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## How to Think About the Fed Now

April 15, 2020 - 9:58 AM [Jeff Deist](#) <sup>[1]</sup>

**[This text is excerpted from the introduction to *Anatomy of the Crash*, a Mises Institute ebook to be released in April 2020.]**

The Great Crash of 2020 was not caused by a virus. It was *precipitated* by the virus, and made worse by the crazed decisions of governments around the world to shut down business and travel. But it was *caused* by economic fragility. The supposed greatest economy in US history actually was a walking sick man, made comfortable with painkillers, and looking far better than he felt—yet ultimately fragile and infirm. The coronavirus pandemic simply exposed the underlying sickness of the US economy. If anything, the crash was overdue.

Too much debt, too much malinvestment, and too little honest pricing of assets and interest rates made America uniquely vulnerable to economic contagion. Most of this vulnerability can be laid at the feet of central bankers at the Federal Reserve, and we will pay a terrible price for it in the coming years. This is an uncomfortable truth, one that central bankers desperately hope to obscure while the media and public remain fixated on the virus.

But we should not let them get away with it, because (at least when it comes to legacy media) the Fed's gross malfeasance is perhaps the biggest untold story of our lifetimes.

Symptoms of problems were readily apparent just last September during the commercial bank repo crisis. After more than a decade of quantitative easing, relentless interest rate cutting, and huge growth in "excess" reserves (more than \$1.5 trillion) parked at the Fed, banks still did not have enough overnight liquidity? The repo market exposed how banks were capital constrained, not reserve constrained. So what exactly was the point of taking the Fed's balance sheet from less than \$1 trillion to over \$4 trillion, anyway? Banks still needed money, after a decade of QE?

As with most crises, the problems took root decades ago. What we might call the era of modern monetary policy took root with the 1971 Nixon Shock, which eliminated any convertibility of dollars for gold. Less than twenty years later, in October 1987, Black Monday wiped out 20 percent of US stock market valuations. Fed chair Alan Greenspan promised Wall Street that such a thing would never happen again on his watch, and he meant it: the "Greenspan Put" was the Maestro's blueprint for providing as much monetary easing as needed to prop up equity markets. The tech stock crash of the NASDAQ in 2000 only solidified the need for "new" monetary policy, and in 2008 that policy took full flight under the obliging hand of Fed chairman Ben Bernanke—a man who not only fundamentally misunderstood the Great Depression in his PhD thesis, but who also had the self-regard to write a book titled *The Courage to Act* about his use of other people's money to reflate the biggest and baddest stock bubble in US history.

James Grant of *Grant's Interest Rate Observer* characterizes the Fed's recent actions as a "leveraged buy-out of the United States of America." The Fed is assumed to have an unlimited balance sheet, able to provide financial markets with "liquidity" as needed, in any amount, for any length of time. Pennsylvania senator Pat Toomey urges the Fed to do more, and Congress to spend more, all in the unholy name of liquidity.

But liquidity is nothing more than ready money for investment and spending. In the current environment it is a euphemism for free manna from heaven. It is "free" money—unearned, representing no increase in output or productivity. It has no backing and no redeemability. And not only are there no new goods and services in the economy, there are far fewer due to the lockdown.

So monetary "policy" as we know it is dead as a doornail. What central banks and Fed officials do no longer falls within the realm of economics or policy; in fact the Fed no longer operates as what we think of as a central bank. It is not a backstop or "banker's bank," as originally designed (in theory), nor is it a steward of economic stability pursuing its congressionally authorized dual mandate. It does not follow its own charter in the Federal Reserve Act (e.g., impermissibly buying corporate bonds). It does not operate based on economic theory or empirical data. It no longer pursues any identifiable public policy other than sheer political expediency. Fed governors do not follow "rules" or targets or models. They answer to no legislature or executive, except when cravenly collaborating with both to offload consequences onto future generations.

The Fed is, in effect, a lawless economic government unto itself. It serves as a bizarro-world *ad hoc* credit facility to the US financial sector, completely open ended, with no credit checks, no credit limits, no collateral requirements, no interest payments, and in some cases no repayments at all. It is the lender of first resort, a kind of reverse pawnshop which pays top dollar for rapidly declining assets. The Fed is now the Infinite Bank. It is run by televangelists, not bankers, and operates on faith.

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