Financial Backlash: "Quantitative Easing" Will Trigger Another Wave of Mergers and Acquisitions

By Washington's Blog
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As I noted when the government started bailing out the big banks:

> [The] Treasury Department encouraged banks to use the bailout money to buy their competitors, and pushed through an amendment to the tax laws which rewards mergers in the banking industry.

Yesterday, former Secretary of Labor Robert Reich pointed out that quantitative easing won't help the economy, but will simply fuel a new round of mergers and acquisitions:

> A debate is being played out in the Fed about whether it should return to so-called "quantitative easing" — buying more mortgage-backed securities, Treasury bills, and other bonds — in order to lower the cost of capital still further.
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> The sad reality is that cheaper money won't work. Individuals aren't borrowing because they're still under a huge debt load. And as their homes drop in value and their jobs and wages continue to disappear, they're not in a position to borrow. Small businesses aren't borrowing because they have no reason to expand. Retail business is down, construction is down, even manufacturing suppliers are losing ground.
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> That leaves large corporations. They'll be happy to borrow more at even lower rates than now — even though they're already sitting on mountains of money.
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> But this big-business borrowing won't create new jobs. To the contrary, large corporations have been investing their cash to pare back their payrolls. They've been buying new factories and facilities abroad (China, Brazil, India), and new labor-replacing software at home.
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> If Bernanke and company make it even cheaper to borrow, they'll be unleashing a third corporate strategy for creating more profits but fewer jobs — mergers and acquisitions.

Similarly, Yves Smith reports that quantitative easing didn't really help the Japanese economy, only big Japanese companies:

> A few days ago, we noted:
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> > When an economy is very slack, cheaper money is not going to

> induce much in the way of real economy activity.
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> Unless you are a financial firm, the level of interest rates is a secondary or tertiary consideration in your decision to borrow. You will be interested in borrowing only if you first, perceive a business need (usually an opportunity). The next question is whether it can be addressed profitably, and the cost of funds is almost always not a significant % of total project costs (although availability of funding can be a big constraint)…..
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> So cheaper money will operate primarily via their impact on asset values. That of course helps financial firms, and perhaps the Fed hopes the wealth effect will induce more spending. But that's been the movie of the last 20+ years, and Japan pre its crisis, of having the officialdom rely on asset price inflation to induce more consumer spending, and we know how both ended.

Tyler Cowen points to a Bank of Japan paper by Hiroshi Ugai, which looks at Japan's experience with quantitative easing from 2001 to 2006. Key findings:

> ….these macroeconomic analyses verify that because of the QEP, the premiums on market funds raised by financial institutions carrying substantial non-performing loans (NPLs) shrank to the extent that they no longer reflected credit rating differentials. This observation implies that the QEP was effective in maintaining financial system stability and an accommodative monetary environment by removing financial institutions' funding uncertainties, and by averting further deterioration of economic and price developments resulting from corporations' uncertainty about future funding.
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> Granted the positive above effects of preventing further deterioration of the economy reviewed above, many of the macroeconomic analyses conclude that the QEP's effects in raising aggregate demand and prices were limited. In particular, when verified empirically taking into account the fact that the monetary policy regime changed under the zero bound constraint of interest rates, the effects from increasing the monetary base were not detected or smaller, if anything, than during periods when there was no zero bound constraint.

Yves here, This is an important conclusion, and is consistent with the warnings the Japanese gave to the US during the financial crisis, which were uncharacteristically blunt. Conventional wisdom here is that Japan's fiscal and monetary stimulus during the bust was too slow in coming and not sufficiently large. The Japanese instead believe, strongly, that their policy mistake was not cleaning up the banks. As we've noted, that's also consistent with an IMF study of 124 banking crises:

> Existing empirical research has shown that providing assistance to banks and their borrowers can be counterproductive, resulting in increased losses to banks, which often abuse forbearance to take unproductive risks at government expense. The typical result of forbearance is a deeper hole in the net worth of banks, crippling tax burdens to finance bank bailouts, and even more severe credit supply contraction and economic decline than would have occurred in the absence of forbearance.

> Cross-country analysis to date also shows that accommodative policy measures (such as substantial liquidity support, explicit government guarantee on financial institutions' liabilities and forbearance from prudential regulations) tend to be fiscally costly and that these particular policies do not necessarily accelerate the speed of economic recovery. Of course, the caveat to these findings is that a counterfactual to the crisis resolution cannot be observed and therefore it is difficult to speculate how a crisis would unfold in absence of such policies. Better institutions are, however, uniformly positively associated with faster recovery.

But (to put it charitably) the Fed sees the world through a bank-centric lens, so surely what is good for its charges must be good for the rest of us, right? So if the economy continues to weaken, the odds that the Fed will resort to it as a remedy will rise, despite the evidence that it at best treats symptoms rather than the underlying pathology.

As I pointed out on August 11th:

> "Deficit doves" – i.e. Keynesians like Paul Krugman – say that unless we spend much more on stimulus, we'll slide into a depression. And yet the government isn't spending money on the types of stimulus that will have the most bang for the buck: like giving money to the states, extending unemployment benefits or buying more food stamps – let alone rebuilding America's manufacturing base. See this, this and this. [Indeed, as Steve Keen demonstrated last year, it is the American citizen who needs stimulus, not the big banks.]
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> Keynes implemented his policies in an era of much less debt than we have today. We're now bankrupt, with debt levels so high that they are dragging down the economy.
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> Even if Keynesian stimulus could help in our climate of all-pervading debt, Washington has already shot America's wad in propping up the big banks and other oligarchs.
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> Keynes implemented his New Deal stimulus at the same time that Glass-Steagall and many other measures were implemented to plug the holes in a corrupt financial system. The gaming of the financial system was decreased somewhat, the amount of funny business which the powers-that-be could engage in was reined in to some extent.
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> As such, the economy had a chance to recover (even with the massive stimulus of World War II, unless some basic level of trust had been restored in the economy, the economy would not have recovered).
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> Today, however, Bernanke, Summers, Dodd, Frank and the rest of the boys haven't fixed any of the major structural defects in the economy. So even if Keynesianism were the answer, it cannot work without the implementation of structural reforms to the financial system.
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> A little extra water in the plumbing can't fix pipes that have been corroded and are thoroughly rotten. The government hasn't even tried to replace the leaking sections of pipe in our economy.

> Quantitative easing can't patch a financial system with giant holes in it.

What's needed has been obvious to independent observers for years: Break up the big banks, prosecute the criminals whose fraud caused the financial crisis, and restore the rule of law and transparency.

Until those basic steps are taken, nothing else will work to fix our broken economy.

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