Documentation

Danger of Hyperinflation Breaks into Public Debate

Dallas Federal Resrve President Richard Fisher told **Reuters** news agency Feb. 21, **"I'm not alone anymore"** in thinking that the Federal Reserve's quantitative easing policy is not helping to create jobs.

Fisher hit the Fed's purchase of $40 billion of mortgage-backed securities each month, along with $45 billion in Treasury bonds (totalling $85 billion/month), ostensibly to push down interest rates: "I just don't personally feel the need for further mortgage-backed activity, but the majority rules, and I've been in the minority on that front.... The housing market is even becoming speculative in some places." Fisher said the Fed's actions to lower interest rates have "artificially" boosted markets, but "done little for the real economy."

Fisher said the "wealth effect" of QE3 has not led to the robust employment growth that everyone wants. "The cost, however, is maybe higher than we think, because the more we do, the further into uncharted territory we sail, and how do we get out of it?"

The Wall Street Journal on Feb. 21 headlined its coverage of the just-released minutes of the Federal Open Market Committee's (FOMC) Jan. 29 meeting **"Split on How Long To Keep Cash Spigot Open."**

For the first time, according to the minutes, the potential was openly discussed in the FOMC that if the Fed continues the quantitative easing much longer, it may, when it then attempts to "exit" that policy, wipe out a big chunk of its own capital as a bank. This would result directly from the sharp rise in interest rates these FOMC members now foresee, when and if the Fed starts selling its immense asset book, soon to equal 25% of U.S. GDP. The longer the Fed keeps buying up $85 billion/month in mortgage-backed securities and Treasury securities, the more certain this "exit" interest-rate spike becomes. If Fed asset losses were to wipe out part of its capital in such an "exit" situation, either the Treasury would have to step in with tens of billions more in taxpayer funds as additional capital—bailing out the Fed!—or the Fed itself would have to lurch back in the direction of even more rapid money-printing—or both. In a word, the Fed may soon become *unable* to exit from the hyperinflationary policy, as many fearful FOMC members are suspecting.

The ***Journal*** had reported Feb. 20 that FOMC members were alarmed that the money-printing policy is causing "excessive risk-taking and instability in financial markets." Bubbles in "junk" corporate bonds and in mortgage-backed securities have zoomed back up again, as in 2005-07.

"Don't sit on the same hot stove twice," is the way Richard Fisher put it, as quoted by the newspaper.

Yalman Onaran, in a **Bloomberg** article titled **"U.S. Banks Bigger Than GDP as Accounting Rift Masks Risk,"** Feb. 19, quoted from an interview with **FDIC vice-chairman Thomas Hoenig** who said that "derivatives, like loans, carry risk. To recognize those bets on the balance sheet would give a better picture of the risk exposures that are there." Hoenig is an advocate of restoring the Glass-Steagall Act (although Bloomberg does not say so).

Onaran reviewed data compiled by Bloomberg that bear out this point, and continued:

"Using international standards for derivatives and consolidating mortgage securitizations, JPMorgan Chase & Co., Bank of America Corp. and Wells Fargo & Co. would double in assets, while Citigroup Inc. would jump 60 percent, third-quarter data show. JPMorgan would swell to $4.5 trillion from $2.3 trillion, leapfrogging London-based HSBC Holdings Plc and Deutsche Bank AG, each with about $2.7 trillion.

"JPMorgan, Bank of America and Citigroup would become the world's three largest banks and Wells Fargo the sixth-biggest. Their combined assets of $14.7 trillion would equal 93 percent of U.S. gross domestic product last year, the data show. Total assets of the country's banking system would be 170 percent of economic output, still lower than 326 percent for Germany.

"U.S. accounting rules for netting derivatives allow banks to erase about $4 trillion in assets, the data show. The lenders also can remove from their books most mortgages they package into securities, trimming an additional $3 trillion."