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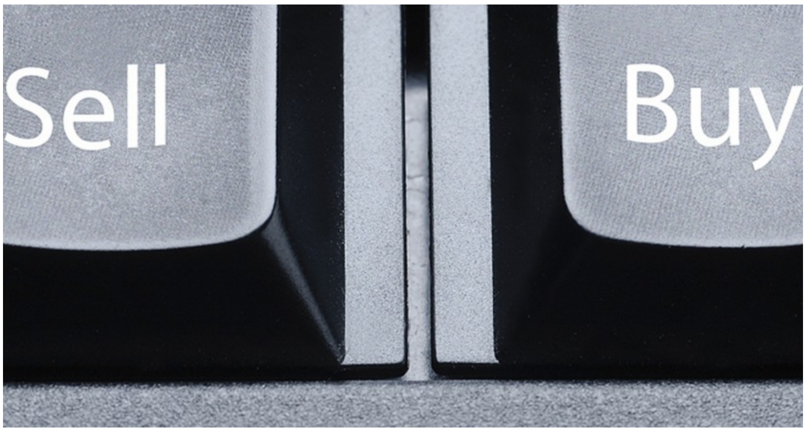
Markets Tumble After Fed Chair Bernanke Predicts the End of Quantitative Easing



Stock and commodities markets went into a two-day slide after Federal Reserve Chairman Ben Bernanke hinted that the United States would end so-called "quantitative easing" sometime during 2014. "Quantitative easing" is the term used by Federal Reserve Bank officials for the inflationary creation of money to finance U.S. government debt and purchase mortgage-backed securities from banks on the open market.

The June 21 trading day ended slightly up, with the Dow Jones Industrial Average up 41.08 to 14,799.40, after losing more than 500 points in the previous two days. Gold dipped below the $1,300 per ounce threshold, the lowest price in more than two years, and other precious metals and oil also fell over the same period.

In the release about the Federal Reserve Bank's Open Market Committee meeting, Fed officials predicted three percent GDP growth in the U.S. economy next year, low inflation, and a reduction of the unemployment level to six percent by the end of 2015. The prediction may have been too rosy, considering the extraordinarily low savings rates of consumers, high national debt, and recent economic history. In the past 20 years, the U.S. economy has only seen CPI-adjusted growth exceeding three percent of GDP in years before an economic crash. The U.S. economy saw two three-percent growth years in 2004-05 (before the housing/banking bubble burst), and four years of four-percent growth from 1997-2000 (before the dot-com bubble burst).

Regarding "quantitative easing," the Fed explained that "the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month." The Federal Reserve release also announced almost unanimous plans to continue the Fed's policy of a near-zero discount loan rate for banks through the end of 2014. Members of the Federal Reserve's Open Market Committee split on what the policy should be in 2015:

> The Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent.

Discounted interest rates — a result of the Fed's policy of discounted loans to banks — was the primary reason for huge capital inflows to the stock market in the 1920s before the Great Depression and capital inflows to the housing markets a decade ago, which resulted in the housing bubble bursting. The Fed's continued policy of suppressing market interest rates has created another housing boom in the past year, with housing prices rising 15.4 percent over a year ago. The 14,799.40 closing stock price for the Dow Jones — though reduced substantially from its all time high — is still more than double the price at the bottom of the recession in 2008-09.

Regarding a new housing bubble, even the pollyannaish National Association of Realtors is starting to get nervous. Lawrence Yun, chief economist for the National Association of Realtors, explained in a June 20 press release, “The home price growth is too fast, and only additional supply from new home building can moderate future price growth.”

The interesting thing about the two-day stock market plunge — along with the plunge in orders for precious metals, such as gold, silver, platinum, and palladium — is that the two-day crash occurred only on the word of Federal Reserve officials who had announced no actual change in policy. All of the crash was speculative: metals traders speculating high price inflation abandoned their speculative efforts, and stock market investors left the market expecting some sort of economic crash. It also serves as evidence that the stock market is being driven more by speculation than market fundamentals.