High View Economics

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ANOTHER EXCUSE FOR THE FED?

Within minutes of the release Friday morning of the August employment report showing zero jobs growth, gold launched into a powerful rally, soon surpassing $50 and netting nearly $60 on the day. As if affirming the judgment being rendered by the gold market, the *Wall Street Journal* online carried a story later in the morning headlined “Jobs Paralysis Raises Odds of Fed Action.”

According to the *Journal*, “Job market paralysis in August increases the chance the Federal Reserve will do something new to help the economy.” The story then quoted an economist offering that “We all know that Bernanke is predisposed to act, and today’s data will only reinforce the resolve of Bernanke and the doves on the FOMC to push another button. In fact, I find it hard to imagine that the Fed would hold back from acting again over the next meeting or two.”

Apparently, the fact that all the Fed’s ministrations for going on three years have yet to yield any sign of robust jobs growth while the economy remains lackluster doesn’t enter into any of this thinking. The idea that easy money is a cure for all economic ills is ingrained deeply in the economic thinking that defines the conventional wisdom. Meanwhile, headline CPI inflation is now running at 3.6% year-on-year, up from 1.2% a year ago, and with gold now trading near $1,900 and the dollar chronically weak in forex markets, there’s no reason to think that acceleration will not continue.

The key objective of the Fed “doing something” would be to lower long-term interest rates. That was the reasoning behind the Fed’s move last month to pledge that the funds rate would be kept near zero at least through mid-2013. In the minutes of the August 9 FOMC meeting released last week, the Fed said that “reinforcing the Committee’s forward guidance about the likely path of monetary policy was seen as a possible way to reduce interest rates and provide greater support to the economic expansion.”

But if low interest rates were the answer to what’s ailing the economy, isn’t it likely we’d have seen some sign of it by now? For the most part, 10-year yields have been below 4% for the past three years, and the 10-year Treasury is now trading near record lows below 2%. These ultra-low yields are a sign of the deep economic pessimism presently

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afflicting the markets. By signaling that it sees the economy as so weak that rates need to stay near zero for the foreseeable future, the Fed is feeding that pessimism. One of the best things that the Fed could currently do to restore confidence would be to indicate that the end of this period of hyper-accommodative policy is coming to an end. That would lift yields across the curve as a sign that growth prospects are improving with the Fed moving toward restoring monetary neutrality. Unfortunately, though, the Fed remains committed to its present course, which will sustain the sluggish pace of growth while inflation continues to push higher.

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