The 8th Deadly Innocent Fraud

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Myth

- Raising interest rates works to slow the economy, increase unemployment, and bring down inflation.
- Reducing interest rates works to support the economy, reduce unemployment, and increase inflation.

Fact

- The Fed has it backwards.
- Rate increases cause government deficit spending to increase and support the economy, reduce unemployment, and support prices.
- Cutting rates reduces government deficit spending which reduces economic growth, employment, and price pressures.

What Happens When the Fed Hikes Interest Rates?

- The only thing that changes for the government is that the Fed and Treasury pay more interest to the economy
- The Fed pays more interest on reserves and on reverse repurchase accounts
- The Treasury pays more interest on new securities that it issues, called Treasury bills, notes, and bonds.
- As the rate increases are not done in conjunction with offsetting tax increases, the increase in government interest expense is all new deficit spending.
- **In short, Fed rate hikes continuously flood the economy with new money.**

Federal government current expenditures: Interest payments (A091RC1Q027SBEA)

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Observation:
Q1 2024: **1,059.235**
(+ more)
Updated: Apr 25, 2024 7:57 AM CDT

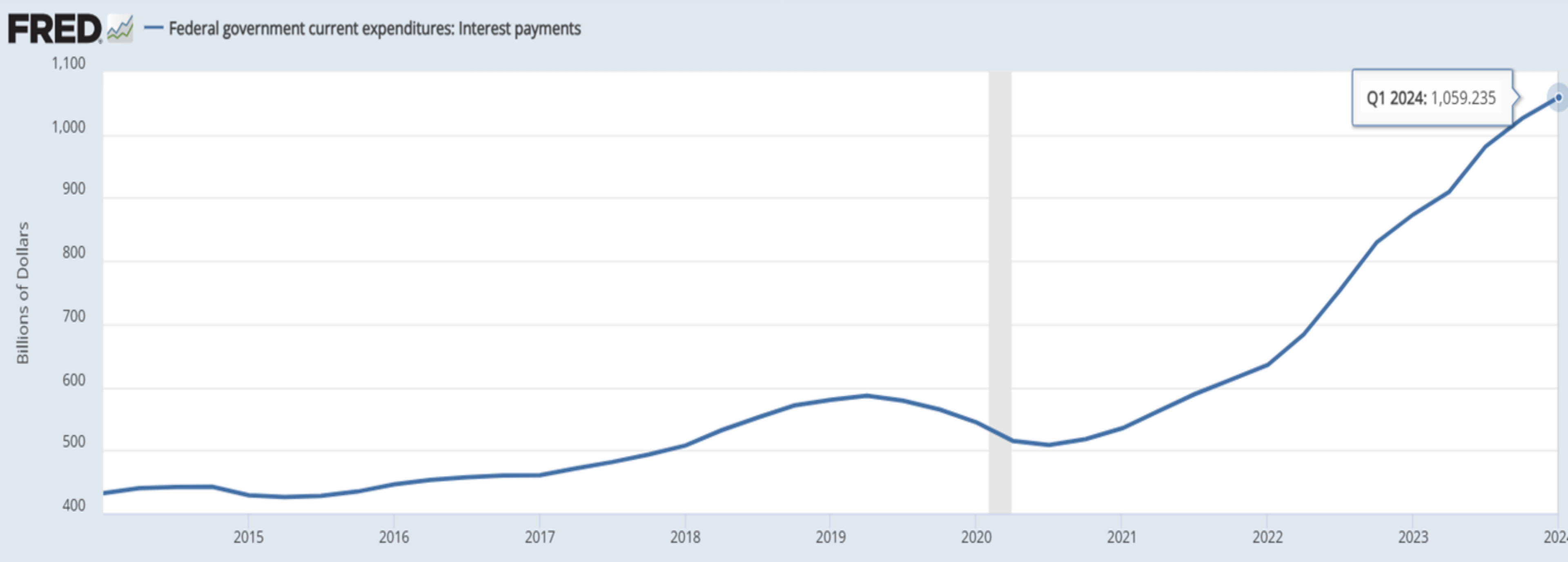
Units:
Billions of Dollars,
Seasonally Adjusted Annual Rate

Frequency:
Quarterly

1Y | 5Y | 10Y | Max

2014-01-01 to 2024-01-01

EDIT GRAPH



Federal Debt Held by the Public as Percent of Gross Domestic Product (FYGFGDQ188S)

DOWNLOAD

Observation:
Q1 2024: **97.39733**
(+ more)
Updated: Jun 27, 2024 8:07 AM CDT

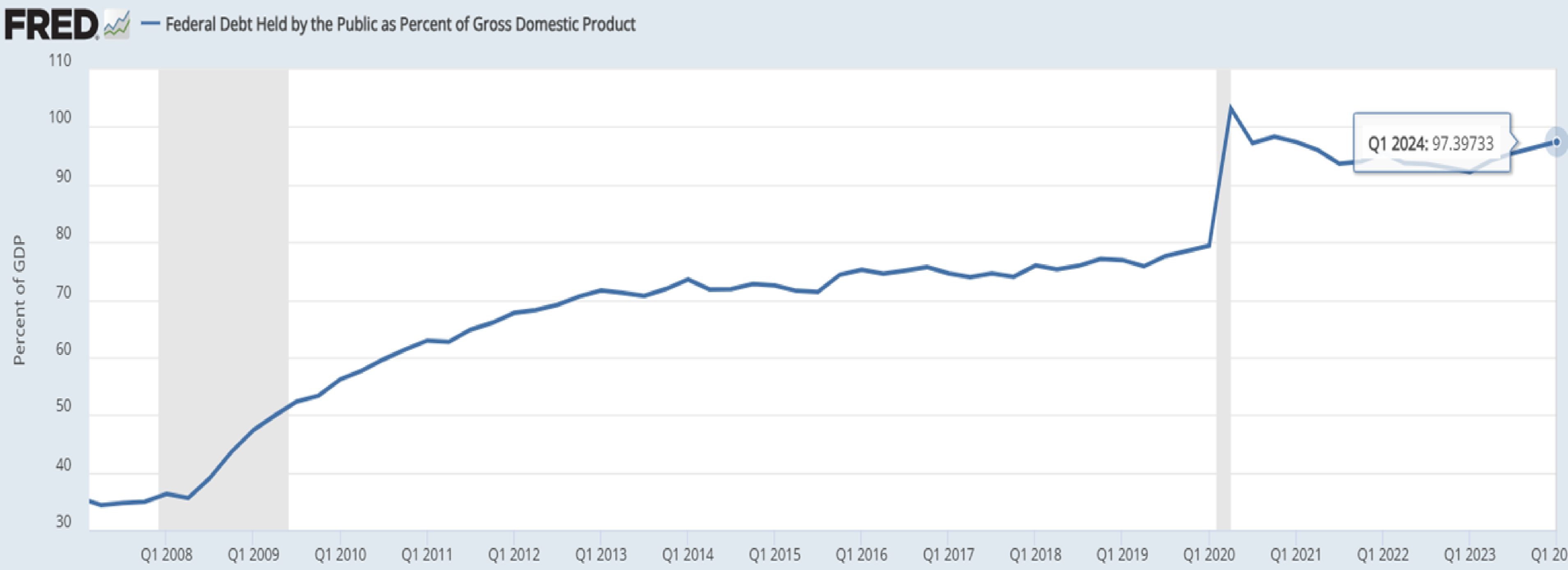
Units:
Percent of GDP,
Seasonally Adjusted

Frequency:
Quarterly

1Y | 5Y | 10Y | Max

2007-02-09 to 2024-01-01

EDIT GRAPH



Interest on the Federal Debt

- Government debt held by the public is over 96% of GDP
- That's about 3x higher than it was the last time the Fed raised interest rates
- The Fed's rate increases, and consequent increased interest expense, has nearly three times the fiscal impact it did during prior periods of Fed rate increases.

How Monetary Policy is Presumed to Work

- In the economy, not including government, for every dollar borrowed there is a dollar saved
- Not including government, rate hikes only shift income away from borrowers who pay more interest to savers who earn more interest.
- That would only slow the economy if the borrowers cut their spending more than savers increased their spending
- Studies show this is a small factor
- It’s dwarfed by the enormous amount of new interest

Rate Hikes are Obscenely Regressive

- Interest payments only go to people who already have money, and in proportion to how much they already have.
- Fed rate hikes are causing the government to spend $ trillions on interest only for people who already have money, and in proportion to how much they already have.
- I call it basic income for people who already have money.
- What could be more obscenely regressive???
- And the Fed decides to do this on its own to fight inflation.

Policy Review

- The Fed, Congress and the entire global financial community, believes that increasing the government’s deficit spending by
- Throwing $ trillions of interest payments to people who already have money
- Fights inflation by causing unemployment to go up and the economy to slow down.
- That’s why they’ve all been forecasting recession ever since the Fed started the rate increases.

What's Been Happening with the Economy?

- The US economy has been booming
- Unemployment near 50 year lows ever since the rate hikes
- The economy is defying the fear mongering and rapidly growing
- Inflation indicators, that spiked higher due to COVID disruptions and an oil price spike from the Ukraine war, came down and flattened well above pre COVID levels.
- The Fed still thinks the rate hikes are restrictive and just need a little more time to create a slowdown.

Consumer Price Index for All Urban Consumers: All Items in U.S. City Average (CPIAUCSL)

DOWNLOAD

Observation:
Jun 2024: 3.0
(+ more)
Updated: Jul 11, 2024 7:41 AM CDT

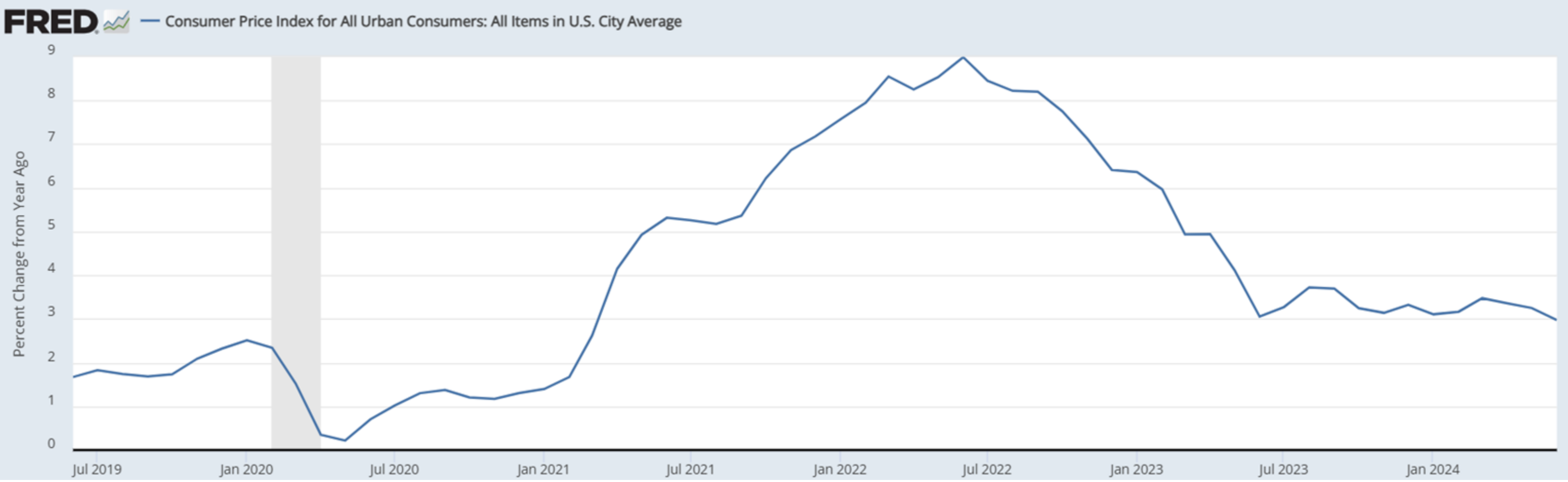
Units:
Percent Change from Year Ago, Seasonally Adjusted

Frequency:
Monthly

1Y | 5Y | 10Y | Max

2019-06-01 to 2024-06-01

EDIT GRAPH



The Fed has had it Backwards

- The Fed responded to high inflation indicators and low unemployment with rate hikes
- The rate hikes made unemployment go lower and inflation indicators go higher
- When the Fed saw that they hikeed again
- This spiral continues with no end in sight if they don’t see the error of their ways and reverse course
- Or, if we get lucky, some other deflationary shock, like a collapse in oil prices, may cause them to cut rates to stimulate the economy, which doesn’t work either!

What’s the Answer?

- The Fed should cut its policy rate back to 0%
- This ultimately cuts government interest expense to by over $1 trillion per year
- Upward pressure is removed from the inflation indicators so they can settle back to where they were before the COVID crisis.

Post Script:

The Fed also doesn't understand that the inflation rate tends to gravitate to the interest rate set by the Fed. It's too complex for this post, but can be found in my latest paper:

A Framework for the Analysis of the Price Level and Inflation - Google Docs