THERE IS MORE
WHERE THIS GIFT HAS COME FROM

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On Wednesday, March 18, another handsome gift was delivered by the Fed to the bond bulls. It was the announcement that the Open Market Committee has made a unanimous decision for the central bank to buy \$300 billion in long-term Treasury bonds and notes over the next six-month period. The yield on the 30-year Treasury bond immediately fell from 3.8% to 3.5%, while the yield on the benchmark 10-year Treasury note fell more: from 3% to 2.53%, increasing the price of the note by $4^{2}/_{32}$ from $97^{26}/_{32}$ to $101^{28}/_{32}$, the biggest one-day rise in years. The gift of risk-free profits is granted to the bond bulls through courtesy of the Fed, in telling them in advance about its intention of buying long-dated government debt.

Note that in the past Fed purchases of long-term Treasurys have been exceedingly rare. The last time the Fed resorted to it was in 1959. But half-a-century ago it was not meant to be a permanent fixture of monetary policy. This time is different. Wednesday's announcement is the opening salvo in a brand new game of serial interest-rate cuts in the high-end of the yield-curve now that the Fed has chewed up the low end. It has used up all its ammunition in the short-term T-bill market where the rate is only microscopically greater than zero, rendering the Fed helpless and impotent. A new bag of tricks is coming into play: the monetization of long-term government debt. The market tells it all. The dollar index fell 3%, the biggest drop in more than two decades.

Actually, as I have suggested in several earlier articles, 'serial *cutting* of interest rates' is a misnomer. The correct phrase is 'serial *halving* of interest rates'. The nuance is important. Serial cutting comes to an end when you have cut it to the bare bones: all the way back to zero. Not so serial halving that can be fine-tuned like water-torture. It can continue indefinitely, while each halving causes the same devastation in the economic landscape as it doubles the liquidation value of total debt.

Central banks in Japan and the United Kingdom have announced similar monetary policies. The Bank of Japan has said that it will increase its volume of bond purchases by 30%. According to Mr. Shiraskawa, the governor of the bank, "bond purchases are not intended to finance the Japanese government's spending. That would be too dangerous." Who is the governor kidding? As long as the Japanese government spends more than its revenue from taxes, every act of buying a government bond is an act of financing the government. Even in Switzerland, the paragon of monetary and fiscal rectitude, where the Swiss National Bank is hard put to find a government bond it can buy, they have to do something to enter the mad race to find out which country can increase the money supply at the fastest rate. The Swiss are resourceful: since they cannot increase the money supply through purchases of bonds, they will increase it through sales of Swiss francs. All masks are off. The Swiss will not let others outbid them in the game of bidding *down* the value of national currencies around the globe. This is competitive currency debasement at its most vicious. It is a cover-up for the underlying trade war.

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Why should we worry about a monetary policy that depends on risk-free profits offered to speculators betting on higher bond values? Because it reflects the utter corruption of the profit-and-loss system on which capitalist production is based. It makes the businessman appear foolish who takes risks in the producing sector while trying to satisfy the needs of the consumers – when risk-free profits are available in the financial sector. As a matter of fact, the risk-free profits of the bond bulls do not come out of nowhere. They come right out of the capital accounts of the producers. These gains are the flipside of the capital losses suffered by the real risk-takers, the sitting ducks in this shoot-out.

I have been in a minority of one in my quest to inform the public about the *single* cause of the present economic disaster. In fact I have been predicting it for the past eight years. The single cause is the Fed's deliberate policy to drive down interest rates through serial halving. This policy is animated by the economic theories of John Maynard Keynes, according to which interest ought to be abolished so that the stone can be turned into bread and water into wine. The miracle is worked by a central bank well-equipped with printing presses and a factory to produce green cheese in unlimited quantities, to shove it down the throats of savers who are trying to provide for their twilight years, or for the education of their offspring, or just for a rainy day.

Continuing or even accelerating that disastrous monetary policy of unlimited green cheese production will not alleviate the crisis. It will make it worse. Much worse.

Look at it this way. The present contraction of the world economy is not due to a glut in global savings for which businessmen can find no good use, and which consequently has to be mopped up through expanding the balance sheet of the central banks all over the world, as "explained" by Paul Krugman and his friend, mentor, and former boss Ben Bernanke. The contraction is due to the lethargy of businessmen who see their past investments turn sour one after another at each interest-rate cut. *Businessmen will not make new investments, no matter how badly central bankers want to force-feed them at the trough of newly created money, as long as the mad driving-down of interest rates continues.* Would you buy a car today if you were told that its price will be cut tomorrow? Of course you wouldn't. Well, it is the same with businessmen. *They would not make an investment today if they were told that tomorrow they could finance it at a cheaper rate and, the day after tomorrow at a rate cheaper still*. It is as simple as that.

Now the Fed is saying that it has got a new toy-grenade to try on the economy: the T-bond purchase plan. Businessmen conclude that this is time to go into hibernation-mode. They just want to survive with their remaining capital intact until this madness runs its full course. They will come back and start investing again in saner times, when interest rates are stabilized at their natural level. Those who listen to the siren song from the Fed and other central banks, and invest at today's teaser-rate will get massacred at the next halving, when even lower teaser rates will be offered.

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What we are witnessing is the closing of Keynes' system. This system is based on the worst fallacy ever embraced by pretenders and impostors in science: the fallacy, inspired by Karl Marx, of over-saving and under-consumption. It was under this banner that the Fed introduced its illegal policy of open market purchases of government bonds that would be legalized retroactively later. But with this *coup d'etat* the Fed shot itself in the foot. It has forgotten to take the reaction of bond speculators into account. Of course, speculators would not sit idly by when they are told that, as a matter of high monetary policy, the Fed will have to make periodic trips to the bond market to purchase its quota of government bonds. Of course speculators would want to pre-empt the Fed. Of course they wanted to buy first so that they could dump their bonds on the Fed at a profit later. Of course bond speculators would lie in wait for the Fed and ambush it at the moment it was ready to pick up its next quota of government bonds in the open market.

The present monetary system promises risk-free profits to bond speculators. This guarantees that the interest rate structure will keep falling indefinitely. Astute businessmen who understand the interaction between finance and production will stay on the sidelines. They will not join the mad tea party of teaser rates whether offered in the subprime mortgage market or whether offered on loans to finance future production. Teaser rates are there to tempt individuals and businesses to commit hara-kiri.

This raises the question just how sound a monetary system is that wants to create money, lots of it, but can only do it through bribes and blackmails. This also raises the question how it is possible to treat Keynes' system with respect.

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Mine is a cry in the wilderness. You had thought that the political system was rotten as it was a system of bribes, blackmails, and vote-buying facilitated by irredeemable currency. You had thought that the judiciary was rotten as no complaint about the fraud involved in the check-kiting conspiracy between the Treasury and the Fed would ever be heard in a court. You had thought that victims of the Ponzi-scheme whereby the government would sell bonds, which it had neither the means nor the intention to pay off, could have their day in court.

But look: the educational system, our only hope for the future, is equally rotten. Its faculties of criticism are so badly disabled that one can no longer hope for an open discussion of burning issues. Keynesians, in concert with their Friedmanite comrades, control everything: monetary policy, fiscal policy, the judiciary, appointments and the research agenda at universities and other think-tanks, the publication programs in the editorial offices of scholarly journals. A Cassandra such as myself would never get a hearing before the disaster struck.

Now, as it turns out, I won't get a hearing even *after* disaster has struck. Keynesians and their Friedmanite cronies want to control the rescue effort and they certainly do not want to see their past errors and misdeeds, that lie at the root of the problem, exposed to public scrutiny.

The economic and financial crisis that is plaguing the world is extremely serious. Damage to the social fabric could be even greater than that during the Great Depression. But a reasoned, high-level discussion on the genesis of the crisis is ruled out. You have to buy the official crap on the global savings glut. You are not allowed to challenge the official dogma of under-consumption even after the most wasteful episode of over-consumption in history, running up private and public debt to stratospheric heights.

The present crisis is about past, present, and future destruction of capital due to the Keynesians' deliberate policy of driving down interest rates. Education of public opinion about these matters is sorely needed. Keynesians have been successful in convincing the public that their monetary policy to drive down interest rates is a blessing. But the truth is that falling interest rates erode capital, because the return from earlier investments proves insufficient to amortize debt contracted at higher rates. At the end of the capital erosion road comes the realization that production and finance stands bereft of any capital. The result is a credit collapse that can no longer be covered up with the usual Keynesian nostrums

My conclusion is that the latest move of the Fed is going to entrench deflation through entrenching the trend of falling interest rates. The mechanism works through bond speculation, making risk-free capital gains available to speculators, who will then bid up bond prices unopposed to any high level.

Other observers may violently disagree with this view. For example Clive Maund had this to say: “So Treasuries spiked yesterday [on March 18], but the large gains were almost entirely erased by the drop in the dollar… So in an environment where the Fed and the Treasury are going to have to create dollars, i.e., to dilute the currency, to prop up financial instruments… who but a complete imbecile is going to buy them?… The Treasury market will collapse in due course anyway despite, and perhaps even because of, the Fed’s desperate and reckless attempts to backstop it.”

Not so fast, please. Ultimately the market for Treasury bonds will collapse in a hyper-inflationary scenario, but this may be years down the road. In the meantime we have to face the music that keeps the game of musical chairs going: the serial halving of interest rates to enable bond speculators to earn risk-free profits. This stokes the fires of deflation, not the fires of inflation. Obituaries of the dollar are written prematurely. The death throes of the Dollar Almighty, as the U.S. currency was known not so long ago, will continue for quite a while yet and, unfortunately, will cause a lot more damage to the world economy, and a lot more economic pain to ordinary people.

It is an inane and malicious Keynesian propaganda that falling interest rates are good for the economy, for you, for me, for business. On the contrary, they are lethal. Only *low and stable* interest rates can help us to get out of the present mess – an unachievable goal under the regime of irredeemable currency.

Reference

By the same author: *That Accursed Propensity To Save,* March 9, 2009, www.professorfekete.com .

Calendar of events

Szombathely, Martineum Academy, Hungary, March 27-29, 2009

Encore Session of Gold Standard University Live.

Topics: *When Will the Gold Standard Be Released from Quarantine?*
The Continuing Vaporization of the Derivatives Tower
Labor and Great Depression II
Silver in Backwardation: What Does It All Mean?

Further details: GSUL@t-online.hu

This conference is the swan song of GSUL which has been succeeded by the Gold Standard Institute. For information about the latter contact: philipbarton@goldstandardinstitute.com

Instituto Juan de Mariana, Madrid, Spain, June 18, 2009

Gold & Silver Meeting Madrid 2009. This one-day conference will be followed by a three-day seminar. For more information, contact: gcalzada@juandemariana.org

San Francisco School of Economics, July 15-August 31, 2009

Money and Banking, a ten-week course based on the work of Professor Fekete who will be delivering 18 of the 20 lectures. Enrolment is limited; first come, first served.. The Syllabus for this course can be seen on the website: www.professorfekete.com as well as that of the school: www.sfschoolofeconomics.com

National University of Australia, Canberra, November, 2009

Peace and Progress through Prosperity: Gold Standard in the 21st Century
This is the first conference organized by the newly formed Gold Standard Institute.
For information please e-mail: feketeaustralia@gmail.com

Professorfekete on DVD: Professionally produced DVD recording of the address before the Economic Club of San Francisco on November 4, 2008, entitled *The Revisionist History of the Great Depression: Can It Happen Again?* plus an interview with Professor Fekete, is available from www.Amazon.com and from the Club www.economicclubsf.com at $14.95 each.

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