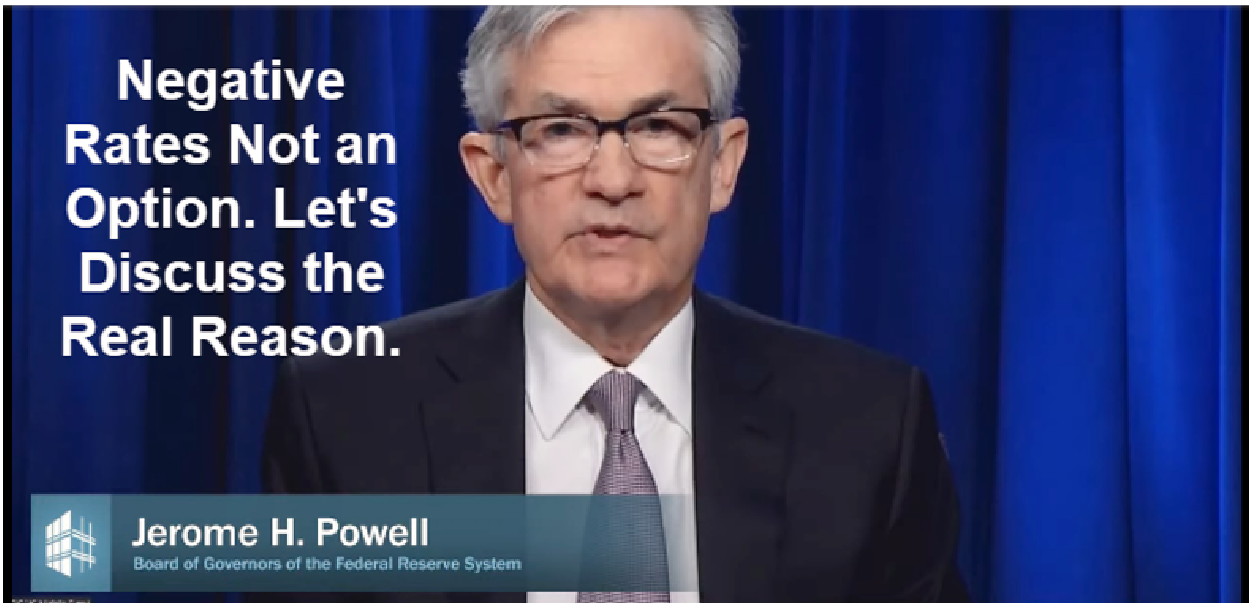
RIA Advice

Negative rates are not an option*. That was Fed Chair Jerome Powell's point as he reiterated the Fed's position on negative rates. He gave his economic assessment as well.*



Economic Outlook *"Highly Uncertain"*

In a live economic interview with PIIE, Jerome Powell discussed the Fed's outlook for the economy and the advisability of negative interest rates.

The video interview is above and here is Here is [Powell's Prepared Transcript].

Key Transcript Snips

> *The scope and speed of this downturn are without modern precedent, significantly worse than any recession since World War II*. We are seeing a severe decline in economic activity and in employment, and already the job gains of the past decade have been erased. Since the pandemic arrived in force just two months ago, more than 20 million people have lost their jobs. A Fed survey being released tomorrow reflects findings similar to many others: Among people who were working in February, almost 40 percent of those in households making less than $40,000 a year had lost a job in March.
>
> While the economic response has been both timely and appropriately large, it may not be the final chapter, given that *the path ahead is both highly uncertain and subject to*

> *significant downside risks*. Economic forecasts are uncertain in the best of times, and today the virus raises a new set of questions: How quickly and sustainably will it be brought under control? Can new outbreaks be avoided as social-distancing measures lapse? How long will it take for confidence to return and normal spending to resume? And what will be the scope and timing of new therapies, testing, or a vaccine? The answers to these questions will go a long way toward setting the timing and pace of the economic recovery. Since the answers are currently unknowable, policies will need to be ready to address a range of possible outcomes.

Job Losses & Economic Impact

> *The loss of thousands of small- and medium-sized businesses across the country would destroy the life's work and family legacy of many business and community leaders and limit the strength of the recovery when it comes*. These businesses are a principal source of job creation?something we will sorely need as people seek to return to work. A prolonged recession and weak recovery could also discourage business investment and expansion, further limiting the resurgence of jobs as well as the growth of capital stock and the pace of technological advancement. *The result could be an extended period of low productivity growth and stagnant incomes*.
>
> The current downturn is unique in that it is attributable to the virus and the steps taken to limit its fallout. This time, high inflation was not a problem. **There was no economy-threatening bubble to pop and no unsustainable boom to bust**. The virus is the cause, not the usual suspects?something worth keeping in mind as we respond.
>
> At the Fed, we will continue to use our tools to their fullest until the crisis has passed and the economic recovery is well under way. *Recall that the Fed has lending powers, not spending powers.* A loan from a Fed facility can provide a bridge across temporary interruptions to liquidity, and those loans will help many borrowers get through the current crisis. But the recovery may take some time to gather momentum, and *the passage of time can turn liquidity problems into solvency problems*. Additional fiscal support could be costly, but worth it if it helps avoid long-term economic damage and leaves us with a stronger recovery. This tradeoff is one for our elected representatives, who wield powers of taxation and spending.

Negative Interest Rates

The above transcript takes up the first 9 minutes of the video. The rest is a Q&A discussion between PIIE president Adam S. Posen and Powell .

Posen asked Powell about negative interest rates.

"The committee's view on negative rates has not changed. This is not something that we are looking at. ... We revisited this question last *October* and the minutes said all FOMC presidents - and that's not a sentence you get to say very often - that participants did not see negative rates as an attractive policy."

This subject comes up time and time again. Even before the Fed openly discussed negative rates I was of the view the Fed would never do so.

That Tweet was in response to articles like these.

- *It Begins: For The First Time Ever, Futures Price "Fatal" Negative US Rates Starting Dec 2020*
- *Why The Fed Will Go Negative*

In Search of the Effective Lower Bound

Last September I penned Negative Interest Rates Are Social Political Poison.

Also last September I discussed the lower bound in In Search of the Effective Lower Bound

> The Fed pays interest on excess reserves but the ECB charges them. Whereas the Fed gave free money to banks, the ECB charged the banks for excess reserves it forced into the system.

Whereas the Fed slowly recapitalized banks over time by paying interest on excess reserves, the ECB further punished the banks, perhaps purposely.

What better way to get Eurobonds or debt commingling that to purposely kill the banks?

No Economy-Threatening Bubble

I strongly disagree with the Fed's self-serving statement "*There was no economy-threatening bubble to pop and no unsustainable boom to bust.* "

The Fed blew the third major economic bubble in 20 years.

1. Dotcom Bubble
2. Housing Bubble
3. Everything Bubble

What many label as the "Everything Bubble" is really a junk bond and asset bubble.

What one label's it isn't important, how it came about is.

The Fed embarked on a nonsensical battle against routine CPI deflation spawning the third major asset bubble.

Plenty of Inflation

There was plenty of inflation, in housing, in junk bonds, in Airbnb leverage, in borrowing everywhere and in the search for yield.

None of that shows up in the CPI. Home prices are nor in the CPI, just rent.

Very Deflationary Outcome Has Begun: Blame the Fed

On March 5, well before the Covid-19 bust, I cautioned Very Deflationary Outcome Has Begun: Blame the Fed

To be fair, that was not timely because something like this would trigger a deflationary bust, all in the name of "preventing deflation"

Economic Challenge to Keynesians

Of all the widely believed but patently false economic beliefs is the absurd notion that falling consumer prices are bad for the economy and something must be done about them.

My Challenge to Keynesians ?Prove Rising Prices Provide an Overall Economic Benefit? has gone unanswered.

BIS Deflation Study

The BIS did a historical study and found routine deflation was not any problem at all.

?*Deflation may actually boost output. Lower prices increase real incomes and wealth. And they may also make export goods more competitive*,? stated the BIS study.

The existing bubbles ensure another deflationary outcome.

So prepare for another round of debt deflation, possibly accompanied by a lower CPI especially if one accurately includes home prices instead of rents in the CPI calculation.

Historical Perspective on Deflation

For a discussion of the BIS study, please see Historical Perspective on CPI Deflations: How Damaging are They?

Fed Lie of the Day: "Low Inflation is One of the Major Challenges of Our Time"

Please recall my May 18, 2019 post Fed Lie of the Day: "Low Inflation is One of the Major Challenges of Our Time".

In reality, Fed-sponsored bubbles were the major challenge. Then when bubbles pop, what the Fed claimed to be preventing happens.

Supply Shock and a Demand Shock Coming Up

A Supply Shock and a Demand Shock are Coming Up.

> So prepare for another round of debt deflation, possibly accompanied by a lower CPI especially if one accurately includes home prices instead of rents in the CPI calculation.
>
> Central banks? seriously misguided attempts to defeat routine consumer price deflation is what fuels the destructive asset bubbles that eventually collapse.

And here we are, with the Fed's Balance Sheet Ballooning Out of Control hoping to prevent the asset bubble deflation that the Fed itself caused.