

September 2015

How the Fed Saved the Economy

“I am sufficiently proud of my knowing something to be modest about my not knowing all.”
 — Vladimir Nabokov, *Lolita*

I didn’t have to look long for a title to this letter. It was supplied in an opinion piece in the October 5th edition of the Wall Street Journal submitted by former Fed Chairman, Ben Bernanke (he is currently on a promotional tour for his newly published book, "The Courage to Act: A Memoir of a Crisis and Its Aftermath"). Ben followed the title of this letter with the following subtitle: “Full employment without inflation is in sight. The central bank did its job. What about everyone else?” This man certainly doesn’t lack self-confidence.

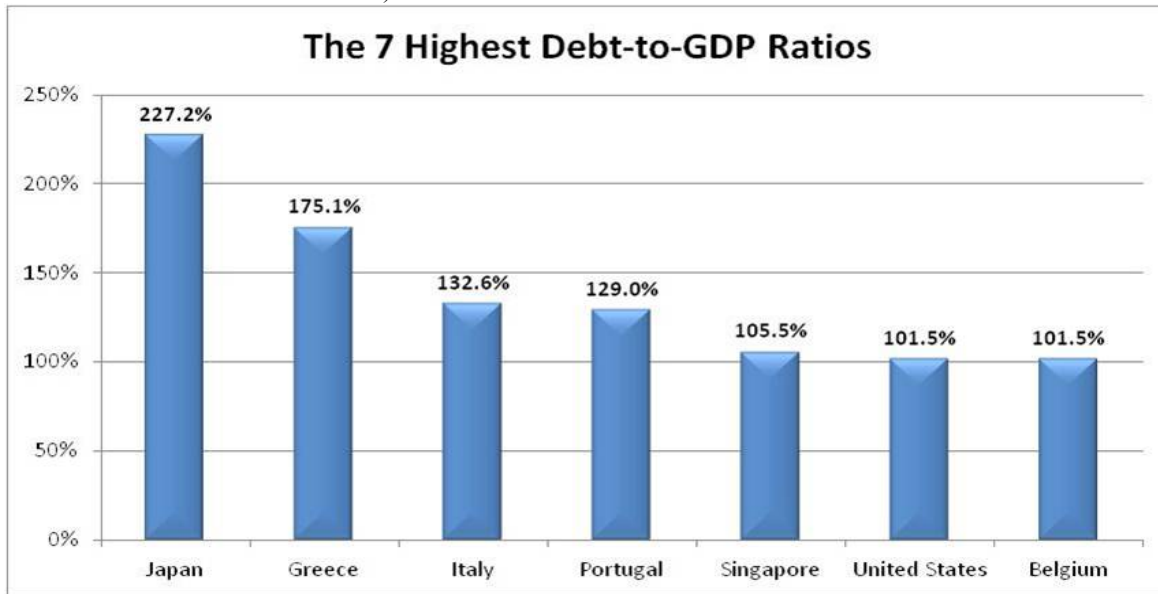
In an interview with CNBC he said “Growth has certainly been slower around the world, but the U.S. economy has been doing better than others, evidence the Fed’s monetary policy since the financial crisis has been correct.” In the Wall St. Journal piece referenced above *on the same day* he wrote: “To begin, it’s essential to be clear on what monetary policy can and cannot achieve. Fed critics sometimes argue that you can’t “print your way to prosperity,” and I agree, at least on one level. The Fed has little or no control over long-term economic fundamentals—the skills of the workforce, the energy and vision of entrepreneurs, and the pace at which new technologies are developed and adapted for commercial use”. Ben really needs to start reading from a script.

Is it possible that there is even another factor not discussed by Mr. Bernanke? Below is a chart detailing the amount of debt that has been created worldwide in the past 15 years itemized by the segment that created it – households, corporations, governments, or the financial sector (banks, insurance companies and brokerages).



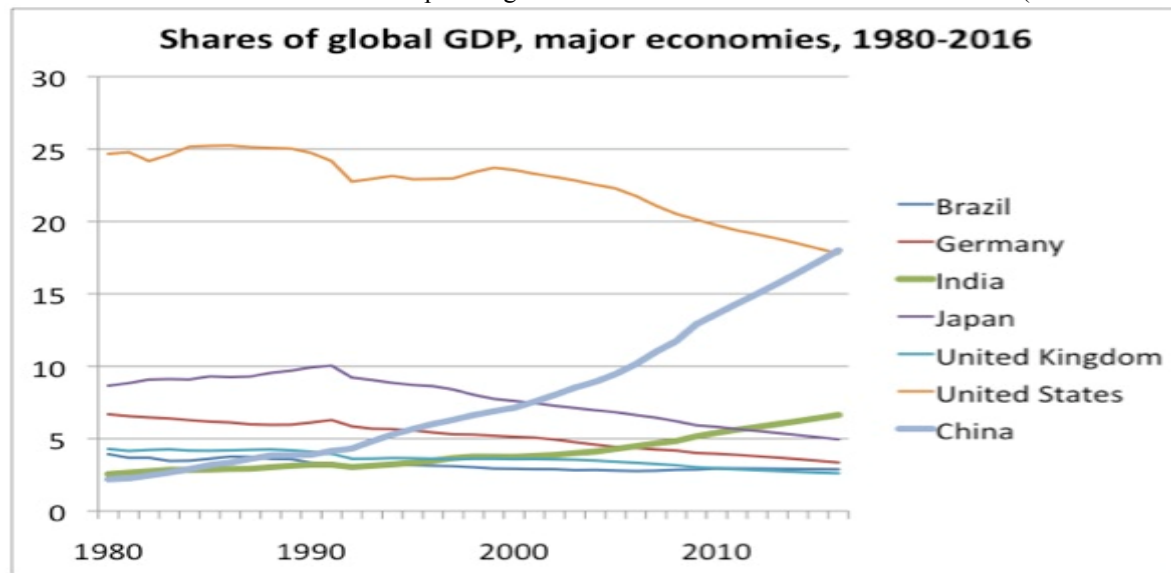
Notice that total worldwide debt has more than doubled in the past decade and a half from around \$90tr to \$200tr by the end to 2014 (tr: the Deutsche Bank abbreviation for trillion, although the Brits use tn – another dustup in the making between the Germans and the Brits?). Financial debt and household debt have been the slowest growers since the financial crisis (2.9% and 2.8% annually), while Government debt has exploded to over 9% per year. See the additional debt created (\$57tr) since the financial crisis in 2007.

At the end of last year the US had cracked the top 10, landing at number 6, for government debt created as a percent of Gross Domestic Product (this ratio is analogous to the total debt of a company versus its annual sales, or the debt of a household versus its annual income).



<http://www.forbes.com/sites/mikepatton/2014/09/29/the-seven-most-indebted-nations/>

At the same time notice how US and Japanese growth have stalled relative to China and Brazil (not on the list above)..



<http://www.marketoracle.co.uk/Article34514.html>

I had the naïve hope that after the experience of the financial (debt) crisis that the world would take notice, and if not decrease the total amount of debt, at least slow the pace of its growth. I was wrong on both counts. When you can create money out of thin air by issuing more debt, it's tempting to create even more. I wonder though what the world will look like when folks wake up to the fact that a lot of this debt isn't ever going to get repaid. Maybe I should write Ben a letter. I'm sure he'll know.