GlobalResearch
Center for Research on Globalization

Quantitative Easing Announcement Triggers Buying Frenzy: Bernanke's Head Fake Sends Stocks Soaring

By Mike Whitney
Global Research, September 29, 2013
informationclearinghouse.info

Region: USA
Theme: Global Economy

Fed chairman Ben Bernanke shocked the world on September 18 when he announced there would be no change in the Fed's $85 billion-per-month asset purchase program dubbed QE. The announcement sparked a buying frenzy on Wall Street where all three major indices shot to record highs. The Dow Jones Industrial Average (DJIA) climbed 146 points to 15,676 while the S & P 500 logged another 38 points to 1,725 on the day. Bonds and gold also rallied big on the news with the yield on the benchmark 10-year US Treasury dipping sharply to 2.69 percent (from 2.85 percent the day before) while gold rose more than 4.1 percent to $1,364. The US dollar was hammered savagely on the news, dropping to a seven-month low against a basket of major currencies. According to Reuters, the buck "saw its biggest one-day slide in more than two months" and "has fallen to levels not seen since well before Fed Chief Ben Bernanke first floated the idea of reducing the stimulus in May."

Bernanke attempted to justify his reversal (some are calling it a "head fake") on continuing weakness in the economy, particularly high unemployment and tightening in the financial markets. He also implied he was worried about the possibility of a government shutdown and the impact that would have on the anemic recovery.

While Bernanke presented a rational defense for his pet program, he was not convincing. The truth is, the Princeton professor is out on a limb and doesn't know how to get down. That's why he didn't trim his bond buying by even a measly $5 billion per month, because he's afraid the announcement would trigger a selloff that would unravel his $2.8 trillion reflation effort. So he decided to stand pat and do nothing.

But standing pat is not a long-term option, eventually the Fed will have to end the program and wind down its balance sheet. Investors know this, which is why Thursday's giddiness quickly morphed into somber reflection and head scratching on Friday. Everyone wants to know "what's next", especially since QE's impact is diminishing, financial markets are getting frothy, and improvements in the economy are marginal at best. Can the Fed really inflate its balance sheet by another 1 or $2 trillion hoping that the economy picks up in the meantime, or will Bernanke simply call it quits and let the chips fall where they may? Who really knows? This is the problem with unconventional policies; it's impossible to predict the downside risks because they're, well, unconventional, and haven't been thoroughly tested before.

In the case of QE, we can see now that Bernanke forged ahead without developing a coherent exit strategy. That's a big no-no; you never want to paint yourself into a corner especially when trillions of dollars and the stability of the financial system are at stake. But that's where Bernanke finds himself today four years after embarking on a policy path that has boosted corporate profits to all-time highs, widened income inequality to levels not seen since the Gilded Age, and pushed Dow Jones Industrial Average up by 146% since its March 2009 low.

And that’s what made QE such an irresistible policy, because the upside rewards were so great. QE created a vehicle for transferring incalculable wealth to the investor class while concealing its real purpose behind public relations blather about lowering unemployment and strengthening the recovery.

As we have pointed out before in this column, QE has no effect on unemployment. The swapping of Treasuries for bank reserves does not create a transmission mechanism for increasing demand that leads to additional hiring. As Lee Adler of the Wall Street Examiner says:

> “Job growth has not accelerated as a response to the flood of money printing…The growth rates were actually stronger before the Fed started pumping money into the economy in November when it settled its first MBS purchases in QE3…Money printing works to inflate asset prices, but it does nothing to stimulate job growth…
>
> House prices and stock prices have inflated, thanks to too many dollars chasing too few assets. But job growth has been slow–steady, but slow, growing at slightly above the rate of population growth…..” (“Here’s How BLS Data Proves QE Has Had Zero Effect As Jobs Growth Plods Along”, Wall Street Examiner)

QE does not lower long-term interest rates either, in fact, long-term rates have edged higher during QE1, QE2 and now QE3. (Presently, rates are a full percentage point above what they were when the program was first announced on 13 September 2012) Similarly, rates should fall again when Bernanke finally settles on an exit strategy and stock holders pile back into Treasuries acknowledging the feeble state of the economy. Long-term yields will fall because the demand for funds remains weak. When the demand for money is weak, the price of money decreases which means that rates fall. It’s another sign that we are in a Depression. Now check this out from Reuters:

> “Since the bottom of the recession just over four years ago, commercial bank loans and leases have grown 4.0 percent, one of the weakest post-recession recoveries in terms of borrowing since the 1960s, according to Paul Kasriel, the former chief economist of Northern Trust Company. For comparison, over the same period after the July 1990-March 1991 recession, loans and leases grew over four times faster…..” (“Time to taper? Not if you look at bank loans”, Reuters)

Once again, credit expansion is weak, because the economy is still on the ropes.

Consumers and households aren’t borrowing because they are still deleveraging from the big bust of ’08 that wiped out their home equity and a good part of their retirement savings. They’re not borrowing because their wages have stagnated and their income is falling. Also, they’re not borrowing because they’ve lost confidence in the institutions which they used to think were governed by regulations and the rule of law. They know now that that’s not how things work, so they have become more cautious in their spending.

QE doesn't even increase inflation which is why the Fed is still unable to hit its target rate of 2 percent. The fact that inflation has stayed so low (The Consumer Price Index was up just 0.1% in August) while stock prices have more than doubled at the same time, proves that Bernanke's nearly $3 trillion in liquidity has not "trickled down" to the real economy at all. The injections have merely boosted profits on inflated asset prices for financial parasites and speculators.

Even hedge fund managers like Duquesne Capital's Stanley Druckenmiller are now willing to admit that QE is a farce. Here's what Druckenmiller said in an interview with CNBC following Bernanke's announcement on Wednesday:

> "This is fantastic for every rich person. This is the biggest redistribution of wealth from the middle class and the poor to the rich ever."
>
> Indeed, while the dwindling middle class faces deeper budget cuts and tattered safety net programs, the rich have never had it so good. And much of the credit goes to Ben Bernanke and his bond buying program, QE.
>
> As economist Anthony Randazzo of the Reason Foundation wrote last year QE "is fundamentally a regressive redistribution program that has been boosting wealth for those already engaged in the financial sector or those who already own homes, but passing little along to the rest of the economy. It is a primary driver of income inequality." ("Druckenmiller: Fed robbing poor to pay rich", CNBC)

Mike Whitney lives in Washington state. He can be reached at fergiewhitney@msn.com.