

Piling On The Fed... The Price of Bubblenomics

You probably know by now that I tend to do things in an unconventional way. Publishing [Bubble 3.0 via Substack](#) is such an example. (However, the highly regarded Pippa Malmgren is also releasing her [newest](#) book via Substack).^{*} It was also a bit unorthodox to run a few chapters ahead of their normal sequence. The logic for doing so was the urgency of their messages. Based on how conditions have evolved with what I've been referring to as The Third Energy Crisis, the inflation explosion, and the immolation of what I've long called The COPS (Crazy Over-Priced Stocks), I'm glad I did.

Now, with Chapter 16, we get to the heart of my book, the Fed. As a lead-in to this chapter, I'm going to go atypical once again by plugging another author's work. Coincidentally, [The Lords of Easy Money](#) by Christopher Leonard was published at almost exactly the same time we began running *Bubble 3.0*. Its subtitle is right-on in my view: "How the Federal Reserve Broke the American Economy". It has drawn praise from influential individuals such as James Grant, one of my book's key characters, as well as Mohammed El-Erian, former CEO and co-Chief Investment Office at bond titan, Pimco. *House of Cards* author William Cohan also gave it a thumbs-up.

Because it is such an ideal companion-piece to *Bubble 3.0*, I thought it would be appropriate to introduce my Fed-related chapter with a few excerpts from *The Lords of Easy Money*. The hero of the first part of his book is former CEO/President of the Kansas City Fed, Thomas Hoenig. Mr. Hoenig was also a voting member of the all-powerful Federal Open Market Committee (FOMC) which sets the Fed funds rate. It was the FOMC that raised rates by one-quarter of a percentage point on Wednesday... finally!

The "finally" is a critical element of Mr. Leonard's book. A fascinating aspect is that the Fed's sluggishness in raising rates has long been characteristic of its modus operandi — other than under the legendary inflation-slayer, Paul Volcker. In fact, this molasses-in-January MO goes back as far as the 1970s when Mr. Hoenig first joined our nation's central bank. The Fed of that decade was consistently behind the inflation curve, allowing monetary policy to stay much too stimulative.

This not only stoked consumer inflation, it also led to significant inflation in hard assets like farmland and energy lending (stocks and bonds were victims, not beneficiaries, of that era). When this bubble burst, as Mr. Volcker jacked up short-term rates to over 20%, it triggered the failure of hundreds of banks in the early to mid-1980s, despite the Reagan economic boom. These institutions had been heavily involved in property and energy loans, including Washington state's once mighty Sea-First Bank. This forced a shot-gun marriage to Bank of America. It also left Mr. Hoenig with a well-deserved fear of both too-easy Fed policies and asset bubbles. He came to appreciate that these were joined at the hip, and, in fact, they still are.

It was this experience that caused him to be the lone dissenter starting in 2010 with regard to the second round of Ben Bernanke's Quantitative Easing (QE) program. As I've noted in *Bubble 3.0*, Mr. Bernanke assured Congress that the first QE was temporary. Yet, the Fed was still at it in 2019, despite a hiatus of a few years. Of course, since Covid, QE went into hyperdrive and has only now, at long last, been halted.

Mr. Hoenig took considerable heat for his reluctance to go along with the continuation of the

Fed's Magical Money Machine (MMM). Yet, his fears were extremely well-founded as we are already learning as this third great bubble of the last 25 years is deflating. For countless COPS, the deflation has been excruciating — like down 70% or more.

Here are a few of what I think are the most interesting excerpts and, in my mind, they are highly relevant to current conditions: “Volcker recognized that when he was fighting inflation, he was actually fighting two kinds: asset inflation and price inflation. He called them ‘cousins’ and **acknowledged that they have been created by the Fed**”. (emphasis mine) ‘The real danger comes from (the Fed) encouraging or inadvertently tolerating rising inflation and its close cousin of extreme speculation and risk taking, in effect standing by while bubbles and excesses threaten financial markets,’ Volcker wrote in his memoir.”

Wow, do those words ever ring true today! Too bad that Mr. Volcker's memoir isn't required reading — and re-reading — for every voting member of the FOMC. In a most ironic development, current Fed-head Jay Powell is attempting to channel Mr. Volcker. Talk about a decade late and about \$8 trillion dollars short (of monetary sanity)! In 1998, when Alan Greenspan was Fed chairman, “The Maestro” was still cutting rates despite a booming economy and an immense — though temporarily correcting — tech stock bubble. Even though Mr. Hoenig voted to cut rates due to extreme stress overseas and the collapse of Long Term Capital in the U.S., he did presciently observe: “I have concerns that a bubble economy syndrome may be building.”

He also went along with the Fed's drastic interest rate cuts in the first years of this century/millennium. It was at that time the Fed had reduced its key rate to 1%. This poured napalm on an already *en fuego* housing market which led to that humongous bubble and, of course, crash. As Mr. Leonard wrote about this period: “The Fed had kept rates at 1 percent for too long, **and when it started raising rates so slowly that they were still ‘accomodative’, still incentivizing speculation and easy lending**. ‘That left an impression on me’ Hoenig recalled. ‘**When you keep rates very low—even if you're raising them but you keep them very low—you are inviting bubbles.**’” The reason I bolded those words is because that's exactly what I see the Fed doing once again. In fact, it's been doing so for years, and I'm convinced it is now far further behind the inflation curve than it ever was in the 1970s.

Hopefully, that's enough to give you a sense of what *The Lords of Easy Money* is all about and, to go-rogue once again, I'd strongly recommend you purchase this book. If *Bubble 3.0* hasn't convinced you that what the Fed has done over the last 13 years is an unmitigated disaster — at least for those who haven't been securing real protection with real assets — Mr. Leonard's classic-to-be should do the trick.

*To hear an insight-rich interview with Pippa on the Russia/Ukraine crisis, pls click on [this link to MacroVoices](#). It's a surprisingly upbeat take on the long-term implications despite the near-term risks and the heart-wrenching human suffering in Ukraine.