Fed Policy of Hyperinflation Sparks Revolt

by Paul Gallagher

Jan. 28—The increasing clamor from within the banking community for re-enactment of the Glass-Steagall Act is evidence of what few elected officials understand about Glass-Steagall: It slams the door against the Federal Reserve, and other central banks, continuing their hyperinflationary money-printing policy.

That policy, with the five-year virtual zero-interest-rate regime connected with it, has deranged the U.S. commercial banking system, while absolutely failing to bring about the return of big-bank lending which was its public justification in every country. It is simply enabling years-long bailouts of the "toxic" securities loading the books of these large banks, while causing severe problems for small and medium-sized commercial banks' lending, and driving them towards securities speculation as well.

Thus we have seen state bank leaders stand up with LaRouchePAC activists to call for Glass-Steagall at hearings in Montana and Washington State in recent weeks; the campaigning for Glass-Steagall by American Banking Association leaders in Connecticut and other states; and the powerful response from community bankers to Dallas Federal Reserve president Richard Fisher's Jan. 17 speech on bank separation in Washington, D.C.

The simultaneous statements that day by Fisher and FDIC vice-chairman Thomas Hoenig (former Kansas City Fed president and an advocate for restoring Glass-Steagall) showed a revolt against central-bank hyperflation policy which has reached within the Fed itself. It was also shown in the small uproar among members of the Federal Open Market Committee (FOMC) in their Dec. 12, 2012 meeting, when several voiced fears that the Fed was trapping itself in its money-printing "QE" policy and could be unable to end it—permanent zero-interest hyperinflation.

Helga Zepp-LaRouche, speaking to hundreds of activists at the Schiller Institute's Jan. 26 conference in New York, warned of a "major, existential crisis, the fact that the entire trans-Atlantic financial system, as a result of the high-risk speculation, the '25% profit' as [Deutsche Bank CEO] Mr. Ackermann liked to say, and the continuous bailout policies of the too-big-to-fail banks, has now come to a situation where the only thing left is a hyperinflationary blowout of the entire system." And she noted the Jan. 24 article of Prof. Hans-Werner Sinn, head of the leading German economic think-tank, the Munich IFO, who warned that the European banking system faces insolvency, and bank creditors will lose their investments. Sinn said that bank debt of just six Euro countries was $12 trillion, three times their national sovereign debt, and much of it unpayable.

While Zepp-LaRouche spoke, the third-largest bank in Italy leaned at the edge of bankruptcy with the Italian government attempting a bailout—Monte dei Paschi di Siena, the oldest operating bank in the world, ruined by massive speculations and losses in derivatives (see article, this issue).

Only the immediate reimposition of Glass-Steagall banking policies will stop this disaster.

No-Exit Quantitative Easing

Despite some $2.5 trillion newly printed Federal Reserve dollars issued since the 2007-08 financial crash, lending by U.S.-based banks' is still falling. The Fed has expanded its asset book by that amount since 2008, printing money to buy securities from the major banks to provide them liquidity and capital—and to hold up the otherwise collapsing values of many of the securities the Fed has been buying. It plans to print another $1 trillion in 2013 in the same operations.

The Fed released data Jan. 24 showing it holds just under $1.7 trillion in Treasury securities; it had held just $475 billion when Barack Obama took office in early 2009. It also holds over $1.5 trillion in mortgage-backed securities bought from large banks; and its now $3 trillion-plus "asset book" is growing at 30% a year, $85 billion a month in money-printing. Yet the European Central Bank's money-printing has been greater than the Fed's; ECB's asset book is already over $4 trillion.

The public justification from the likes of Bernanke, Draghi, and Geithner has been that this enables large banks to lend to the economy at low interest rates. But that has failed in reality. U.S. banks' and thrifts' deposits reached a record $10.6 trillion at the end of 2012,

according to the deposit tracking firm Market Rates Insight Inc., reported in the *Wall Street Journal* Jan. 11. Combine this with another report, from SNL Financial Corp., that the share of deposits *loaned* by U.S. banks and thrifts hit a new low of 72% at the same time; this share loaned had been over 95% in 2007. And even the absolute dollar total of loans, $7.58 trillion, is 5.3% lower than bank lending two years ago.

Recent bank data has shown smaller U.S. banks being driven to load up their own balance sheets with securities—especially mortgage-backed securities—instead of lending, because the years-long zero-interest and bailout policies put them at a disadvantage in acquiring capital, and eliminates their loan income.

The Fed's hyperinflationary money-printing, while driving up the stock market, had has no effect on bank lending—its claimed "purpose." Instead, it combines with austerity policies to make a hyperinflationary explosive combination.

At the Dec. 12 meeting of the Fed, what the minutes described as "several" members of the FOMC expressed clear worries that unless the Fed stops printing money in the next couple of months, it will become trapped, unable to stop at all—to "exit quantitative easing" in Fed-speak—because attempting to exit will have severe consequences for the economy and the Fed's balance sheet itself. At soon-to-be $4 trillion in assets, 25% of U.S. GDP, the Fed will be dominating purchases of Treasuries and all other fixed-asset securities in the U.S. economy during 2013." Its "asset book" will drive down securities "values," including its own, rapidly, and raise interest rates sharply, as soon as the New York Fed were to try to start stop the money-printing by selling assets off. The Fed cannot thus "go bankrupt," of course; it could always then avoid that, and hold interest rates down, by—printing more money, faster. Therefore the clear anxiety among FOMC members in December.

Stopping the Fed

In contrast, the potent response is the demand for Glass-Steagall bank separation being raised among a courageous few in Congress and by Dallas Fed president Fisher, FDIC's Hoenig, and other Fed presidents demanding Rooseveltian bank reorganization measures, such as Kansas City's Esther George. The *New York Times* reported on Jan. 19 that Fisher's speech on "chopping up the megabanks into pieces, so that no one of them could endanger the financial system" was having a strong impact. Members of Congress from both parties were calling Fisher, and other sources reported that bankers from throughout his Fed district called the Dallas office to urge him on. Fisher also insisted in his speech that the Fed's "quantitative easing" policy was producing no economic effect.

A week later, Steven Denning reported in *Forbes* that "there is a "call for the return to Glass-Steagall.... Its straightforward disclosure regime that prevailed for decades starting in the 1930s didn't require extensive legal rules. Nor did vigorous prosecution of financial crime. However it does require political will-power."

Times financial columnist Gretchen Morgenson wrote that Fisher's speech "may sound like a return to the Glass-Steagall Act, the Depression-era law that separated investment banking and commercial banking until it was dismantled in 1999. But Mr. Fisher's plan is much more sophisticated...." But any Member of Congress looking at Fisher's proposed regulations would have to say, "If this isn't Glass-Steagall, then what is it?"

Restoring Glass-Steagall would stop the Federal Reserve's money-printing cold, and potentially reverse it. The Fed is massively purchasing securities, predominantly from various investment divisions of banks—divisions which, under Glass-Steagall bank regulation, are ineligible to receive *any* form of such support, bailout, or "safety net" involving United States credit.

Furthermore, the low quality of mortgage-backed securities and their derivatives bars the Fed from buying—or even lending against—them under Glass-Steagall regulations, which became Article 23A of the Federal Reserve Act. And Glass-Steagall regulations definitively bar financial derivatives from Federal backup. Big bank holding companies have moved exposures to those "financial weapons of mass destruction" by the tens of trillions of dollars, onto the books of their Federally insured commercial banking units; that would end and be reversed under Glass-Steagall.

By slamming those hyperinflationary doors shut, Glass-Steagall will uniquely open the door to the use of national credit for investment in high-productivity economic projects of new infrastructure, and long-term skilled employment. It will also enable the 6,000 commercial banks to lend productively again, with the same effects in other trans-Atlantic countries otherwise facing bank panic and collapse.