PRICEVALUEPARTNERS

For god's sake, stop !

"Most economists, it seems, believe strongly in their own superior intelligence and take themselves far too seriously. In his open letter of 22 July 2001 to Joseph Stiglitz, Kenneth Rogoff identified this problem. 'One of my favourite stories from that era is a lunch with you and our former colleague, Carl Shapiro, at which the two of you started discussing whether Paul Volcker merited your vote for a tenured appointment at Princeton. At one point, you turned to me and said, "Ken, you used to work for Volcker at the Fed. Tell me, is he really smart ?" I responded something to the effect of, "Well, he was arguably the greatest Federal Reserve chairman of the twentieth century." To which you replied, "But is he smart like us ?"

- Satyajit Das.

"..Every time a report lands on their desks, central bankers must stop to think about the economic, social and political havoc their policies have caused over the past 10 years.

"The desperate attempt to avoid deflation via quantitative easing and record-low interest rates has had horrible side effects, and this observation is hardly controversial. The rich have become much richer; corporate wealth has become more concentrated; soaring house prices have created intergenerational strife; low yields have made all but the super-rich paranoid that they will be entirely unable to finance their futures. Most markets have ended up overvalued (this will really matter one day), while pension fund deficits and a constant sense of crisis have discouraged capital investment — and have possibly held down wages in the UK.

"Set a target, get a distortion. This is standard stuff. But the fact that extreme monetary policy has been going on for so long means that central bankers do not just have macro problems to feel bad about. They are also effectively responsible for the increasingly dodgy micro policies governments have felt forced to put in place in an attempt to alleviate the nasty side effects of very low interest rates, over which they have no control."

- Merryn Somerset Webb, *Billionaire boom is a sign that rates need to rise*, Financial Times 28.10.17.

In his latest piece for the *Financial Times* ('Central banks alone cannot deliver stable finance' – may require subscription, but seriously, don't bother), Martin Wolf issues his usual apology for the extraordinary recent activity of central bankers, including the radical policy triumvirate of QE, ZIRP and NIRP. His article ends,

> Criticising the success of our central banks in reflating our crisis-hit economies, because this created today's financial risks, is not a valid reaction to their actions. It is, however, an extremely valid criticism of finance. It is also a valid criticism of the failure of governments to address the many frailties that still lead to financial excess. The central banks did their job. Unfortunately, almost nobody else has done theirs.

As has come to be commonplace, almost everything Mr Wolf suggests is incorrect, outrageous, or both. But no sooner had his column appeared on the FT website than it was met with the following response by the blogger MarkGB. It is reprinted below in full, unedited, with the consent of the author.

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Central Banks have done their job?

The Federal Reserve, along with the other CBs, has spent the past 8 years desperately trying to create inflation. This is because the thing that scares the hell out of them is deflation.

Deflation is the 'monster' because in a debt based monetary system new debt has to be constantly created to keep asset values expanding. When asset values shrink, the debt acquired to 'buy' them doesn't - revealing what was hidden all along – insolvency – which leads to contagion – which leads to bailouts – and the process starts all over again. Except that this time the CBs are afraid the monster will be too big to bail out. For once they are right.

This Ponzi scheme serves the interests of two groups of people:

a) Governments – who borrow billions of dollars every month that they cannot acquire through taxation: this is used to bribe 'special interests' with government contracts (military, pharmaceutical, oil etc.), and to bribe the masses with entitlements and benefits. A sizeable proportion is used to pay interest on old debt.

b) Banks – who raise this 'money' for governments by selling their debt into the bond markets, making huge profits in a wide variety of ways: some by performing useful functions, and some that can be summarised as 'front-running', 'insider dealing' and good old-fashioned 'selling crap to muppets'.

Here's what CBs and mainstream economists don't want you to know:

They don't know why they have been unable to create inflation. They've rehashed spurious explanations like 'secular stagnation', and 'savings glut' in an attempt to sound like they do…but they don't.

However, whilst they may not have a clue how the real world works…they do have an uncanny ability to get everything backwards…they are the most 'arse about face' group of people imaginable.

Bernanke, Yellen, Draghi, et al were convinced QE and ZIRP/NIRP would be inflationary because their theories told them that if you loosen monetary conditions – make credit very cheap – consumers will rush out to borrow and spend; businesses will invest to meet the increase in demand; banks will increase lending…and hey presto unemployment will fall, companies will pay more to attract a shrinking pool of workers, and inflation will rise…the Phillips curve will indicate where the sweet spot is…and everything will be fine. Except that it doesn't work that way - the real world has different ideas.

Beyond a certain level of indebtedness, which we reached earlier this decade, the psychology of the markets shifted…not as in 'gear change'…but as in 'tectonic plate'. This is how the shift has affected behaviour:

a) Consumers refuse to buy any more crap that they don't need with money that they don't have. So they 'make do' with what they've got. This used to be called 'common sense'.

b) Business people – who lose their jobs unless they return earnings to shareholders - realise that an economy where the cost of money is zero is artificial and sick. The last thing they have felt emboldened to do, for years now, is to invest in a glowing future that is nowhere in sight. So instead, they borrow to buy back their own shares, which boosts EPS and keeps them sitting round the boardroom table…for now anyway .

c) Savers - a selfish bunch of responsible human beings who are thoroughly disapproved of by economists (a selfish bunch of irresponsible human beings who thoroughly approve of themselves) - rather than thinking 'what's the point in saving at these rates, I'll buy stuff '…think: I'd better save even more to make sure I can support myself in retirement'.

d) Banks, who can make billions from front-running the Federal Reserve, who can park their QE back at the Fed for interest, have no imperative to provide loans to the diminishing number of smaller businesses who are still looking to expand.

In short…QE, ZIRP and NIRP have been deflationary, not inflationary.

When we look at the real economy, we must first debunk the Fed's claim, via the Bureau of Labour Statistics, that unemployment is around 4%. I.E.: that the labour market is 'tight':

There are 255 million Americans of working age. Of these, 102 million are not employed. This represents 40% of the working age population, up from 35% at the millennium. Of those, the percentage of unemployed males in the core group of 25 to 54 is at record highs. Meanwhile the percentage of Americans over 55 who are still in work is soaring…again arse about face…

Of the 153 million Americans who are employed, 26 million are in low wage, part time jobs. Of those, 8 million hold multiple jobs. 10 million people classify themselves as 'self-employed', which includes a large number who are barely scraping by. A further 21 million people work for the government, jobs that generate no revenue, which are therefore funded by private sector taxes.

Jim Quinn of 'The Burning Platform' summarises it thus:

"When it is all said and done, there are approximately 94 million full-time workers in private industry paying taxes to support 102 million non-workers and 21 million government workers. In what world does this represent a strong job market?"

So: there are a lot more people available in the labour market than is suggested by the BLS. So then the question is this: Why aren't businesses hiring them? Why do employment surveys consistently quote employers ticking the box that says 'hard to find workers'?

Here's Jeffrey Snider from Alhambra Investments:

"Let's assume the survey results are correct, and that firms are finding it hard to attract candidates. Coming from the other direction, it's not hard to translate what they are actually saying. In other words, the mainstream always interprets "hard to find workers" as a shortage situation, when that is only one possible interpretation. Since the price of labour over the past decade has barely risen, it isn't, can't be, the most likely one. Instead, there is an unspoken stipulation that is never explicitly stipulated. Businesses are surely finding it difficult to hire good workers at the rate they want to pay today. Obviously, that rate is insufficient so as to clear market demand for supply. Why don't they pay that market-clearing rate? Simple. Because unlike how the economy is talked about in the media, the one always derived from the unemployment rate, actual business is sluggish and uncertain at best. There is no rush to find qualified workers, because in reality the economy is tight - not favourably tight as in no slack in the labour market, but more so tight in that there is little margin for addition."

In summary: the phrase 'labour shortage' is yet more blanket macroeconomic garbage from people who've never had a real job let alone run a business that employs people. The reality in the markets is this: executives are reluctant to pay wages at a market-clearing rate. This is the same reluctance that leads them to buy back shares rather than invest in the future, the same reluctance that leads consumers to pull back and savers to double down:

Economic conditions are poor. We are not in a recovery; we are in a depression, which Keynes defined as an extended period of below trend growth.

Central Banks don't understand the problem because central banks are a very large part of the problem.

[Emphasis mine.]

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You can read more by MarkGB here and his twitter handle is @MarkGBblog.

If you have found value in this commentary, we invite you to share it with your extended network of acquaintances and friends. To all who value free markets and financial stability, this debate could not be more important. Thank you.

We also invite readers to listen to the inaugural podcast of 'The State of the Markets' with myself and the technical analyst Paul Rodriguez, which you can find here. If there is a topic which you would like to raise for discussion on future episodes, we welcome any suggestions.

Tim Price is co-manager of the VT Price Value Portfolio and author of 'Investing through the Looking Glass: a rational guide to irrational financial markets'. You can access a full archive of these weekly investment commentaries here.

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