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INTEREST RATE OBSERVER®

Vol. 30, No. 18a | Two Wall Street, New York, New York 10005 • www.grantspub.com | SEPTEMBER 21, 2012

Wisdom of crowds

The Federal Reserve Bank of San Francisco, forgetting never to ask a question without knowing the answer, sought the opinions of the visitors to Facebook on the latest iteration of "non-traditional" monetary policy: "What effect do you think QE3 will have on the U.S. economy?" it inquired. The responses, posted Monday, according to *The Wall Street Journal*, were just as sour as they should have been. "Thanks for the $5 gas," said one; "Weimar," said another; and "I am a big bank and I love it," was a third.

Even Ben Bernanke, channeling his better academic side, might have blasted himself. In his lecture series at George Washington University in March, the chairman held forth on the evils of price controls. "[A]s you know," he reminded the students, "prices are the thermostat of an economy. They are the mechanism by which an economy functions. So, putting controls on wages and prices meant that there were shortages and all kinds of other problems throughout the economy. . . . [A]s Milton Friedman put it, this was like dealing with an overheating furnace by breaking the thermostat."

The price controls to which Bernanke referred were the Nixon administration's, but he could just as easily have condemned his own. Interest rates are prices, and the chairman has got them under his thumb. Asset prices, too, are economic thermostats, and the Fed, once more with the launch of QE3, is trying to fiddle with them.

To what purpose? Why, to raise up business activity in order to boost hiring. On the basis of which evidence? No evidence that stands up either under the glare of common sense or under the lamp of scholarship. "The Macroeconomic Effects of Large-Scale Asset Purchase Programs," a study released in December by the Federal Reserve Bank of New York, had to stretch to produce a moderately affirmative answer. "Our simulations," concluded the authors, "suggest that such a program increases GDP growth by less than half a percentage point, although the effect on the level of GDP is very persistent." One-half of a percentage point? Van Hoisington, king of the bond bulls, points out that 50 basis points on the GDP are statistically invisible. Indeed, the mean absolute revision to the annual rates of change of quarterly GDP between the years 1983-2009 averages more than one percentage point.

The New York Fed investigation reaches another doubtful conclusion. "The program's marginal contribution to inflation is very small," it declares. Let us see about that. At the expansion of QE1 in March 2009, the CPI registered a year-over-year decline of 0.4%. At the conclusion of that maiden bond-buying voyage in March 2010, the CPI registered a year-over-year rise of 2.3%. At the first intimation of the launch of QE2 in August 2010, the CPI showed a year-over-year rise of 1.1%. At the close of this second monetary adventure, in June 2011, the CPI showed a year-over-year rise of 3.6%. True it is, however, that the measured rate of inflation subsided to 1.7% from 3.9% during the opening 12 months of Operation Twist, September 2011 through August 2012 (then again, Twist was no money-printing operation, but, rather, a yield-curve management operation).

Market intervention usually has consequences, but not necessarily the consequences that the authorities expected. As for ZIRP and Twist and—now—QE3, how might the Fed surprise itself, if not the rest of us?

Possibilities include enriching the speculative classes and starving the savers; inflating commodity prices and running up the stock market; throwing a monkey wrench into the everyday calculations of a satisfactory minimum hurdle rate for business investment; seducing the bondholders through the perpetuation of artificially high prices (low yields); impairing investment returns in the insurance industry; prolonging the present era of unprecedented peacetime fiscal deficits; and presenting a once-in-a-lifetime gift to every gold and silver investor (see, it's not all bad).

There are subtler forms of mischief in the wings. For instance, come Jan. 1, traders must begin to post high-grade collateral before operating in the $648 trillion derivatives markets. Between $500 billion and $2.6 trillion in top-rated assets may be required. Such collateral in such volume does not happen to exist, in part because the Fed is soaking it up in asset purchases. But Wall Street has a solution. Let us, for a fee, suggest the bankers, swap our top-rated collateral for the lower-rated collateral traders own. "And if," colleague Evan Lorenz points out, "the synthetic transformation business really gets rolling, price volatility can explore new frontiers in the next crisis. Come some future crack-up, price volatility in the 'transformed' collateral can feed off price volatility in the derivatives market."

One phrase in last week's QE announcement was, to us, especially provoking. "In determining the size, pace and composition of its asset purchases," said the FOMC, "the Committee will, *as always* [emphasis added], take appropriate account of the likely efficacy and costs of such purposes." *As always*? From whence comes "as always"? Did the Bank of Bernanke not really mean to say, "the Committee will, *natch*, take appropriate account. . . ."? Or "the Committee will, *duh*, take appropriate account. . . ."? Or, "the Committee will, as always, *sigh*, take appropriate account. . . ."? The Fed has been stepping on rakes, tumbling into ditches and falling down staircases at intervals since the day it opened for business. *As always*, we must each look to our own assets.

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