Bernanke’s Balance Sheet Ensures Disaster

By Michael Pento *Mon, Jan 7, 2013*

Fed chairman Ben Bernanke "should start shrinking his balance sheet and allow interest rates to normalize now. When the free market does it for him it will be too late," writes guest columnist Michael Pento.

As expected, Ben Bernanke officially launched a fourth round of quantitative easing (QE 4) with his announcement last week of $85 billion dollars worth of unsterilized purchases of MBS and Treasuries. In unprecedented fashion, the Fed also tied the continuation of its zero interest rate policy and trillion dollars per annum balance sheet expansion to an unemployment rate that stays above 6.5%. Now, pegging free money and endless counterfeiting to a specific unemployment figure would be a brilliant idea if printing money actually had the ability to increase employment. But it does not.

The Fed recently celebrated the fourth anniversary of zero percent rates and massive expansion of its balance sheet. However, even after this incredibly accommodative monetary policy has been in effect since 2009, the labor condition in this country has yet to show significant improvement.

Last month’s Non-Farm Payroll report showed that the labor force participation rate and employment to population ratio is still shrinking. Goods-producing jobs continue to be lost and middle aged individuals are giving up looking for work. This is the only reason why the unemployment rate is falling. I guess if all those people currently looking for work decide it’s a better idea to stay home and watch soap operas instead, the unemployment rate would then become zero.

But more of the Fed’s easy money won’t help the real problem because the issue isn’t the cost of money but rather the over-indebted condition of the U.S. government and private sector. Keeping the interest rate on Treasuries low only enables the government to go further into debt. And consumers aren’t balking on buying more houses because mortgage rates are too high.

The plain truth is this is a balance sheet recession and not one due to onerous interest rates. More of the Fed’s monetization may be able to bring down debt service payments a little bit further on consumer’s debt. However, it will also cause food and energy prices to be much higher than they would otherwise be. The damage done to the middle class will be much greater than any small benefit received from lower interest rates. Therefore, the net reduction in consumer’s purchasing power will serve to elevate the unemployment rate instead of bringing it lower.

Rather than aiding the economy and fixing the labor market, what the Bernanke Fed will succeed in doing is to ensure his unshrinkable balance sheet will not only destroy the economy but also drive the rate of inflation to unprecedented levels in this country.

Ben’s balance sheet was just $800 billion in 2007. It is now $2.9 trillion and is expected to grow to nearly $6 trillion by the end of 2015. A few more years of trillion dollar deficits that are completely monetized by the Fed should ensure that our government’s creditors will demand much more than 1.6% for a ten-year loan. The problem is that rising interest rates will cause the Fed to either rapidly and tremendously expand their money printing efforts, which could lead to hyperinflation; or begin to sell trillions of dollars worth of government debt at a time when bond yields are already rising.

If yields at that time are rising due to the fact that our creditors have lost faith in our tax base and its ability to support our debt, just think how much higher yields will go once the bond market becomes aware that the Fed has become another massive seller. This new Fed policy is incredibly dangerous and virtually guarantees our economy will suffer a severe depression in the near future. Bernanke should start shrinking his balance sheet and allow interest rates to normalize now. When the free market does it for him it will be too late.

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