Federal Reserve sets stage for Weimar-style Hyperinflation

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The Federal Reserve has bluntly refused a request by a major US financial news service to disclose the recipients of more than $2 trillion of emergency loans from US taxpayers and to reveal the assets the central bank is accepting as collateral. Their lawyers resorted to the bizarre argument that they did so to protect 'trade secrets.' Is the secret that the US financial system is de facto bankrupt? The latest Fed move is further indication of the degree of panic and lack of clear strategy within the highest ranks of the US financial institutions. Unprecedented Federal Reserve expansion of the Monetary Base in recent weeks sets the stage for a future Weimar-style hyperinflation perhaps before 2010.

On November 7 Bloomberg filed suit under the US Freedom of Information Act (FOIA) requesting details about the terms of eleven new Federal Reserve lending programs created during the deepening financial crisis.

The Fed responded on December 8 claiming it's allowed to withhold internal memos as well as information about 'trade secrets' and 'commercial information.' The central bank did confirm that a records search found 231 pages of documents pertaining to the requests.

The Bernanke Fed in recent weeks has stepped in to take a role that was the original purpose of the Treasury's $700 billion Troubled Asset Relief Program (TARP). The difference between a Fed bailout of troubled financial institutions and a Treasury bailout is that central bank loans do not have the oversight safeguards that Congress imposed upon the TARP. Perhaps those are the 'trade secrets the hapless Fed Chairman,Ben Bernanke, is so jealously guarding from the public.

Coming hyperinflation?

The total of such emergency Fed lending exceeded $2 trillion on Nov. 6. It had risen by an astonishing 138 percent, or $1.23 trillion, in the 12 weeks since Sept. 14, when central bank governors relaxed collateral standards to accept securities that weren't rated AAA. They did so knowing that on the following day a dramatic shock to the financial system would occur because they, in concert with the Bush Administration, had decided to let it occur.

On September 15 Bernanke, New York Federal Reserve President, Tim Geithner, the new Obama Treasury Secretary-designate, along with the Bush Administration, agreed to let the fourth largest investment bank, Lehman Brothers, go bankrupt, defaulting on untold billions worth of derivatives and other obligations held by investors around the world. That event, as is now widely accepted, triggered a global systemic financial panic as it was no longer clear to anyone what standards the US Government was using to decide which institutions were 'too big to fail' and which not. Since then the US Treasury Secretary has reversed his policies on bank bailouts repeatedly leading many to believe Henry Paulson and the Washington Administration along with the Fed have lost control.

In response to the deepening crisis, the Bernanke Fed has decided to expand what is technically called the Monetary Base, defined as total bank reserves plus cash in circulation, the basis for potential further high-powered bank lending into the economy. Since the Lehman Bros. default, this money expansion rose dramatically by end October at a year-year rate of growth of 38%, has been without precedent in the 95 year history of the Federal Reserve since its creation in 1913. The previous high growth rate, according to US Federal Reserve data, was 28% in September 1939, as the US was building up industry for the evolving war in Europe.

By the first week of December, that expansion of the monetary base had jumped to a staggering 76% rate in just 3 months. It has gone from $836 billion in December 2007 when the crisis appeared contained, to $1,479 billion in December 2008, an explosion of 76% year-on-year. Moreover, until September 2008, the month of the Lehman Brothers collapse, the Federal Reserve had held the expansion of the Monetary Base virtually flat. The 76% expansion has almost entirely taken place within the past three months, which implies an annualized expansion rate of more than 300%.

Despite this, banks do not lend further, meaning the US economy is in a depression free-fall of a scale not seen since the 1930's. Banks do not lend in large part because under Basle BIS lending rules, they must set aside 8% of their capital against the value of any new commercial loans. Yet the banks have no idea how much of the mortgage and other troubled securities they own are likely to default in the coming months, forcing them to raise huge new sums of capital to remain solvent. It's far 'safer' as they reason to pass on their toxic waste assets to the Fed in return for earning interest on the acquired Treasury paper they now hold. Bank lending is risky in a depression.

Hence the banks exchange $2 trillion of presumed toxic waste securities consisting of Asset-Backed Securities in sub-prime mortgages, stocks and other high-risk credits in exchange for Federal Reserve cash and US Treasury bonds or other Government securities rated (still) AAA, i.e. risk-free. The result is that the Federal Reserve is holding some $2 trillion in largely junk paper from the financial system. Borrowers include Lehman Brothers, Citigroup and JPMorgan Chase, the US's largest bank by assets. Banks oppose any release of information because that might signal 'weakness' and spur short-selling or a run by depositors.

Making the situation even more drastic is the banking model used first by US banks beginning in the late 1970's for raising deposits, namely the acquiring of 'wholesale deposits' by borrowing from other banks on the overnight interbank market. The collapse in confidence since the Lehman Bros. default is so extreme that no bank anywhere, dares trust any other bank enough to borrow. That leaves only traditional retail deposits from private and corporate savings or checking accounts.

To replace wholesale deposits with retail deposits is a process that in the best of times will take years, not weeks. Understandably, the Federal Reserve does not want to discuss this. That is clearly also behind their blunt refusal to reveal the nature of their $2 trillion assets acquired from member banks and other financial institutions. Simply put, were the Fed to reveal to the public precisely what 'collateral' they held from the banks, the public would know the potential losses that the government may take.

Congress is demanding more transparency from the Federal Reserve and US Treasury on its bailout lending. On December 10 in Congressional hearings by the House Financial Services Committee, Representative David Scott, a Georgia Democrat, said Americans had 'been bamboozled,' slang for defrauded.

Hiccups and Hurricanes

Fed Chairman Ben S. Bernanke and Treasury Secretary Henry Paulson said in September they would meet congressional demands for transparency in a $700 billion bailout of the banking system. The Freedom of Information Act obliges federal agencies to make government documents available to the press and public.

In early December the Congress oversight agency, GAO, issued its first mandated review of the lending of the US Treasury's $700 billion TARP program (Troubled Asset Relief Program). The review noted that in 30 days since the program began, Henry Paulson's office had handed out $150 billion of taxpayer money to financial institutions with no effective accountability of how the money is being used. It seems Henry Paulson's Treasury has indeed thrown a giant 'tarp' over the entire taxpayer bailout.

Further adding to the troubles in the world's former financial Mecca, the US Congress, acting on largely ideological grounds, shocked the financial system when it refused to give even a meager $14 billion emergency loan to the Big Three automakers-General Motors, Chrysler and Ford.

While it is likely that the Treasury will extend emergency credit to the companies until January 20 or until the newly elected Congress can consider a new plan, the prospect of a chain-reaction bankruptcy collapse of the three giant companies is very near. What is being left out of the debate is that those three companies account for a combined 25% of all US corporate bonds outstanding. They are held by private pension funds, mutual funds, banks and others. If the auto parts suppliers of the Big Three are included, an estimated $1 trillion of corporate bonds are now at risk of chain-reaction default. Such a bankruptcy failure could trigger a financial catastrophe which would make what has happened since Lehman Bros. appear as a mere hiccup in a hurricane.

As well, the Federal Reserve's panic actions since September, by their explosive expansion of the monetary base, has set the stage for a Zimbabwe-style hyperinflation. The new money is not being 'sterilized' by offsetting actions by the Fed, a highly unusual move indicating their desperation. Prior to September the Fed's infusions of money were sterilized, making the potential inflation effect 'neutral.'

Defining a Very Great Depression

That means once banks begin finally to lend again, perhaps in a year or so, that will flood the US economy with liquidity in the midst of a deflationary depression. At that point or perhaps well before, the dollar will collapse as foreign holders of US Treasury bonds and other assets run. That will not be pleasant as the result would be a sharp appreciation in the Euro and a crippling effect on exports in Germany and elsewhere should the nations of the EU and other non-dollar countries such as Russia, OPEC members and, above all, China not have arranged a new zone of stabilization apart from the dollar.

The world faces the greatest financial and economic challenges in history in coming months.

The incoming Obama Administration faces a choice of literally nationalizing the credit system to insure a flow of credit to the real economy over the next 5 to 10 years, or face an economic Armageddon that will make the 1930's appear a mild recession by comparison.

Leaving aside what appears to have been blatant political manipulation by the present US Administration of key economic data prior to the November election in a vain attempt to downplay the scale of the economic crisis in progress, the figures are unprecedented. For the week ended December 6 initial jobless claims rose to the highest level since November 1982. More than four million workers remained on unemployment, also the most since 1982 and in November US companies cut jobs at the fastest rate in 34 years. Some 1,900,000 US jobs have vanished so far in 2008.

As a matter of relevance, 1982, for those with long memories, was the depth of what was then called the Volcker Recession. Paul Volcker, a Chase Manhattan appendage of the Rockefeller family, had been brought down from New York to apply his interest rate 'shock therapy' to the US economy in order as he put it, 'to squeeze inflation out of the economy.' He squeezed far more as the economy went into severe recession, and his high interest rate policy detonated what came to be called the Third World Debt Crisis. The same Paul Volcker has just been named by Barack Obama as chairman-designate of the newly formed President's Economic Recovery Advisory Board, hardly grounds for cheer.

The present economic collapse across the United States is driven by the collapse of the $3 trillion market for high-risk sub-prime and Alt-A home mortgages. Fed Chairman Bernanke is on record stating that the worst should be over by end of December. Nothing could be farther from the truth, as he well knows. The same Bernanke stated in October 2005 that there was 'no housing bubble to go bust.' So much for the predictive quality of that Princeton economist. The widely-used S&P Schiller-Case US National Home Price Index showed a 17% year-year drop in the third Quarter, trend rising. By some estimates it will take another five to seven years to see US home prices reach bottom. In 2009 as interest rate resets on some $1 trillion worth of Alt-A US home mortgages begin to kick in, the rate of home abandonments and foreclosures will explode. Little in any of the so-called mortgage amelioration programs offered to date reach the vast majority affected. That process in turn will accelerate as millions of Americans lose their jobs in the coming months.

John Williams of the widely-respected Shadow Government Statistics report, recently published a definition of Depression, a term that was deliberately dropped after World War II from the economic lexicon as an event not repeatable. Since then all downturns have been termed 'recessions.' Williams explained to me that some years ago he went to great lengths interviewing the respective US economic authorities at the Commerce Department's Bureau of Economic Analysis and at the National Bureau of Economic Research (NBER), as well as numerous private sector economists, to come up with a more precise definition of 'recession,' 'depression' and 'great depression.' His is pretty much the only attempt to give a more precise definition to these terms.

What he came up with was first the official NBER definition of recession: Two or more consecutive quarters of contracting real GDP, or measures of payroll employment and industrial production. A depression is a recession in which the peak-to-bottom growth contraction is greater than 10% of the GDP. A Great Depression is one in which the peak-to-bottom contraction, according to Williams, exceeds 25% of GDP.

In the period from August 1929 until he left office President Herbert Hoover oversaw a 43-

month long contraction of the US economy of 33%. Barack Obama looks set to break that record, to preside over what historians could likely call the Very Great Depression of 2008-2014, unless he finds a new cast of financial advisers before Inauguration Day, January 20. Required are not recycled New York Fed presidents, Paul Volckers or Larry Summers types. Needed is a radically new strategy to put virtually the entire United States economy into some form of an emergency 'Chapter 11' bankruptcy reorganization where banks take write-offs of up to 90% on their toxic assets, that, in order to save the real economy for the American population and the rest of the world. Paper money can be shredded easily. Not human lives. In the process it might be time for Congress to consider retaking the Federal Reserve into the Federal Government as the Constitution originally specified, and make the entire process easier for all. If this sounds extreme, perhaps revisit this article in six months again.

F. William Engdahl is author of A Century of War: Anglo-American Oil Politics and the New World Order (Pluto Press) and Seeds of Destruction: The Hidden Agenda of Genetic Manipulation (www.globalresearch.ca). His newest book, Full Spectrum Dominance: Totalitarian Democracy in the New World Order (Third Millennium Press) is due out early in 2009.

Seeds of Destruction

The Hidden Agenda of Genetic Manipulation

by F. William Engdahl

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