

Crony capitalism strikes again: The Federal Reserve juices speculators

By [David Stockman](#)

Global Research, April 06, 2011

[MarketWatch](#) 6 April 2011

Region: [USA](#)

Theme: [Global Economy](#)

This is part one of a two-part series by David Stockman.

Someone has to stop the Federal Reserve before it crushes what remains of America's Main Street economy.

In the last few weeks alone, it launched two more financial sector pumping operations which will harm the real economy, even as these actions juice Wall Street's speculative humors.

First, joining the central banking cartels' market rigging operation in support of the yen, the Fed helped bail-out carry traders from a savage short-covering squeeze. Then, green lighting the big banks for another go-round of the dividend and share-buyback scam, it handsomely rewarded options traders who had been front-running this announcement for weeks.

Indeed, this sort of action is so blatant that the Fed might as well just look for a financial vein in the vicinity of 200 West St., and proceed straight-away to mainline the trading desks located there.

In any event, the yen intervention certainly had nothing to do with the evident distress of the Japanese people. What happened is that one of the potent engines of the global carry-trade — the massive use of the yen as a zero cost funding currency — backfired violently in response to the unexpected disasters in Japan.

Accordingly, this should have been a moment of condign punishment — wiping out years of speculative gains in heavily leveraged commodity and emerging market currency and equity wagers, and putting two-way risk back into the markets for so-called risk assets.

Instead, once again, speculators were reassured that in the global financial casino operated by the world's central bankers, the house is always there for them—this time with an exchange rate cap on what would otherwise have been a catastrophic surge in their yen funding costs.

Is it any wonder, then, that the global economy is being pummeled by one speculative tsunami after the next? Ever since the latest surge was triggered last summer by the Jackson Hole smoke signals about QE2, the violence of the price action in the risk asset flavor of late — cotton, met coal, sugar, oil, coffee, copper, rice, corn, heating oil and the rest — has been stunning, with moves of 10% a week or more.

In the face of these ripping commodity index gains, the Fed's argument that surging food

costs are due to emerging market demand growth is just plain lame. Was there a worldwide fasting ritual going on during the months just before the August QE2 signals when food prices were much lower? And haven't the EM economies been growing at their present pace for about the last 15 years now, not just the last seven months?

Similarly, the supply side has had its floods and droughts — like always. But these don't explain the price action, either. Take Dr. Cooper's own price chart during the past 12 months: last March the price was \$3.60 per pound — after which it plummeted to \$2.80 by July, rose to \$4.60 by February and revisited \$4.10 per pound.

That violent round trip does not chart Mr. Market's considered assessment of long-term trends in mining capacity or end-use industrial consumption. Instead, it reflects central bank triggered speculative tides which begin on the futures exchanges and ripple out through inventory stocking and de-stocking actions all around the world — even reaching the speculative copper hoards maintained by Chinese pig farmers and the vandals who strip-mine copper from the abandoned tract homes in Phoenix.

The short-covering panic in the yen forex markets following Japan's intervention, and the subsequent panicked response by the central banks, wasn't just a low frequency outlier — the equivalent of an 8.9 event on the financial Richter scale. Rather, it is the predictable result of the lunatic ZIRP monetary policy which has been pursued by the Bank of Japan for more than a decade now-and with the Fed, BOE and ECB not far behind.

Thinking beyond the Fortune 500 for women

Claudia Goldin tells WSJ's Alan Murray that women are making their way to the top at many Ivy League schools. Plus: Saadi Zahidi of the World Economic Forum discusses how women in foreign countries are contributing to their nations' economies.

Japan has been suffering from a real estate asset deflation which followed the collapse of its spectacular 1980's financial bubble — but not price deflation on consumer goods and services. In fact, Japan's headline CPI index was 94.1 in 1990 compared to 99.8 during the last quarter of 2010. Thus, during the past 20 years there has been a slight CPI inflation (0.3% annually) — notwithstanding the incessant deflation-fear mongering of the Keynesian commentariat.

To be sure, Japan's so-called "core" CPI is down several points during that long period, but by all accounts the Japanese people have been eating, driving and heating their homes for the past two decades on a regular basis. Accordingly, they have paid slightly more for mostly imported food and energy and slightly less for everything else. But the overall consumer price index has been flat, meaning that real interest rates have been zero for the better part of a decade now.

And that's the evil. Free money has not reflatated domestic real estate because Japan's bubble era prices were absurdly high and can't be regained, and because Japanese real estate — both residential and commercial — is still heavily burdened with debt which cannot be repaid. Yet market economies — even Japan's cartelized kind — are not disposed to look a gift horse in the mouth. Free money always finds an outlet, and the pathway of choice has been the transformation of the yen into a global "funding" currency.

This sounds antiseptic enough, but it means that in its wisdom the BOJ has invited the whole

world — everyone from Mr. and Mrs. Watanabe to state-of-the-art London hedge fund traders — to short the yen in order to finance speculations in the Aussie dollar, the big iron and copper miners, cotton futures, the Brent/WTI spread, and an endless procession of like and similar speculative cocktails. Yet as the speculators rotate endlessly from one risk asset class to the next they can remain supremely confident that their yen carry cost will remain virtually zero. Yen interest rates will not go up because the BOJ is intellectually addicted to ZIRP, and because, in any event, it dare not surprise the market with an interest rate hike, thereby triggering a violent unwind of the yen carry trades it has fostered

In short, the BOJ is sitting on a financial fault line. The post-intervention rip to 76 yen to the dollar was not the work of a fat finger; instead, it represented a real-time measure of the furies bottled up in the system due to Japan's foolish rental of its "funding currency" to global speculators. Having long ago urged the BOJ to embrace this absurd monetary policy, it is not uprising that Bernanke and his confederates have come to the rescue—for the moment.

It is only a matter of time, however, before the yen explodes under the accumulated short seller's pressure, and then the lights will really go out on Japan Inc. In the meanwhile, ordinary people the world around will get less food per dollar from Wal-Mart Stores Inc. (NYSE:WMT) and speculators, basking in the wealth effect, will have even more dollars to spend at Tiffany & Co. (NYSE:TIF)

In this context, there can also be little doubt that the Fed is trying really hard to transform the dollar into a funding currency, too. In the name of fighting a phantom deflation, the nation's central bank has kept interest rates absurdly low—transforming the dollar into a weakling even against the misbegotten Euro, and therefore something which speculators can more safely short.

But just like the case of Japan, there is no sign of CPI deflation in the U.S. Our headline CPI index has gone from 130.7 in 1990 to 218.1 in 2010 — marking a 2.6% annual inflation over the past two decades. And, no, it hasn't slowed down much during the Bernanke era of deflation phobia.

The headline CPI index has risen at a 2.4% rate in the last 10 years, hardly a measureable de-acceleration; and it has gained at a 2.2% rate in the last five years — a rate at which, as Paul Volcker right observed, the purchasing power of the dollar would be cut in half during the typical American's working lifetime. Even since the alleged June 2009 recession bottom, the headline CPI has climbed at a 2.1% annual rate.

So there is no deflation — just a simulacrum of it based on the observation that the CPI less food and energy has randomly fluttered around the flat-line on several recent monthly readings. It is not obvious, of course, that the rise of this index at a 1.1% annual rate during the last 20 months of recovery is a bad thing — for at that rate we begin to approach the idea of honest money. But the spurious circular logic of the Fed's focus on this inflationless inflation index is self-evident upon cursory examination of its internals.

Fully 40% of the CPI less food and energy is owner's equivalent rent—the one price that is actually deflating and which is doing so precisely due to the Fed's own policies. Residential rents are falling or flat because the market is being battered with a) millions of involuntary rental supply units owing to the wave of home mortgage foreclosures, and b) an extraordinary shrinkage in the number of rental units demanded due to the doubling-up,

and even tripling-up, of destitute households.

Part two of this column will be published next week.

David Stockman is a former member of the House of Representatives and a member of the Reagan administration. He currently owns his private equity fund, Heartland Industrial Partners, L.P

The original source of this article is [MarketWatch](#)

Copyright © [David Stockman](#), [MarketWatch](#), 2011

[Comment on Global Research Articles on our Facebook page](#)

[Become a Member of Global Research](#)

Articles by: [David Stockman](#)

Disclaimer: The contents of this article are of sole responsibility of the author(s). The Centre for Research on Globalization will not be responsible for any inaccurate or incorrect statement in this article. The Centre of Research on Globalization grants permission to cross-post Global Research articles on community internet sites as long the source and copyright are acknowledged together with a hyperlink to the original Global Research article. For publication of Global Research articles in print or other forms including commercial internet sites, contact: publications@globalresearch.ca

www.globalresearch.ca contains copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available to our readers under the provisions of "fair use" in an effort to advance a better understanding of political, economic and social issues. The material on this site is distributed without profit to those who have expressed a prior interest in receiving it for research and educational purposes. If you wish to use copyrighted material for purposes other than "fair use" you must request permission from the copyright owner.

For media inquiries: publications@globalresearch.ca