Written by **Bob Adelmann** on December 8, 2010

The Fed's Bernanke: Hubris and Dissimulation

Fed Chairman Ben Bernanke's recent 60 Minutes interview raised more questions than it answered. Some even questioned the questions. Gary North explained that the Fed chair was being pushed to defend his decision to purchase more government securities in order to stimulate the economy. Interviewer Scott Pelley was at an admitted disadvantage, and failed to ask Bernanke exactly why he thought additional stimulating would work when past stimulations haven't.

As North suggested, Pelley should have asked Bernanke "Why?"

> Why do you think that a reduction of the 10-year T-bond rate, if it even happens, will be sufficient to get banks lending again and businesses hiring again?

Instead, Pelley asked this:

> The major banks are racking up profits in the billions. Wall Street bonuses are climbing back up to where they were. And yet, lending to small businesses actually declined in the third quarter. Why is that?

And Bernanke punted:

> A lot of small businesses are not seeking credit, because, you know, because their business is not doing well, because the economy is slow. Others are not qualifying for credit, maybe because the value of their property has gone down. But some also can't meet the terms and conditions that banks are setting.

And so Pelley let Bernanke off the hook, leaving unanswered why banks aren't lending even though they are holding enormous reserves, and especially why if those reserves were increased through the increased purchases of government debt that banks would be more inclined to loan them out.

The answer that Bernanke should have provided in the interest of transparency is that he really doesn't have any idea. At the moment, banks are very happy investing their reserves at two or three percent by buying government securities, while borrowing them from the Fed at close to zero. That's called "milking the spread," and explains how the banks continue to profit despite not making loans to small businesses.

The other answer as to why Bernanke thinks continued purchases of government debt will work is because the Fed has nothing else it can do and it certainly must not give the appearance of doing nothing, or admitting that it is out of options.

Pelley then asked Bernanke about the risk of inflation as a result of the increase in the money supply because of these Fed purchases. Bernanke makes two mistakes here. He claims that there isn't any inflation. And then he claims that if there were any inflation, he knows what to do about it. The interchange is remarkable:

> Pelley: Many people believe that [the $600 billion program] could be highly inflationary. That it's a dangerous thing to try.

Bernanke: Well, this fear of inflation. I think it is way overstated. We've looked at it very carefully. We've analyzed it every which way. One myth that's out there is that what we're doing is printing the money. We're not printing money. The amount of currency in circulation is not changing. The money supply is not changing in any significant way.

First of all, the inflation has already taken place. A quick review of the Fed's own graph of the M1 money supply over the past five years reveals that money supply has grown by nearly a third, while the one-year chart is equally un-nerving. So the inflation of the monetary base of the economy has already taken place, and Bernanke wants to add to it.

When Bernanke says that the fear of inflation is way over-stated, he is talking, in Fed-speak, about the eventual, inevitable rise in prices that will take place over time. This is measured by another Fed chart with which Bernanke is well-acquainted, the velocity of money which has declined sharply since the onset of the Great Recession, and is just now beginning to stir upwards. This sharp decline in velocity has masked, for the present, the massive monetary increases just waiting to enter the economy.

Bernanke says that although there is no inflation (price increases) that he can see right now, he's ready to handle it when it shows up:

> The trick is to find the appropriate moment when to begin to unwind this policy. And that's what we're gonna do.

Pelley had the good sense then to ask Bernanke "Can you act quickly enough to prevent inflation from getting out of control."

Bernanke: We could raise interest rates in 15 minutes if we have to. So, there really is no problem with raising rates, tightening monetary policy, slowing the economy, reducing inflation, at the appropriate time. Now, that time is not now.

Pelley: You have what degree of confidence in your ability to control this?

Bernanke: One hundred percent.

This comes from the man who didn't see the Great Recession coming. In fact, Bernanke laments the fact: "I wish I'd been omniscient and seen the crisis coming…I didn't…it was a very difficult situation…"

It is helpful to remember that Bernanke is the most powerful man in the world. And yet, in March, 2007, he said:

> At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency.

in May, 2007, he said this:

> The rise in subprime mortgage lending likely boosted home sales somewhat, and curbs on this lending are expected to be a source of some restraint on home purchases and residential investment in coming quarters. Moreover, we are likely to see further increases in delinquencies

> and foreclosures this year and next as many adjustable-rate loans face interest-rate resets. All that said … we believe the effect of the troubles in the subprime sector on the broader housing market will likely be limited, and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system.

Even as late as June, 2008, he said:

> The risk that the economy has entered a substantial downturn appears to have diminished over the past month or so.

This litany of false analyses and conclusions by the "best and the brightest" at the Fed leaves one with two regrets: It's too bad that Pelley didn't pursue Bernanke more aggressively about why he thought he could determine future policy with such an awful track record, and that the machinery of the central bank is in the hands of someone who knows that his policies will continue to be destructive to the economy and yet is persuaded, and tries to persuade others, like Pelley, that everything will work out just fine.

Remember Bernanke's chilling assurance:

> The trick is to find the appropriate moment when to begin to unwind this policy. And that's what we're gonna do