

## THE FEDERAL RESERVE TO THE PRIVATE SECTOR, “RIP”

Since the start of the financial crisis in 2008, the Federal Reserve Board, headed by the lauded Benjamin Bernanke, has been quietly starving the private sector for capital and indirectly jobs and opportunity. This is of course not a stated policy of the Fed, but an unintended consequence of their actions. The Fed's balance sheet has grown from \$915 billion in 2007 to almost \$2.9 trillion today. The Fed has spent almost \$2 trillion on asset purchases, QE1, QE2 and the current twist (i.e. buying longer dated and selling shorter dated treasury securities). The Fed has also pushed short term interest rates to zero and the 30 year bond rate to approximately 3.1%. They believe that these low rates are the only way to jump start the economy, help the depressed housing market and get the consumer, who accounts for 70% of GDP, to start spending again. The other reason they have lowered rates is too help the banking system restore its profitability and build up capital to cushion future distressed asset write offs by increasing the interest rate spread. The interest rate spread is the difference between a bank's interest earning assets (loans) and its interest paying liabilities (deposits). The current spread is about 4%.

The Fed believes that the only way to stimulate consumer demand and get the country out of this depression is through lower interest rates. This monetary policy has worked in the past but is working now due to the debt overhang in the economy. For the last thirty years, the growth of the U.S. economy has been based on debt and consumption. Consumers borrowed on their credit cards and credit lines and bought lots of stuff like autos, homes, vacations houses, clothes, plasma TV's, trips, college, jewelry, etc. and this created an economic boom that was primarily based on credit expansion. When the bubble burst in 2007, consumers were left with too much credit card, housing and auto debt. So the remedy from the Fed's playbook was too flood the economy with cheap money and zero interest rates and hope that this would stimulate spending and revive the moribund economy. After more than four years of zero interest rates and Fed balance sheet expansion, this hasn't worked because the consumer does not need to consume, it needs to save and invest. Giving highly indebted consumers cheaper money to borrow and consume more is like inviting a recovering alcoholic to 5 cent beer night at the local pub. Thirty years of debt and consumption is what lead to this current depression. And yes, I believe we are in a depression not a recession. I think this depression is similar to the Great Depression of 1929 except that today, we have various government safety programs like food stamps, Medicaid, unemployment payments and the accommodative Fed with a printing press.

This misguided policy of the Fed of zero interest rates is also hurting savers and those on a fixed income but helping the new debtor in town, the federal government. Savers and those on fixed incomes are not getting any nominal return on cash investments and with inflation at 3.6%, are experiencing high negative real rates of return. This phenomenon along with the lack of work is the main reason consumers have stopped spending. The government is now borrowing more than \$110 billion per month to fund its operations and service its \$14.5 trillion debt. Zero interest rates have helped Wall

Street and the banking system recover and allows the federal government to obtain this \$110 billion a month at a relatively cheap cost of about 1.5% but is starving Main Street.

The average consumer and saver in this country is getting killed. They have lost their job, the loan on their house is worth more than the house, they are extended on their credit cards and they can't find a job. The Fed's zero interest policy has allowed the government to grow exponentially and devour a larger portion of the capital that should be going to the private sector. The Fed is saving Wall Street, the banks and government at the cost of the consumer and this is what is wrong about economic policy in this country. This is also what is really behind the Occupy Wall Street crowd.

The consumer needs to save and invest; especially with 60 million baby boomers retiring in the next twenty years and this will cause less demand and less debt. We don't need to buy stuff, we need to save and this saving will lower interest rates and provide capital to the private sector for investment and expansion. Private sector investment will lead to job creation, which will lead to higher disposable income, which will lead to higher home values and a growing economy. The Fed's policy is only feeding the beast of the U.S. government which needs to borrow more than \$1.3 trillion per year. The government's insatiable appetite for debt is crowding out private sector investment and coupled with an anti-business administration, is starving the private sector.

Until we change course and reduce the size of the government and its huge appetite for capital, this policy will continue to destroy the great U.S. economy. I believe that the remedy is to start reducing the size of the U.S. government by reducing spending in all areas. Annual spending has grown from \$2.27 trillion in 2007 to \$3.6 trillion in 2011 while tax receipts declined from \$2.5 trillion in 2007 to \$2.3 trillion in 2011. Any yes, reducing spending is painful and there will be many lost jobs and programs, but unless we take this bold step, the country will face an even worse fate. That fate is that a time will come in the next few years, where no one will buy our debt except at usurious interest rates or not at all and then the market will force a reduction in spending and our standard of living similar to what is currently happening to Greece.

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