Central banks hell-bent on a currency debauch Lenin would love


If you’re wanting a barbecue stopper, central banks don’t normally come to mind. Most of us know of our Reserve Bank only because it sets interest rates that bear on our monthly mortgage payments.

Today, with rates so low, even that raises little comment. But if you say that thanks to the co-ordinated actions of the world’s central banks we’re heading for an economic and financial disaster, probably worse than the last, that could burn a sausage or two.

Incredibly, for the third time in 15 years, we’re back in a financial bubble searching for a pin. Once again the world’s elected representatives, fooled into believing this time it’s different, abdicate their responsibility to unelected, unaccountable central bankers, even as they grapple with the mess those bankers created eight years ago. Go figure.

Ben Hunt, author of the Epsilon Theory newsletter, talks about the faith politicians, investors and businesses have in the power of central banks to create value. Hunt says “as long as enough of us believe this narrative, it becomes a self-fulfilling prophecy”. These narratives, he says, are maintained by repeating expressions of common knowledge like “everyone knows that low interest rates spur the economy”.

But with interest rates in the major economies zero or negative, belief is wearing thin. Even the central banks’ bank, the Bank for International Settlements, recognises this. It identifies “growing clouds of doubt around the continued efficacy of central bank action”. It worries about the way financial markets depend on central bank policy and how public confidence, if shaken, will have serious economic consequences.

In its report The Future will Soon Be Today, the BIS warns “We badly need policies that we will not once again regret when the future becomes today. What used to be considered ‘unthinkable risks’ are becoming the ‘new normal’ with clear risks to future stability.”

David Folkerts-Landau, chief economist of Deutsche Bank, agrees. He says the European Central Bank “has lost credibility within markets and more worryingly among the public”. He refers to the “litany of distortions, perversions and disincentives which grow by the day” and describes Europe as “seriously ill”. This despite the ECB injecting €1 trillion into the economy across the past 12 months.

Of course, central bankers know their reputations are on the line, so they dismiss the clear link between financial speculation and economic harm, and persist with ever more extreme policies. They care little that this leaves behind the majority of us who are unable or unwilling to gamble on asset prices. For them, we are collateral damage.
Try telling that to the millions of victims of the global financial crisis who have never recovered. As Hunt says, “Central banks have failed to protect incomes and have pushed income and wealth inequality past a political breaking point.” But the focus of central bankers is on inflating asset prices, not social cohesion and equity. That’s for governments.

Even so, politicians share responsibility for today’s distorted economy, having recklessly spent tomorrow’s productive capital on consumption. Global indebtedness stands at more than $US200 trillion ($267 trillion), about three times world product, having increased $US57 trillion since 2008.

Yet for all that debt and quantitative easing, in the first quarter of this year the US grew at just 0.5 per cent, down from 1.4 per cent in the previous period. Job openings in May plunged 345,000, the second steepest decline since 2008, and new hirings are down 474,000 compared with three months ago.

In the eurozone, unemployment stands at 10.1 per cent. In December 2007 it was 7.3 per cent. Forecast gross domestic product for this year is a downwardly adjusted tepid 1.6 per cent.

What’s that about low interest rates spurring the economy? Well, despite the evidence, one of the world’s last holdouts, the Reserve Bank of Australia, is reported to be considering joining the quantitative easing groupthink.

Austrian economist Ludwig von Mises was one of the few to predict the 1930s Depression. In *The Trade Cycle and Credit Expansion: The Economic Consequences of Cheap Money*, he wrote, “The depression is the necessary process of readjusting the structure of business activities to the real state of the market data … The depression is the first step on the return to normal conditions, the beginning of recovery and the foundation of real prosperity based on solid production of goods and not on the sands of credit expansion … If one does not terminate the expansionist policy in time by a return to balanced budgets, by abstaining from government borrowing and, by letting the market determine the height of interest rates, one chooses the German way of 1923.”

Vladimir Lenin advocated: “The best way to destroy the capitalist system is to debauch the currency.” True or not, we seem hell-bent on finding out. What ostensibly started as a one-off financial market rescue has morphed into cover for achieving unsustainable leftist ideals. We have reached the point where there is no painless reversal.

Meanwhile, as markets lurch from crisis to crisis and central banks and governments expose us to ever more “unthinkable risks”, we insist on believing the central bank narrative that makes bad news good news until bad news is all we know.

The BIS has rung the alarms. We are warned that the world’s most reckless monetary experiment, which has taken interest rates to the lowest in recorded history, is failing. Central bankers remain silent, not knowing how or when to end what they began, while the political class simply looks on, impotent and mired in its own economic mistakes.
This leaves only the market’s invisible and heavy hand to make the required adjustments. What follows will be indiscriminate, unpredictable, socially far-reaching and, politically ugly. If that doesn’t stop the barbecue, nothing will.