Bernanke Whitewashes Fed Responsibility for "Great Recession"

Federal Reserve Board Chairman Ben Bernanke largely whitewashed Federal Reserve responsibility for the housing bubble and resultant economic recession in testimony before the congressional Financial Crisis Inquiry Commission September 2.

Bernanke's testimony admitted the obvious, that he had no clue that a housing bubble even existed, let alone that it would burst in late 2007, while at the same time claiming there was little he could have done to prevent the crisis or mitigate its impact upon the economy. Bernanke argued that several Wall Street giant financial firms such as Lehman Brothers failed because he had too little legal power to bail them out. "It was with great reluctance and sadness that I conceded there was no other option" than allowing Lehman to fail, Bernanke told investigators, concluding he lacked the legal authority to bail out Lehman Brothers. Bernanke explained that "the Federal Reserve under normal conditions is permitted to lend only to depository institutions and had the authority to lend to nondepositories only in unusual and exigent circumstances. Thus, the Federal Reserve could not directly address liquidity problems at nondepositories until the crisis was well underway."

But perhaps the most unbelievable part of Bernanke's testimony was his claim that the Federal Reserve's suppression of interest rates "was only a small factor" in creating the housing bubble. "Did the low level of short-term interest rates undertaken for the purposes of macroeconomic stabilization inadvertently make a significant contribution to the housing bubble?" asked rhetorically, answering his own question with the claim that "studies of the empirical linkage between monetary policy and house prices have generally found that that that linkage is much weaker than would be needed to explain the behavior of house prices in terms of FOMC policies during this period."

Of course, interest rates have a direct impact upon housing affordability because affordability has traditionally been calculated by the income of the borrower, the price of the house and the interest rate of the amount borrowed. Because a lower interest rate means a lower mortgage payment (and qualification for home loans is a percentage of income), the Federal Reserve's monetary policy of suppressing interest rates had a strong impact on the affordability of larger houses and the eligibility for lower-income people to afford mortgages. By increasing the eligibility for housing, demand for housing spiked throughout the last decade. Even a 2009 study of the housing bubble by the Federal Reserve itself (though it too was a whitewash) admitted: "Nominal house price growth began to pick up in the late 1990s.... This timing clearly predates the accommodative monetary policy following the 2001 recession. However, the pace of house price appreciation increased notably after 2002, and much of the overvaluation in house prices appears to have occurred after 2002 as well."

But Bernanke instead blamed the housing bubble on Wall Street for following the Federal Reserve's lead. Bernanke testified that "innovations in mortgage lending and the easing of standards had far greater effects on borrowers' monthly payments and housing affordability than did changes in monetary policy." Of course, if the Federal Reserve created a decade-long housing prices boom with its suppression of interest rates, one would reasonably expect Wall Street to cater to — and cash in on — the central bank's manipulation of the housing market. Bernanke paints this foolish accommodation by many private banks of the Fed's interest rate policy as the cause, rather than a symptom, of the problem. "Although a number of developments helped trigger the crisis, the most prominent one was the prospect of significant losses on residential mortgage loans to subprime borrowers that became apparent shortly after house prices began to decline."

Moreover, Bernanke told investigators that in hindsight he probably wouldn't have changed a thing anyway, as interest rates were being suppressed for purely political reasons:

> Monetary policy is a blunt tool; raising the general level of interest rates to manage a single asset price would undoubtedly have had large side effects on other assets and sectors of the economy. In this case, to significantly affect monthly payments and other measures of housing affordability, the FOMC likely would have had to increase interest rates quite sharply, at a time when the recovery was viewed as "jobles"' and deflation was perceived as a threat.

In essence, Bernanke told investigators for the Financial Crisis Inquiry Commission that he can't be blamed for building a bubble with his interest rate suppression because he was under political pressure to do so.

The problem, Bernanke told investigators, was not a cowardly Federal Reserve making decisions to help politicians rather than trying to correct systemic problems in the economy, but private industries that were too big to fail. Private industries that are "too-big-to-fail generates a severe moral hazard," Bernanke concluded. "If the crisis has a single lesson, it is that the too-big-to-fail problem must be solved." Bernanke's solution to a recession created by the federal government's central bank is to give the central bank more power. He argued that the Federal Reserve Bank should oversee

> tougher regulation and supervision of the largest firms, including restrictions on activities and on the structure of compensation packages; and measures to increase transparency and market discipline. Oversight of the largest firms must take into account not only their own safety and soundness, but also the systemic risks they pose.

This is the perpetual plea of all big government politicians: We failed, so give us more power and money.

Yet Bernanke inadvertently noted in testimony that huge federal deficit spending also worsened the recession. The massive increase in federal debt securities — just as the financial crisis was breaking —

soaked up all the private investment that could have been used to finance a recovery. "An increase in the risk of a [bank] run induces financial firms to hoard liquidity, for example, by shifting asset holdings into highly liquid securities such as Treasury securities."

Since the crisis, the federal government has continued to subsidize Wall Street Banks with taxpayer dollars. Many banks have borrowed from the Federal Reserve Bank's discount window for nearly zero percent (the Fed is currently suppressing interest rates even more than at the height of the housing boom), while investing those funds in Federal Treasury securities that have been issued at a higher interest rate. While the banks have allowed the Obama administration to continue to spend freely, all of those funds have been denied to private industry that would lead to re-tooling and innovation that has traditionally created jobs and economic growth.

Photo of Fed Chairman Ben Bernanke: AP Images