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# American Account: Fed gambles with inflation to give jobs boost

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The fiscal cliff is a diversion, designed by politicians to conceal their inability to come to grips with the facts that they continue to spend too much, and refuse to reform a tax structure that reduces the competitiveness of American companies in world markets. No matter what deal is cut, whether before or after the new year, it will at best nibble at the edges of the trillion-dollar annual deficits that are being piled up.

The real action has shifted from America's inactive politicians to our hyperactive central bankers, the members of the monetary policy committee, who are making Las Vegas high rollers look like risk-averse wimps. And the highest roller of all is the bewhiskered former Princeton economics professor who presides over the Federal Reserve Board's printing presses. Ben Bernanke, the board's chairman, has an advantage over his Vegas counterparts: he can't run out of money because he can always print more.

Bernanke's "risky bet", to borrow a characterisation from The Wall Street Journal, is that he can safely keep pumping money into the economy until the unemployment rate drops from its current level of 7.7% to at least 6.5%. Unless, of course, the decline in the unemployment rate is due to a drop in the labour force participation rate, in which case quantitative easing will continue. If you think none of this matters because Bernanke will exit stage left in 2014, consider that his likely successor, vice-chairman Janet Yellen, says the Fed's complex mathematical models show that interest rates should not reach 1% by 2017 if unemployment is to reach acceptable levels.

The Fed chairman is not worried that the dollar will collapse, for three reasons. First, his fellow central bankers are prepared to do the same. Witness the statement last week by Mark Carney, the Bank of England's governor-in-waiting: "Today a central bank may need to commit credibly to maintaining highly accommodative policy even after the economy and, potentially, inflation picks up." In plain English, keep printing money even in the face of rising inflation.

A second reason the dollar is unlikely to take a substantial hit is that America remains a safe haven, if not from Bernanke and inflation, at least from overt confiscation, politicised court rulings, and the new UK fad of "moral" retroactive tax exactions.

Finally, Bernanke says that if the Fed's projection of the inflation rate one and two years ahead exceeds 2.5%, he will start to raise interest rates — "take away the punch bowl" in central bank jargon. Note, however, that it is the Fed's projection, rather than hard data, on which the Fed will rely, and inflation forecasts are often an unreliable indicator of the price rises that eventually occur.

Businesses have been clamouring for certainty, and unable to get it from the politicians who control fiscal policy. Now they have it from the Fed in respect to monetary policy. No surprise that the new certainty is not welcomed by those who, like the sole monetary policy committee dissenter, Jeffrey Lacker, chairman of the Richmond Fed, worry that Bernanke is setting the stage for inflation down the road. Or by the frugal, who find that zero interest rates yield derisory returns on their savings and on the pension funds on which they rely.

In a sense, Bernanke's redistribution of income from savers and creditors to debtors makes President Barack Obama's redistribution from the wealthy to the middle class seem trivial by comparison. The new certainty, by keeping interest rates close to zero, also makes it possible for the government to continue borrowing at a more rapid rate than if it faced higher rates, reducing its incentive to slice enough from current spending to make a serious dent in the deficit.

Bernanke is not the only central banker expanding his balance sheet. The Fed will add $1 trillion to its balance sheet next year, and other central banks an additional $10 trillion, leaving the world awash in fiat money. Central bankers are reacting to a long period of recession and slow growth, and in Bernanke's case to what he calls the "enormous waste of human and economic potential" reflected in the high unemployment rate and the decline in the labour force participation rate. This significant change in targeting — using an economic indicator rather than a date to determine when the Fed's work is done — announces a dramatically new monetary policy, one that elevates the goal of full employment far above the Fed's other goal of stable prices.

To be fair to Bernanke, it is not clear that he has got it wrong. First, it is arguable that his launch of QE1 and QE2 created vehicles that could and did throw life rafts to financial institutions that were drowning in flawed debt instruments, and that QE3 boosted post-recession growth. To mix my metaphors, another dose of an efficacious medicine might just be in the patient's interest. Second, a new QE that dare not speak its name — make no mistake, the new policy is QE4 — might well be needed if fiscal policy tightens when taxes go up and spending comes down, as will happen in 2013 no matter how the fiscal cliff is resolved, or even if no deal is made.

Finally, Bernanke believes that the economy will grow at the unsatisfactory rate of 1.7%-1.8% this year, and 2.7% next year (the central point of the predicted range), in part because uncertainty over the governability of the nation is driving down consumer confidence and stifling business investment.

There you have it. The Fed has been buying $40bn of mortgage-backed securities and $45bn of long-term Treasuries every month, but until now it has also been selling $45bn in short-term government securities. Those sales have stopped, so net purchases will go from $40bn per month to $85bn. Do that for a few months, and you have to print a lot of money. Do that until 2017 and you just might have a currency so debased that paying off the national debt will be a snap. So unless you are sitting on a batch of Uncle Sam's IOUs, as are the Chinese, don't worry, be happy. We will print our way out of our debt.

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