The Difficulty in Stopping Train Wrecks

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They were desperate to stop the fall. A 750 billion dollar stimulus program was implemented. Even though "spades in the ground" it would take too long to halt the slide. That needed something fast-acting, thus the flood of liquidity in the form of the Fed purchase of government bonds with freshly printed cash, and a near zero prime interest rate.

It worked. It halted the free fall and, while the real economy bounced along the bottom, the boom in the unreal economy was called a recovery. The dream of the Fed was that the tail would wag the dog; they would pack so much wealth at the top that enough would eventually seep down to rev up the engine of the real economy, the only part of the economy that ultimately matters. Instead an increasing gap has developed between the economic divisions. Had they shifted some of the $10 trillion in financial bailouts to strengthening the real economy, in a couple of years there would have been a significant increase in full-time good paying jobs. That output and consumer income would gradually create growth based on substance rather than paper. But that didn't happen. Instead the social core of the economy and society, the 25-54 year old age group, has had their labor force participation rate drop to the lowest point in 30 years.

That failure was of no concern to those living in the other worldly financial sphere. Just keep the liquidity flowing enough so that they can stay drunk, and everything is fine. But the Fed, being in the driver's seat, must remain sober and the increasing gap between unreal and real signals danger. They expected QE tapering to slow things down, perhaps bring on the long over due correction, but that hasn't happened. Partly it's the Fed's own fault, they wanted to lessen the irrational exuberance without being party poopers. But just a hint that they were about to ease up on the easy money often caused such a scare that the Fed would backtrack -- saying not to worry, changes will be far off and always reversible. The problem: since the "recovery" they claim to have is based upon the totally irrational, they risk losing everything if they now start making sense.

But the Fed has to do something or face the worst possible outcome, that the bubble bursts on their watch. Yellen and Fed heads have recently sent out more urgent messages that speculators have lost sight of the increasing risks they've taken -- that interest rates will rise sooner and be larger than expectations. They still avoid acknowledging a bubble, Yellen says that stock valuations are "substantially stretched", but soon we shall know whether there is a correction or whether the Fed is stuck with a boom until it ceases of its own accord.

Meanwhile, the main popular critics of Fed policies have experienced a boom in hysterics to match the unreal economy. QE is almost over and the hyper inflation has yet to appear. Gold has fallen to around $1230. If scaring people with predictions of financial collapse is not enough then maybe adding inevitable world wars, environmental collapse, or Ebola infecting the world might do the trick. Being monetarists they reason much like the people they criticize. They have forgotten that inflation also requires an increase in effective demand which is not forthcoming in weak real economy. Furthermore, the entire capitalist world has weakened their currencies and that means the dollar remains fairly strong and imports aren't inflated.

Despite Krugman's lack of concern with inflation, those involved in the creation of policies that he supports have mixed feelings. One Fed report has inflation risk increasing if the unemployment rate drops much further. A lower rate means employers will have to pay more to get the people they want, hence, inflation. but another Fed report determined that the real unemployment rate is about 8% if one factors in involuntary part timers and the low quality of job opportunities. Perhaps that is why speculators are ignoring Fed warnings. They feel that the Fed must stay with current policies until employment improves.

The most interesting report this week was the surprise increase in new unemployment claims. Coming immediately after the surprise fall in new jobs, and that 312,000 new claims was more than the 307,000 a year ago, this may signal a concrete turn in the economy if it is repeated in the following weeks. And today it was reported that the Fed has created a Committee on Financial Stability. If they are unable to prevent the train wreck, as least they will have created an historical record for future reference.

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