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The House That Ben Built

"The law of unintended consequences pushes us ceaselessly through the years, permitting no pause for perspective." – Richard Schickel

History will be the final judge of the Federal Reserve under Ben Bernanke's leadership. I have my own opinion. Ben is the current chair of the Federal Reserve, sometimes referred to as "The Fed". The Fed is the central banking system of the United States. Formed by an act of Congress in 1913, *The Federal Reserve Act* created the Federal Reserve System in response to a number of financial panics in the early 1900's. Its initial role was to provide for maximum employment, stable prices, and moderate long term interest rates. If only.

The Fed is governed by seven members of the Board of Governors appointed by the President of the United States, and twelve regional bank presidents (only five of these vote at any time). These twelve representatives comprise the Federal Open Market Committee (FOMC), responsible for setting what is known as monetary policy (loosening, or tightening the supply of money in an attempt to control economic activity).

Over time the initial goals set by Congress of maximum employment, stable prices and moderate long term interest rates have been expanded along with the reach, influence and power of the Fed. For example, the list of items typically considered at current FOMC meetings is as follows: trends in prices and wages, employment and production, consumer income and spending, residential and commercial construction, business investment and inventories, foreign exchange markets, interest rates, money and credit aggregates, and fiscal policy (the last being the tool that Congress uses to influence the economy through law making – primarily in tax law). The Fed has been widely criticized over the years for setting arbitrary targets for both interest rates and inflation.

Since the financial meltdown of 2008, the Fed has embarked on a number of strategies in an attempt to "jump start" the US economy. One of the Fed's primary tools is its authority to set the interest rate that banks charge when lending to each other. By setting this rate low, it has the effect of increasing loans between banks and encourages overall lending in the hope of spurring economic activity. In addition to this the Fed has pushed long term interest rates lower through the purchase of long term US Government Securities using proceeds gained from the sale of short term US Government securities it already owns. Dubbed "Operation Twist", it does not affect the overall assets and liabilities of the Fed. It does, however, create artificial demand for long term Government securities driving their rates lower. In short, the Fed is pushing levers on both the public sector front through the manipulation of treasury security prices, and the private side by lowering the interest rate charged between private banks.

So far, these and other efforts by the Fed have had little impact on the US economy. Mr. Bernanke consistently points out in his testimony before Congress that things could be much worse but for the Fed's intervention. Of course this is an un-provable assertion. Clearly what the Fed has accomplished through recent actions is to create winners and losers. The losers have been savers; those whose lifestyles have been dramatically impacted by the precipitous drop in the interest payments they have historically counted on from their low risk savings vehicles. The winners have been any borrowers able to take on debt during this cycle, or those able to refinance existing debt to lower interest rates. Through its policies, the Fed is sending a clear message to the American people – saving bad, spending good. These policies are a direct driver behind the current run-up in financial markets. With little to no interest to be earned in savings accounts, savers have been pushed out into markets that they do not understand and are taking risks that they cannot afford, while at the same time driving US stock and bond prices higher. If any of this sounds familiar it should. The last bubble created by easy money was in Real Estate. I think we all remember how that one ended.