation if the money can get into the real economy. Today, the money is just electronic blips on the computers at the FMOC, and thus not unleashing its viral poison—yet—into the economy. In today's depressed and over---levered debt loads, these monetary excesses thus go to excess bank reserves and inflated ("doped") stock and bond markets—which we are enjoying this very summer, like the warm calm before a storm. Inflation is "low" today because those bubbles haven't burst yet, and lenders aren't getting money into the economy, wages are low and confidence in making new purchases is lacking. (Labor share has fallen 5% since 08 and total labor hours are still the same as where they were 15 years ago.) These forces actually create the deflation (hidden by easy credit) which *precedes* inflation.

I recently rode a horse through Gettysburg and stood at the field where a desperate General Lee ordered over 10,000 men into the mouth of a Union cannon on the 3rd of July, 1863 (aka "Pickett's charge"). Many officers knew it was suicide, but absurdity often gives birth to a desperate faith. As we now wait for another Fed Chairman/woman to save us, it seems we too are ignoring the power of the inflationary cannon ahead of us.