

OPINION

Near-Zero Rates Are Hurting the Economy

By David Malpass

The Federal Reserve implemented an emergency monetary policy after the 2008 Lehman bankruptcy to salvage the world financial system. In his testimony yesterday before the Senate Banking Committee, Fed Chairman Ben Bernanke said, "We must be prepared to withdraw the extraordinary policy support in a smooth and timely way as markets and the economy recover."

This leaves all-out emergency monetary stimulus in place, but with a different, much weaker justification. With the system stabilized, the

Low rate expectations are pushing dollars abroad. That capital needs to stay here to grow businesses and create jobs.

Fed hopes that artificially low interest rates and its purchases of mortgage-backed securities will spur growth. Instead they are pushing dollars abroad and wasting precious growth capital in asset and commodity bubbles.

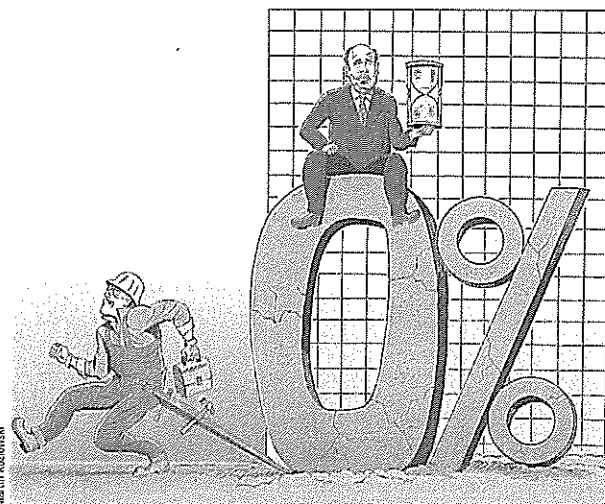
Since the show of global cooperation at the Nov. 6 G-20 meeting, the rest of the world has challenged the Fed's emergency policy.

Asia warned President Barack Obama on his recent trip that the zero-percent fed-funds rate was flooding Asia with excess dollars, causing asset bubbles there and undercutting global growth.

Europe quickly joined Asia's criticism. On Nov. 20, German Finance Minister Wolfgang Schäuble said that the U.S. policy threatened "enormous turbulence." European Central Bank President Jean-Claude Trichet has repeatedly tried to bolster the U.S. commitment to a strong dollar, most recently with yesterday's comment that "I trust the sincerity of the U.S. authorities."

Nevertheless, more than a year after the heart of the panic, the Fed is still promising near-zero interest rates for an extended period and buying over \$3 billion per day of expensive mortgage securities as part of a \$1.25 trillion purchase plan. Capital is being rationed not on price but on availability and connections. The government gets the most, foreigners second, Wall Street and big companies third, with not much left over.

The irony of the zero-rate policy, coupled with Washington's preference for a weak dollar, is a glut of American capital in Asia (as corporations and investors shun the weakening U.S. currency) and a shortage at home. For gold and oil, the low-rate policy works, weakening the dollar so commodity prices go up and providing traders with ample



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funds to buy into the expanding bubble. Those markets are almost daring the Fed to try to break out of its zero-rate box.

But for small businesses and new workers, capital rationing is devastating, spelling business failures and painful layoffs. Thousands of startups won't launch due to credit shortages, in part because the government and corporations took more credit than they needed (because it was so cheap).

Already countries with higher

interest rates, Australia for one, are viewed as less risky because they have room to cut rates if there's another emergency. This wins them capital and jobs that might otherwise be ours.

According to International Monetary Fund data, U.S. GDP has fallen to 24% of world GDP from 32% in 2001. And as U.S. capital escapes the weak dollar and high tax rates, the U.S. share of world equity market capitalization has fallen to 30% from 45%. This leaves the U.S. alone with Japan at the bottom of the monetary heap, with rate expectations so low they repel investment.

Yet the Fed's not nearly as trapped as it seems. Much of its current stimulus is being diverted to commodities and foreign economies—hence Asia's complaint about bubbles. Under emergency stimulus, corporations are borrowing dollars hand-over-fist, pleasing Wall Street while using the proceeds to expand their foreign businesses. If that stimulus could be retained here, the Fed could stand down gradually from the emergency yet still assure appropriate policy accommodation.

The simple goal is to convince the capital now funding gold mines and foreign asset bubbles to instead fund small businesses and the guaranteed mortgages the Fed's been buying. This means stopping the dollar's collapse, since it is fueling the outflow.

Since U.S. inflation is relatively low, even a Fed nod toward normalcy on monetary policy (not evident in Mr. Bernanke's testimony yesterday) should cause a dramatic

improvement in the dollar and the magnitude of capital flows.

The fed-funds rate can stay near zero for a while longer, but the Fed can't keep promising "exceptionally low rates for an extended period," as it did last month. The sooner the Fed moves off its policy extreme, the sooner markets can resume their job of allocating capital and assessing relative value. In a more market-oriented allocation of global capital, the U.S. will be a big winner, especially for jobs and small businesses.

If the Fed wants to speed the capital reflow, it could mention the importance of the dollar in its Dec. 16 committee statement on interest-rate policy and inflation risks. In his Nov. 16 address to the Economic Club of New York, Mr. Bernanke said policies should "help ensure that the dollar is strong and a source of global financial stability." Putting that in the Fed's policy statement—with none of the normal winks to those who favor devaluation—would cause capital to flood back into the U.S., loosening small-business credit and adding jobs even when the Fed eventually contemplates rate hikes.

If the Fed announces that an end is in sight to its all-out emergency policies, two other benefits may accrue. China should be more willing to allow yuan appreciation if it thinks there's a net under the dollar. With no net, China fears that yuan appreciation would accelerate dollar flight, driving commodities even higher. And the Fed should be able to maintain its independence, which is at risk from congressional audits as long as the deeply unsettling emergency policies persist.

Wall Street will threaten a tantrum if the Fed even thinks about damping the air-raid sirens. The Street utterly loves the Fed's largess, earning massive profits from trading unstable currencies, the carry trade (borrow short-term dollars near zero, buy longer-term assets abroad), and the high-margin process of transferring America's capital abroad.

The hitch is that there isn't much trickle-down to normal jobs and small businesses from the sophisticated, zero-rate arbitrage that is propelling asset prices ever higher. It would be better to stand down from emergency stimulus and instead help markets direct the capital that is now going into bubbles into the economy and jobs.

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