The New Fed Chairman Plans to Pop Bubbles

Our criticisms of the Federal Reserve Board since Greenspan took over in 1987 are too numerous to detail in this short report. One fault we find is that they are always wrong about the economy, and by this we mean every single time, without exception, from 1987 through 2017.

Our other largest criticism is that the overriding result of their policies in the last 30 years has been to create financial bubbles, in stocks and debt. They do this by lowering interest rates far too low for far too long. Since bubbles always pop in the end, the net result of their actions is to lead to an unstable economy, which results in financial suffering for the nation.

Of course, they have been asked many, many times about the dangers of financial bubbles and their role in creating them. At least on this one topic they have been quite clear and consistent. They have repeatedly said they have no idea when a bubble is forming or even what a bubble is. Therefore, how can they stop something they cannot even see? While this may actually be a rare instance of an honest response, it also highlights how thoroughly inept the last three Fed Chairs, i.e. Greenspan, Bernanke, and Yellen, have been.

In February we got a new Fed Chairman, Jerome Powell. While still too early to know for sure, it is looking as if Mr. Powell is different. First, he is not an academic but spent his career working in the private financial industry. This is a very good start. The theories which dominate academia today can be proven wrong conceptually, and have been proven wrong in the real world for decades. Mr. Powell may have noticed this during his career on Wall Street.

Mr. Powell made his first speeches to Congress in early April, and we were not encouraged as he sounded just like his predecessor Janet Yellen. In retrospect he may have simply wanted to reassure everyone the Fed was not going to spook the markets by making sudden changes.

But in his second round of speeches to Congress, Mr. Powell actually did indicate a dramatic change in Fed policy. He added financial stability and the elimination of financial excesses as a new Fed mandate, indicating this goal is at least as important as the Fed's only two previous goals of achieving full employment and price stability.

When Fed people talk about eliminating financial excesses or maintaining financial stability, they are specifically saying they want to stop financial bubbles from occurring, or pop them if they have already developed. This means Powell is now saying the Fed is going to do the exact opposite of what the Fed has done for 30 straight years. If he holds to this new mandate, it will be the single greatest development for our economy since 1987.

It will also hasten the next stock market crash. Powell must know the stock market (and much of the corporate bond market) is in an historic bubble, and he must know raising interest rates is the one sure way to pop it. After beginning his second speech to Congress stating he planned to stop financial excesses, i.e. pop bubbles, the rest of the speech essentially explained why he planned to raise short-term interest rates faster and more often than previously predicted. Wow.

Of course, as with all other Fed communications, his speech also contained a great deal of information of questionable validity. Fed leaders have so much financial power, they do have to tread carefully. If he came right out and said the stock market was in a bubble and he planned to pop it ASAP, the stock market would probably fall 20% the next moment. But the other parts of his speech did not detract from the fact he clearly stated - five times - this new Fed Chairman plans to stop financial excesses and instability, i.e. bubbles, before they occur whenever possible, and as quickly as he can if they have already appeared.

This means the Fed should raise interest rates as high as possible, as quickly as possible, which is exactly what he says they intend to do. During my entire career in the financial industry, before Mr. Powell's speech, I had never heard any significant Fed policy which would be beneficial to our nation's economy. I don't care what reasons they give, or if the reasons they give make any sense. The only thing that matters is that the Fed begins to pop bubbles, and then does not attempt to re-inflate them.

This speech was, hands down, the most important development by the Fed in 30 years, yet the financial media did not even notice. (Props to Daniel Nevins at FFWiley.com for writing the only article I've seen about it.) Given so many years of disappointment, I fully expect Mr. Powell to also disappoint sometimes going forward. Still, this was a great start to his tenure.