

# The Fed DID NOT Save the Economy

**Brian S. Wesbury** – Chief Economist  
**Robert Stein, CFA** – Dep. Chief Economist  
**Strider Elas** – Economist

Last week the Wall Street Journal (WSJ) opinion page published a piece by former Federal Reserve Chairman Ben Bernanke. The title was “How the Fed Saved the Economy.”

Editors write headlines; not authors. So, if Timothy Geithner or Hank Paulson wrote an Op-Ed we would expect the title would be similar, but it would say “Treasury,” not, “Fed.”

As usual, the powerful get to write the historical narrative. And just like the Great Depression, the government tells people that without it the world would have collapsed completely or, at least, things would have been much worse.

Milton Friedman set the record straight about the Great Depression. In his book, “A Monetary History of the United States,” he proved that the Fed created the collapse by contracting the M2 money supply (cash, checking and savings accounts, and CD’s). Ben Bernanke is an expert on the Great Depression and his work verifies what Friedman found.

Here at First Trust, we have spent a great deal of time writing about 2008, and we find that it was government failure that caused it, not market failure. Peter Wallison, William Isaac, Richard Kovacevich, and Steve Forbes, among others, have all found the same thing.

Two things stand out. First, it was Fannie Mae and Freddie Mac that drove the subprime loan market. So, when Ben Bernanke writes that more corporate executives should have gone to jail, he is ignoring the role of government. Not to be a cynic, but isn’t it convenient for government to blame it all on the private sector and not on bureaucrats and politicians who imposed lower lending standards?

Second, it is appalling to us that important government officials, including Ben Bernanke, never mention mark-to-

market (M2M) accounting. They completely ignore it even though it obviously played a huge role in the crisis. Bernanke once told me that hedge funds didn’t think M2M was a problem. I told him, “of course not, they were all short.”

In his WSJ piece, Dr. Bernanke makes three key points. First, unemployment has come down dramatically and inflation is low. This is true, so on the surface it’s hard to complain about Fed policy from a 40,000 foot level. He says Fed critics predicted hyperinflation, which is true of some of them, but not First Trust. We never predicted hyperinflation because we realized banks were not using QE, but instead building up excess reserves – and reducing the money multiplier.

Second, Europe was slow to do QE and that’s why the US has outperformed Europe. But there are two things missing from this overly-simplified analysis. One – Europe has higher tax rates and bigger government than the US – it has underperformed the US for decades. Two – Japan has been doing QE since 2001 and it hasn’t worked.

Third, while the Fed has created jobs, the labor force has grown more slowly. Dr. Bernanke argues that this isn’t a problem that “the Fed has the power to alleviate.” So, if it’s good, the Fed did it. If it’s bad, the Fed’s not to blame.

Entrepreneurship saved America, not the Fed or the Treasury. QE started in September 2008 and TARP was passed in October 2008, but the stock market fell an additional 40%. Mark-to-market accounting was changed in March/April 2009 and that’s when the stock market and economy bottomed. The results of bank stress tests weren’t released until weeks later. Government may get to write history, but it doesn’t own it.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-14 / 7:30 am	Retail Sales – Sep	+0.2%	<b>-0.1%</b>		+0.2%
7:30 am	Retail Sales Ex-Auto – Sep	-0.1%	<b>-0.3%</b>		+0.1%
7:30 am	PPI – Sep	-0.2%	<b>-0.3%</b>		0.0%
7:30 am	“Core” PPI – Sep	+0.1%	<b>0.0%</b>		+0.3%
9:00 am	Business Inventories – Aug	+0.1%	<b>0.0%</b>		+0.1%
10-15 / 7:30 am	Initial Claims – Oct 10	270K	<b>266K</b>		263K
7:30 am	Empire State Mfg Survey – Oct	-8.0	<b>-7.0</b>		-14.7
7:30 am	CPI – Sep	-0.2%	<b>-0.3%</b>		-0.1%
7:30 am	“Core” CPI – Sep	+0.1%	<b>+0.2%</b>		+0.1%
9:00 am	Philly Fed Survey – Oct	-2.0	<b>-3.5</b>		-6.0
10-16 / 8:15 am	Industrial Production – Sep	-0.2%	<b>-0.3%</b>		-0.4%
8:15 am	Capacity Utilization – Sep	77.3%	<b>77.3%</b>		77.6%
9:00 am	U. Mich Consumer Sentiment- Oct	89.0	<b>87.5</b>		87.2