

THE SUPPLY OF OXEN AT THE FEDERAL RESERVE

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**Are the Fed and the Bank of Japan conspiring to protect the dollar
by propping up the American bond market?**

*"If fiat money... falters, we may have to go back to oxen as our medium of
exchange.
In that event, I trust, the Federal Reserve... will have an adequate inventory of
oxen."
(Alan Greenspan, The History of Money)*

Hey, Mr. Chairman, in case you haven't noticed, the Federal Reserve already has a goodly supply of oxen!

My father was fond of relating a story about a professor lecturing on geography. A short fellow, he was extolling the agriculture of Switzerland. "In our country oxen are not even as tall as I am. In some countries you see oxen just as tall as myself. But, believe it or not, on the fat pastures of Switzerland there are even greater oxen than myself". For emphasis the good professor stood on his tiptoes and stretched his hand upwards above his head. "We don't believe so!" - shouted someone from the back benches of the lecture theater.

The reason for my dusting off this (not at all funny) wisecrack of the Chairman is that a conjecture of mine got published inadvertently. Rather than recanting, I elaborate on it lest there be any misunderstanding about what I mean. In a private letter I have conjectured that a conspiracy may exist between the Federal Reserve and the Bank of Japan. The latter is buying U.S. Treasury paper through the good offices of the former, *over and above* the deficit America is running in its trade accounts with Japan. These highly secret transactions are reported nowhere, as they are on custodial account.

I am well aware that this conjecture can be neither proved nor disproved. The conspiracy, if one exists, is part of the highly classified contingency plan hatched out at the Fed. It calls for bribing (blackmailing?) the Bank of Japan to get its cooperation in forestalling a run on the dollar led by other foreign central banks. If such a run were to take place, it would destroy the dollar as well as the international monetary system, and drive the rate of interest to stratospheric heights, rendering the Japanese hoard of American paper worthless.

The run is widely expected by many a knowledgeable observer, and the bond market is girding itself for a rise in interest rates more vicious than that 25 years ago. The obituary of the bull market in bonds has in fact been written already by the world's foremost bond trader, Pimco's Bill Gross. However the market, like Mark Twain reading his own obituary, talked back saying: "the reports of my demise are Grossly exaggerated". Chances are that this particular bull, taunted by the oxen at the Fed, is getting ready for another run.

The conjecture is eminently plausible. Why, the Chairman of the Fed is so well conditioned that, even while thinking the unthinkable, the faltering of the irredeemable dollar, he will not think of gold. He compulsively thinks of oxen as the obvious alternative for defunct fiat money. Any

contingency plan prepared under his watch must likewise ignore gold. I hereby issue a challenge for anybody to come up with a better contingency plan to save the moribund dollar (barring to make it gold-redeemable) than conspiring with the Bank of Japan to extend the bull-run in bonds in order to massacre the Cassandras, on either side of the Pacific, who bet on the collapse of the American bond market.

The conspiracy may be to the liking of the Bank of Japan which has a reputation of dealing most ruthlessly with speculators who oppose its policy of a weak yen. It prints yens clandestinely at no cost to itself. The Bank's acquisition of bonds is therefore a windfall. Thrown in as a bonus is the appreciation of the Bank's inordinate hoard of bonds in the wake of falling American interest rates. These bonds were accumulated during earlier decades, in consequence of the U.S. government twisting the Bank's arm not to buy gold with unwanted dollars, which is what Charles De Gaulle would have done. The Japanese know only too well that their hoard is so enormous that the chances of getting rid of it in case of a dollar crisis are nil.

But isn't this conspiracy, if it exists, immoral? Yes, of course it is! It is the epitome of the total depravity of the fiat money regime. Printing yens to support productive enterprise is one thing; printing yens to support bond speculators who have insider knowledge is another. It must also be clear that, if such a conspiracy exists, it is nothing but a rape of the American taxpayer who will have to be skinned alive by the Treasury to pay the maturing coupons on the bonds given away by the Fed.

I have said that the Bank of Japan in printing the yens was supporting bond speculators with insider knowledge. That's right, there is a huge speculative scheme afoot called the yen carry-trade. Speculators borrow yens at 1.5%, sell them for dollars, and buy U.S. Treasury bonds yielding up to 5%. Not only do they pocket the difference, they are also the beneficiaries of the huge appreciation of bond prices in the wake of the falling dollar rate of interest. That is no conjecture. That is a fact. The conjecture is that speculators are acting on insider information. The conspiracy of the Fed and the Bank of Japan provides the favorable back-wind to their speculation which, without it, would be nothing short of suicidal. But with the back-wind, it is extremely profitable, especially in view of the weak dollar which improves the terms of trade of yen sellers and dollar buyers beyond their wildest dreams.

This takes us back to the supply of oxen at the Fed. If the conjecture is correct, the Fed has engineered a scheme to push the rate of interest lower in defiance of the falling dollar. Such a policy is bovine. It spells disaster. It stokes the fires of deflation as I shall now explain.

Let's define inflationary spiral under Kondratiev's long-wave cycle as the decades-long rise of prices *and* interest rates, and deflationary spiral as their similarly long fall. Interest rates may lead and prices may lag, or the other way round. The important thing is linkage. *The long-term movements of prices and interest rates are inevitably linked.* Linkage epitomizes a huge oscillating money-flow back-and-forth between the bond and the commodity markets. When the money-tide begins to flow at the commodity market and ebb at the bond market, we have the inflationary spiral. When it is reversed and flows at the bond and ebbs at the commodity market, we have the deflationary spiral.

Chairman Greenspan in a speech on the History of Money, from which I took the quotation above as well as the title of this article, congratulates himself and his central banker colleagues in other countries for "the success in containing inflation during the past two decades and raising hopes that fiat money can be managed in a responsible way." This is akin to the surfer on the beach boasting that he has turned the flow of the tide back through skillful surfing. What the Chairman calls "containing inflation" is nothing but the receding money-tide from the commodity market that started in 1980, now flowing at the bond market. The Chairman did not cause it but could make it a lot worse and more devastating. In particular, if such a conspiracy between the Fed and the

Bank of Japan exists, the receding money-tide could become a tsunami, repetition of the Great Depression of the 1930's wiping out sound businesses and the life savings of most people.

A bull market in bonds is the *sine qua non* of the deflationary spiral. Deflation is greatly aggravated by central bank intervention in putting more money in circulation through open market purchases of bonds. The central bank hopes that the new money will flow to the commodity market. Speculators forestall it buying the bonds first. The new money, thus intercepted and diverted, flows to the bond market, instead of the commodity market as hoped by the central bank. Interest rates fall, and linkage makes prices to fall with them. Contra-cyclical policy backfires. No wonder, its author, Keynes, was ignorant of the linkage. If the conjecture about the conspiracy between the Fed and the Bank of Japan is correct, *there is an insatiable demand for dollars, especially for falling ones, by bond speculators*. The Fed is the quartermaster general for the coming depression that may make the Great Depression rather tame in comparison.

In 1980 the dollar had a close brush with sudden death. It was saved, barely, by the shock-therapy of ultra-high interest rates, quite openly administered by Chairman Volcker. The dollar now appears to have another death-spell. Is it possible that there is a similarity between the two episodes, except this time the attempt to save the dollar will be through the shock-therapy of ultra-low interest rates, clandestinely administered by Chairman Greenspan? If so, it won't save the dollar, only prolong the agony.

In his History of Money speech Chairman Greenspan observes that "savers have been in sufficient abundance since the beginning of the Industrial Revolution to enable investment to further material well-being. Money, as a store of value, was an early facilitator of savings and one of the great inventions of mankind. The history of money is the history of civilization or, more exactly, of some important civilizing values." We may add that it was the savings of the people that has made America great. In the nineteenth century the American people working hard and saving hard created an economic and financial giant on the continent. America was the world's greatest creditor nation. Now, America is a financial and economic dwarf. It has dismantled its great industries with the exception of the industry producing military hardware. Now the capital, embodying the great savings of earlier generations, is being dissipated. Now, thanks mainly to Chairman Greenspan's long tenure, America is the world's greatest debtor nation. Now, savers in America are no longer in abundant supply. In fact they are an endangered species, at the verge of extinction. Now, the dollar is no longer a store of value. It is a certificate of guaranteed confiscation of value. The most recent history of money is a history of decline of civilizing values.

In his speech Chairman Greenspan related a story. He had met a friend and told him about the speech he was going to make on the history of money. The friend's response was: "I know all about the history of money. When I get some, it's soon history." He could have added: "And if I save some, its *value* is soon history!" The Chairman called his friend "spendthrift". He failed to mention that it was precisely his policies at the Fed that had made his friend, and many millions of others, spendthrift by turning the dollar into the peso of a banana-consuming republic.

Chairman Greenspan said in his speech that "the early history of the post-Bretton Woods system of generalized fiat money was plagued, as we all remember, by excess money issuance." The cheek of the kettle that dares to call the pot black! The excess money issuance under all his predecessors combined is eclipsed by the excess money issuance during this Chairman's tour of duty at the Fed! Nor can he have the excuse that he was misled by the siren-song of the welfare state. As his earlier article "Gold and Economic Freedom" will testify, he is one of the precious few who understands the gold-freedom nexus.

The Chairman is traitor to the cause of sound money.

References

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