

QE Is Only Debt Reorganization. Where Is The Business Restructuring?

I'd like to understand the causality between lower MBS yields and unemployment. I'm sure there is a correlation, but I'm not sure that the dependence is so high.

So if mortgage rates are low house prices will rise leading to lower lending standards, more mortgage lending, rising house prices, which lead to improved sentiment, better credit and the increased propensity to consume leading to an economic recovery. There are too many ifs, too many conditions which might not hold. We've had low mortgage rates for a while now, yet no significant rebound in house prices. The Case Shiller index is showing only nascent signs of improvement but this is probably a consequence of QE1.

For QE3 to work, house prices have to be rising independently of the MBS buying. Also, lower mortgage rates do not necessarily lead to more lending unless the securitization markets are open. (Unless of course the Fed intends to be the sole buyer of MBS.) Lower mortgage rates, absent securitization may drive banks to lend less as their returns from mortgage lending become less attractive relative to their cost of capital under Basel 3.

House prices have to rise at least until households face positive equity otherwise they will not be able to refinance under any mortgage rates. If they cannot refinance then they cannot take advantage of lower mortgage rates, which the Fed's QE was supposed to produce.

There is also existing debt to be repaid. Any refinancing activity that improves household's cash flows may not result in increased discretionary spending as household's are likely to first pay down existing debt. This has to happen with or without QE and so is not an argument against QE, it just means that the impact of QE3 may take much longer than intended. US households need to save more and consume less, not the converse. I wonder if the Fed has this in mind.

Demographics. What if the demand deficiency is a structural consequence of demographics? What if this generation is done with its big spending ways? 2007 coincided with the peak consumption age of the average Baby Boomer. Growth cannot come from unbridled consumption alone. And consumption certainly should not be financed out of debt; it should substantially be funded out of profits and cash flow. And what about exports? Unfortunately the world currently faces a synchronized slowdown and it simply isn't possible for everyone to be a net exporter. Over the longer term, but not the long term, emerging markets' demographics will mean that they will have to take on the mantle of consumer of the world. What does that imply for the US economy and other developed markets? Does the Japanese experience beckon? Does an ageing population lead to deflation and recession? (Not necessarily as Japan has different problems.) In the meantime a period of non-cooperation and self sufficiency appears to be emerging, as one would reasonably expect in a global recession. How long will this period of self sufficiency last? What are its consequences on the path of history.

Does QE increase or decrease the amount of debt? It seems a little bit strange that the proposed solutions to a problem precipitated by excessive debt seem all to involve the creation of more debt. In a bankruptcy reorganization of debt is a necessary step but this comes with a credible business plan. Without fundamental changes to the cash flow generation plan, it is not possible to make an insolvent business solvent simply by shuffling the debt.

QE is a debt reorganization. It is silent about the cash flow generation model of the economy and the government. That part of the problem is equally if not more complicated. Being a macro debt reorg it does not address bottlenecks and agency issues at the micro level, but one could argue that it is sufficient, as a debt reorg.

A culture of entitlement hobbles the world. We want free medical care, free education, free everything, but we don't want to pay the high taxes. Nothing is free but everyone wants it to be. People want others to pay for their stuff. Basically they are either don't understand or don't want to abide by their constraints and demand more than is available to them.

Our political systems ensure oppression by the majority, populism and cynicism.

Where there is democracy, governments have not the strength of resolve to present to their people the hard truths. Where there is no democracy, governments simply trample on the will of the people. The democracies therefore hurtle towards disaster while the undemocratic profit handsomely at the expense of both the West and the haplessness of their own peoples.

The people need to wake up. In the West they need to realize that they cannot have their cake and eat it. The culture of entitlement must be forfeited. In order to get borrowing costs down, some level of austerity is necessary in the form of poorer social security, medical benefits, free services. Governments need to reduce marginal tax rates. This is a commercial reality. As purveyors of tax domicile, they need to cut prices and that price is the marginal income tax rate for individuals and corporates. It is a less contentious alternative to trade war. In order to balance their profit and loss and cash flow, the size of government needs to be reduced. This is not an ideological objective but a practical one.

Undemocratic countries will continue to attract and harbour illicit businesses and capital. This time of economic crisis and ill advised government policy has only exacerbated the exodus of capital away from regulatory scrutiny. Western democracies need to address this in two ways; first, by reducing the tax arbitrage by lowering taxes, and second by pursuing with extreme prejudice, illicit capital and its custodians. Poor economic management can be condoned but willful misconduct must face punitive and if need be destructive consequences. Capital needs to be out in the open if it is to do any good.

Capitalism needs to be restored from its current incarnation. Since the fall of communism, capitalism has become adulterated with myriad forms of moral hazard, adverse selection and agency inefficiencies. Addressing moral hazard is all important. Capitalism needs to be allowed to punish as well as reward. If not, excessive risk taking will always occur with the final bill being visited on the public balance sheet. This pushes up the tax bill and inflates government. As part of this effort, the role of central banks needs to be examined. Unilaterally setting interest rates distorts relative prices as much as the arbitrary purchase of US treasuries or agency mortgage backed securities. The very existence of a lender of last resort is anathema to capitalism. Airbags and seatbelts save lives but increase the incidence of accidents.