

Q: Can the Government Get
This Economy Going ?



Will More Fiscal “Stimulus” Do it ?

- *Keynesian Concept*: Deficit Spend ‘Till We Drop



Wisc. Congressman Obey,
House Appropriations Chair

Stimulus Spending Doesn't Work

Harvard Prof. Robert Barro:

“The available empirical evidence does not support the idea that spending multipliers typically exceed one, and thus **spending stimulus programs will likely raise GDP by less than the increase in government spending.**”

- GDP +0.8% in 2009 ; +1.2% in 2010
- But, this is more than wiped out by effects of future taxes and/or inflation needed to pay for it.

Are There Other Reasons To Spend More ?

- Some have argued that govt. infrastructure spending is more desirable than other spending.
 - \$400 billion annually already
 - Funded projects should have properly calculated benefits that exceed costs
 - *Proper* techniques taught in public economics courses...
...NOT taught in law schools where officials come from.
 - This should NOT be done to increase employment

An Anecdote About Uncle Milton



Nobel Laureate
Milton Friedman:



Another short, feisty
guy who pissed off a
Dean or two.

- Friedman went to Asia, and was shown a canal being dug.
- He noticed it was being dug by thousands of guys with shovels.
- When he asked why they weren't using earth-movers, the officials told him that they wanted to employ more workers.
- Prof. Friedman replied:
 - **“So, why don't you have them dig with spoons?”**

Are There Other Reasons To Spend More?

- From Barry Ritholtz, author of “Bailout Nation”:
More subsidies to owner-occupied housing??
 - Write-down underwater loan balances to 2011 home values, converting the write-downs into 10 year, interest-free balloon loans, etc.



–
KC Fed
Pres. Tom Hoenig

“We must move toward a system with fewer subsidies and misdirected incentives.”

“Subsidies...carefully targeted to...potential homeowners most in need.”

A View From the Top

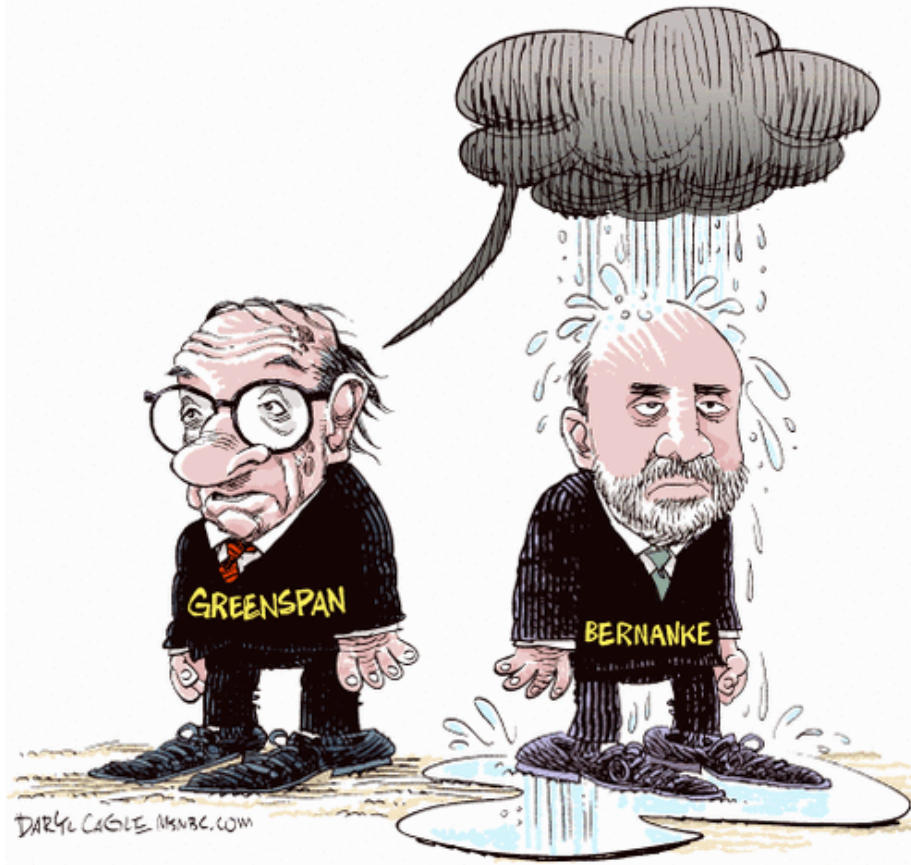
Rich Americans Ditch Home Ownership For Renting

Published: *Friday, 26 Nov 2010 10:09 AM ET*

By: *Joseph Pisani, CNBC News*

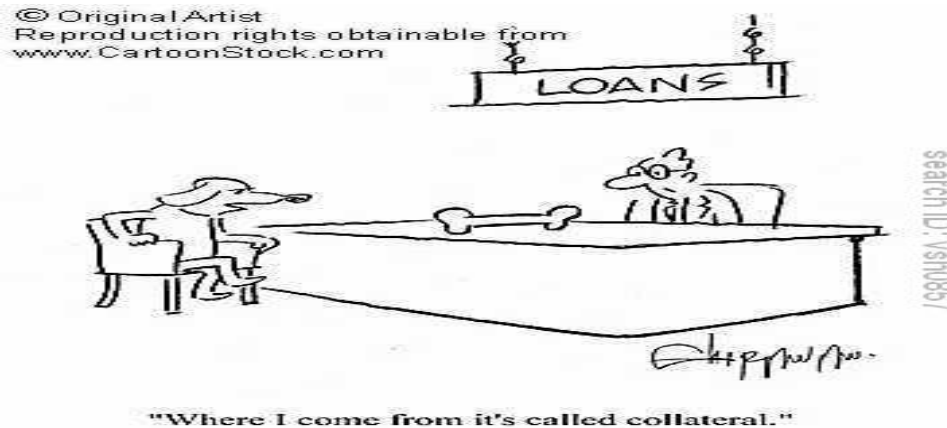
- “ Patrick Lee went from homeowner to home renter this year. In March, he sold the Manhattan apartment he bought in 2008 for about the same price he paid and moved — along with his wife and child — a few steps away into a luxury, two-bedroom rental unit in a brand new building. The rent is around \$11,000 per month.”
- “I wanted to protect ourselves from prices going down,” says Lee, who is a managing director at a major bank.
- “I didn’t want to be an owner anymore.”

Will Monetary Policy Will Save Us ?



The Emergency Liquidity Programs Worked

- After Lehman failure, Fed lent at last resort.
 - Fed ready to buy high-rated commercial paper
 - Fed ready to lend to MMMFs
 - Fed lent against asset-backed securities



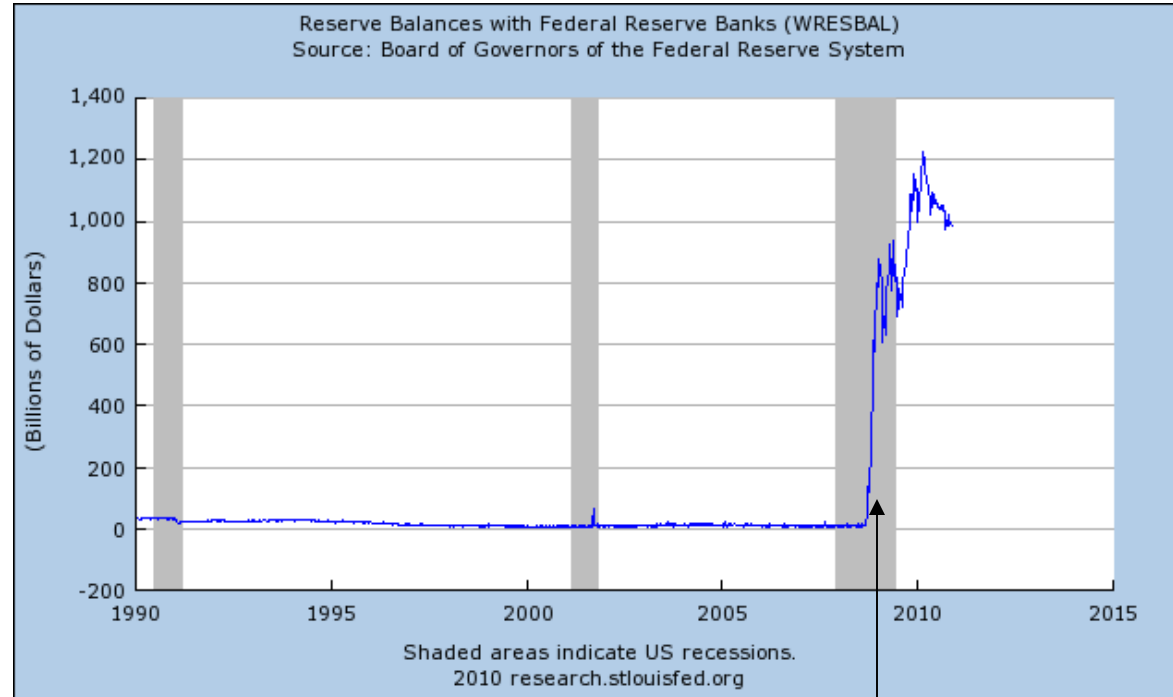
- These actions worked as intended
 - As fear subsided, spreads narrowed.

Open Market Spending Like a Drunken Sailor

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The NY Fed Trading Desk



Bank Reserves Created By Fed Purchasing

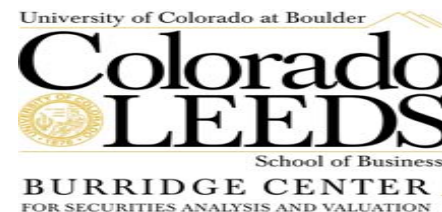
- Drove Fed Funds Rate to (near) Zero
- Fed Started Paying Interest On these Reserves
- Most of this is *Excess Reserves*

So Where is the Rapid Economic Growth?

- Bank reserves are high because banks haven't lent them out.
 - Slack lending → low deposit growth induced by it
 - Low deposit growth → low money supply growth
 - Low money supply growth → low inflation (for now..)
- But if and when bank lending accelerates:
 - More loans → much more deposits induced by them
 - Much more deposits → much more money supply
...AND much more *required* reserves
 - Much more money supply → more inflation later...



“Yup, He is Right About That”

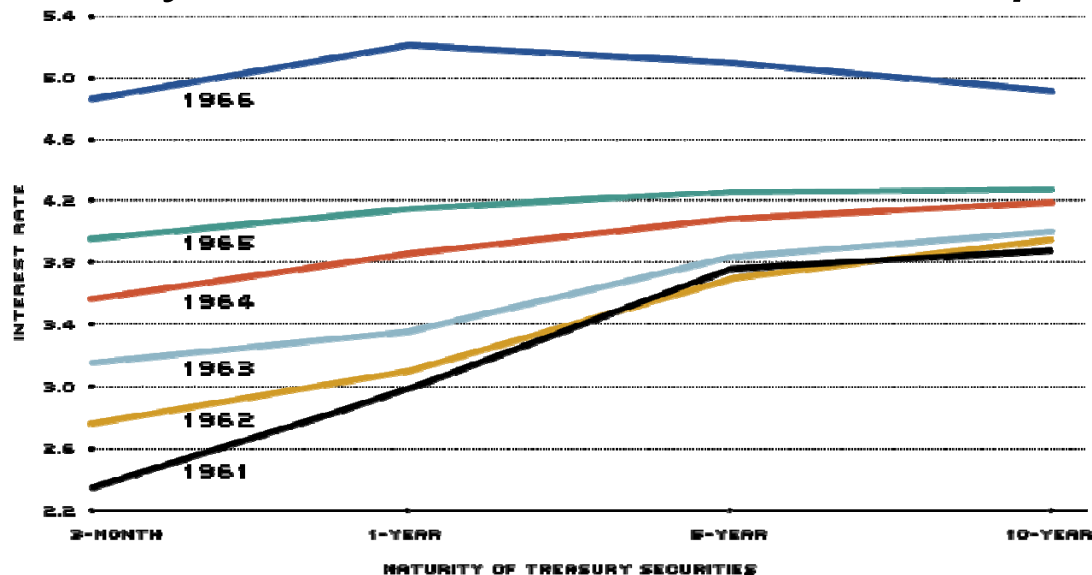


Whither Inflation ?

- As excess reserves get lent out, money supply will grow rapidly, raising fears of inflation.
- Fed's "exit strategy" is two-fold:
 1. Sell a whole bunch of that paper it bought, thus draining reserves and putting upward pressure on the Fed Funds rate.
 2. As the Fed Fund rate rises, raise the interest rate paid on reserves to prevent excessive lending, and subsequent deposit and money supply growth.
- Because this will need to be done *before* recovery is complete, this will be UNPOPULAR -- *perhaps* INFEASIBLE.

QE and QE II ?

- Just more of the same from our drunken sailor
 - i.e. Bar hours have been extended over the holidays
- Not really buying long-term Treasuries
 - Due to interest rate risk: trying to keep net worth > 0
 - Securities' Durations won't be more than 5 years or so
- Already tried from 1961-1965: *Operation Twist*



Yield Curve Flatter...
...but NOT Long Rates
+ Reg. Q Ceiling Raised

Conclusion:

No Savior in More Fiscal and Monetary Stimulus.

What *Else* Could Government Do?

- Don't Panic: Like most personal ow-ies, recessions tend to go away without intervention.
- Or, use the crisis atmosphere to enable landmark tax and regulatory reforms.
 - GOP and Obama want to compromise? Try these:
 - Lower the Corporate Tax rate now, and *a few years from now*, make income millionaires pay the Clinton-era personal tax rate.
 - Lessen regulatory and costly employment mandates for smaller companies, while forcing the relative handful of “megabanks” to divest some units -- credibly preventing “Too Big to Fail”.
 - YOUR THOUGHTS: I Will Now Take Proposals From the Floor