What Does the US Federal Reserve's Jerome Powell Have Up His Sleeve?

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Global Research, December 12, 2022

Region: USA
Theme: Global Economy

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The Real Goal of Fed Policy: Breaking Inflation, the Middle Class or the Bubble Economy?

"There is no sense that inflation is coming down," said Federal Reserve Chairman Jerome Powell at a November 2 press conference, — this despite eight months of aggressive interest rate hikes and "quantitative tightening." On November 30, the stock market rallied when he said smaller interest rate increases are likely ahead and could start in December. But rates will still be increased, not cut. "By any standard, inflation remains much too high," Powell said. "We will stay the course until the job is done."

The Fed is doubling down on what appears to be a failed policy, driving the economy to the brink of recession without bringing prices down appreciably. Inflation results from "too much money chasing too few goods," and the Fed has control over only the money – the "demand" side of the equation.

Energy and food are the key inflation drivers, and they are on the supply side. As noted by Bloomberg columnist Ramesh Ponnuru in the Washington Post in March:

> Fixing supply chains is of course beyond any central bank's power. What the Fed can do is reduce spending levels, which would in turn exert downward pressure on prices. But this would be a mistaken response to shortages. It would answer a scarcity of goods by bringing about a scarcity of money. The effect would be to compound the hit to living standards that supply shocks already caused.

So why is the Fed forging ahead? Some pundits think Chairman Powell has something else up his sleeve.

The Problem with "Demand Destruction"

First, a closer look at the problem. Shrinking demand by reducing the money supply – the money available for people to spend – is considered the Fed's only tool for fighting inflation. The theory behind raising interest rates is that it will reduce the willingness and ability of people and businesses to borrow. The result will be to shrink the money supply, most of which is created by banks when they make loans. The problem is that shrinking demand means shrinking the economy – laying off workers, cutting productivity, and creating new shortages – driving the economy into recession.

Demand has indeed been shrinking, as evidenced in a November 27 article on *ZeroHedge* titled: "The Consumer Economy Has Completely Collapsed – 'It's A Ghost Town' for Holiday Shopping Everywhere." But retailers have cut their prices about as far as they can go. While the *rate* of increase in producer costs is slowing, those costs are still rising; and retailers have to cover their costs to stay in business, whether or not they have customers at their doors. Rather than lowering their prices further, they will be laying off workers or closing up shop. Layoffs are on the rise, and data reported on December 1 showed that U.S. factory activity is contracting for the first time since the lockdowns of the Covid-19 pandemic.

It is not just activity in shopping malls and factories that has taken a hit. The housing market has fallen sharply, with pending home sales dropping 32% year-over-year in October. The stock market is also sinking, and the cryptocurrency market has fallen off a cliff. Worse, interest on the federal debt is shooting up. For years, the government has been able to borrow nearly for free. By 2025 or 2026, according to Moody's Analytics, interest payments could exceed the country's entire defense budget, which hit $767 billion in fiscal 2022. That means major cuts will be needed to some federal programs.

Breaking the "Fed Put"

In the face of all this economic strife, why is the Fed not reversing its aggressive interest rate hikes, as investors have come to expect? Former British diplomat and EU foreign policy advisor Alastair Crooke suggests that the Fed's goal is something else:

> The Fed … may be attempting to implement a contrarian, controlled demolition of the U.S. bubble-economy through interest rate increases. The rate rises will not slay the inflation "dragon" (they would need to be much higher to do that). The purpose is to break a generalized "dependency habit" on free money.

Danielle DiMartino Booth, former advisor to Dallas Federal Reserve President Richard Fisher, agrees. She stated in an interview with financial journalist and podcaster Julia LaRoche:

> Maybe Jay Powell is trying to kill the "Fed put." Maybe he's trying to break the back of speculation once and for all, so that it's the Fed – truly an independent apolitical entity – that is making monetary policy, and not speculators making monetary policy for the Fed.

The "Fed put" is the general idea that the Federal Reserve is willing and able to adjust monetary policy in a way that is bullish for the stock market. As explained in a *Fortune Magazine* article titled "The Stock Market Is Freaking Out Because of the End of Free Money – It All Has to Do with Something Called 'The Fed Put:'"

> For decades, the way the Fed enacted policy was like a put option contract, stepping in to prevent disaster when markets experienced serious turbulence by cutting interest

> rates and "printing money" through QE [quantitative easing].
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> … Since the beginning of the pandemic, the Fed had supported markets with ultra-accommodative monetary policy in the form of near-zero interest rates and quantitative easing (QE). Stocks thrived under these loose monetary policies. As long as the central bank was injecting liquidity into the economy as an emergency lending measure, the safety net was laid out for investors chasing all kinds of risk assets.
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> … The idea that the Fed will come to stocks' aid in a downturn began under Fed Chair Alan Greenspan. What is now the "Fed put" was once the "Greenspan put," a term coined after the 1987 stock market crash, when Greenspan lowered interest rates to help companies recover, setting a precedent that the Fed would step in during uncertain times.

But the "free money" era seems to be over:

> The regime change has left markets effectively on their own and led risk assets, including stocks and cryptocurrencies, to crater as investors grapple with the new norm. It's also left many wondering whether the era of the so-called Fed put is over.

Killing the Parasite That Is Killing the Host

The Fed put favors the rich – investors in the stock market, the speculative real estate market, the multi-trillion dollar derivatives market. It favors what economist Michael Hudson calls the "financialized" or "rentier" economy – "money making money," formerly called "unearned income" – which drives up prices without adding productive value to the "real" economy. Hudson calls it a parasite, which is sucking out profits that should be going toward building more factories and other economic development.

By backstopping the financialized economy, the Fed has been instrumental in widening the income gap of the last two decades, pushing housing prices to heights that are unaffordable for first-time homebuyers, driving up rents and educational costs, and crushing entrepreneurs. DiMartino Booth explains:

> Fed policy feeds passive investing … because you don't have to carefully allocate your resources. You simply have to be long the NASDAQ and sit there with your money. What does that feed? It feeds the monopolization of America. The largest companies, the companies such as Google and Microsoft … if there is a competitor in their world they simply absorb them. They acquire them, which quashes … the entrepreneurial spirit that made this country so great…. If the Fed succeeds, Main Street will be the main winner.
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> … [T]he trick here is for the Fed to not break anything big, and that's the delicate balancing act, … if … they can slowly, methodically take the rot out of the system without breaking anything big that forces them to pull back.

The "rot" in the system is particularly evident in the housing market:

> Since the financial crisis, there's been a lot of private equity that's entered the space and snapped up all these homes and they're renting them … It's definitely exacerbated this housing cycle. It's added an element of speculation because so many of them are

> all cash buyers. Don't get me wrong, they're levered — it is borrowed money — but they're coming in as all cash buyers, and that I think created a lot of these massive bidding wars …

DiMartino Booth discusses the risk of derivatives contagion using the example of AIG, a giant insurance company brought down by derivatives exposure in 2008:

> During the financial crisis … we rescued AIG because we didn't want to actually see what it looked like on the other side of that cliff had derivatives actually been unwound, and what that contagion might have looked like…. We never tested the derivatives market, so that risk continues to lurk out there…. I'm not a cheerleader for there being some kind of a systemic risk event, and I do hope again that the Fed succeeds in managing this unwind, in seeing risk pulled out of the system, but one company at a time, not something that makes the global financial system implode.

Financial blogger Tom Luongo takes this argument further. He maintains that Fed Chair Powell is out to break the offshore eurodollar market – the speculative, unregulated offshore money market where the World Economic Forum and "old European money" (including mega-funds Blackrock and Vanguard) get the cheap credit funding their massive spending power. That is a complicated subject, which will have to wait for another article; but the principle is the same. Without the backstop of the Fed's virtually free dollars to satisfy a surge in demand for them, these highly-leveraged dollar investments will collapse. ("Leverage" is an investment strategy that uses borrowed capital to increase potential returns. The risk is that if the investment sours, losses are also increased.)

Pushing "Until Something Breaks"

Whether or not popping these raging speculative bubbles is the goal, the Fed's interest rate hikes are having that effect. According to a November 25, 2022 article on CNBC.com, "Interest rate hikes have choked off access to easy capital …." As a result, "Investors have lost roughly $7.4 trillion, based on the 12-month drop in the Nasdaq."

House prices are also tumbling. The third quarter of 2022 saw the biggest home equity drop ($1.3 trillion) ever recorded. Fortune Magazine quotes Moody's Analystics: "Before prices began to decline, we were overvalued [nationally] by around 25%. Now, this means prices will normalize. Affordability will be restored."

In 2021, 25% of all real estate purchases were being made by institutional investors. In the third quarter of 2022, investor buying of homes tumbled 30%. Blackstone, a real estate income trust notorious for buying up homes and turning them into rentals, was reported on December 2 to be limiting withdrawals from its $125 billion property fund as investors rush for the exits. George Cipolloni, portfolio manager at Penn Mutual Asset Management, said the U.S. Federal Reserve's sharp interest rate increases have not "worked all the way through the economy yet," and that he expects to see "more Blackstone-type news events coming forward in the next year."

In May 2022, BlackRock stock (BLK) was down 30% for the year. And by November, the cryptocurrency market cap had plummeted from $3 trillion to $900 billion, with Bitcoin, its largest component, down 77% year-over-year.

Currently featured in the news is the crypto exchange FTX and its 30-year-old billionaire owner Sam Bankman-Fried. FTX was exposed as a Ponzi scheme by the receding tide of dollar liquidity, catching Bankman-Fried and team "swimming naked when the tide went out." According to Swiss bank UBS' chief of investment, "FTX's collapse shows Federal Reserve tightening is crushing speculative assets." Outing FTX is thought to be only the beginning of a succession of exposures of financial frauds to come.

The Delicate Balancing Act

DiMartino Booth said in a live twitter presentation on December 8, "If Jay Powell breaks the Fed put and takes away the unfair ability of private capital to rape and pillage the system, he will have finally addressed income inequality in America."

Looked at in that light, breaking the Fed put sounds like a good idea. But can it be done without breaking the whole economy? More reputable establishments than FTX are at risk. Rate hikes seriously impact local retailers and wholesalers. In September, risky leveraged bets brought UK pension funds near to collapse, forcing the Bank of England to reverse course and lower its interest rates. And there is the stress in the U.S. Treasury, which is dealing with an enormous interest tab on its debt.

Other disturbing outcomes are being envisioned. One podcaster posits that the economy is intentionally being driven to collapse, at which point the government will declare a "bank holiday" as Pres. Roosevelt did in 1933. When the banks reopen, he says, we will have a "currency reset" in the form of a central bank digital currency (CBDC). The concern is that it will be a "programmable" currency, one that can be regulated or turned off altogether based on the user's "social credit" score, as is already happening in China.

Alarmed observers note that the New York Fed recently embarked on a pilot project for a CBDC (Central Bank Digital Currency). But defenders point out that it is a "wholesale" CBDC, used just for transfers between banks, particularly overseas transfers. Settlement times of foreign exchange transactions typically take two days. Project Cedar, the New York Innovation Center's pilot project, found that settlement for foreign exchange transactions using distributed ledger technology can happen in 10 seconds or less, significantly reducing risks. Whether that technology will be developed and used by the Fed has not yet been determined. DiMartino Booth observes that Powell and other Fed officials have frequently questioned the need for a "retail" CBDC, in which Fed accounts would be opened directly with the public.In a Substack article titled "A Grand Unified Theory of the FTX Disaster," author and educator Matthew Crawford lays out a darker possibility – that the end goal of the powerful network of players behind the FTX scheme is not just a U.S. CBDC but a "Global Digital Central Bank" run by international powerbrokers. Whether or not the Federal Reserve intended it, aggressive interest rate hikes could expose this sort of parasitic corruption and remove the money machine that is its power source.

Rising from the Ashes

Meanwhile, the supply-side issues inflating the prices of food, energy and other key resources need to be addressed. Those are matters for federal and state legislatures, not the Fed. In the 1930s, a federal financial institution called the Reconstruction Finance Corporation pulled the economy out of the Great Depression, put people back to work, and crisscrossed the country with new infrastructure, including the dams and power lines that brought electricity to rural America. (See my earlier article here.) The government acted quickly and decisively because times were desperate.

A bill for a National Infrastructure Bank modeled on the Reconstruction Finance Corporation is now before Congress, H.R. 3339. For a local government bank, a viable model is the publicly-owned Bank of North Dakota, which pulled that state out of a regional agricultural depression in the 1920s. (See here.) As an iconic Depression-era poster declared, "We can do it!" We just need to roll up our sleeves and get to work.

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This article was first posted on ScheerPost.

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