Asset Price Inflation – a global economic virus which has its origins always in the Federal Reserve

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WHAT DO WE KNOW ABOUT THE DISEASE OF ASSET PRICE INFLATION?

• Asset price inflation is an economic disease about which we hear a lot
• Yet no common definition and no consensus agreement on cause
• Virulent form of the disease gives rise to market bubbles
• Many economists, monetarist and Keynesian, are in a state of denial about the disease
• Old Bundesbank did not recognize the disease but knew how to prevent it
• Old Austrian school concept flawed but introduces monetary origins
• Behavioural finance theorists contribute important understanding but they deny monetary cause
• Two forms of monetary disease which plague the modern economy
• Long-run damage of asset price inflation disease – sick risk appetites and mal-investment meaning diminished prosperity
Friedman quotes J.S. Mill, a rephrasing

MOST OF THE TIME THE SOFTWARE OF MONEY DOES NOT MATTER BUT WHEN IT MUTATES IT SPREADS A VIRUS WHICH ATTACKS ALL THE OTHER SOFTWARE BEHIND PRICE SIGNALS (IN GOODS AND CAPITAL MARKETS) THAT GUIDE THE INVISIBLE HANDS OF THE CAPITALIST ECONOMY

• An economy afflicted by monetary disequilibrium will eventually display symptoms of one or both types of virus
• The two diseases and their progression largely define the business cycle
• Yet each cycle is unique in that the paths taken by each disease and their relative strength are never identical
HOW DOES THE DISEASE OF ASSET PRICE INFLATION SPREAD?

• The spread depends on catalysts to irrational exuberance
• How to define irrational exuberance and speculative fever?
• Monetary disequilibrium fuels irrational exuberance in 3 ways:
  Channel 1: manipulated rates and positive feedback loops
  Channel 2: yield desperation
  Channel 3: inflation terror
• Why the disease is hard to detect at early or mid-stages
• Speculative temperature hard to measure
• Asset price inflation attacks in rotational fashion
• Carry trades boom under asset price inflation
• The virus progresses to asset price deflation endogenously
• How central banks always misdiagnose and worsen the final outcome
Asymmetric power of the US to spread asset price inflation virus

- Asymmetry is greater than for goods inflation, why?
- Monetary terror throughout the dollar and quasi-dollar zone
- Huge weight of investors chasing speculative stories inside and outside dollar area
- Dilemna for central banks of small and medium-size economies attacked by the Fed-virus
- Deflation phobia has weakened defences against the virus
- Historical and contemporary examples of US power to spread asset price inflation (Germany in the 1920s, Japan in mid-1980s, emerging markets in 2010s)
The Obama Federal Reserve’s virus of asset price inflation

- The nature of the US monetary disequilibrium
- Emperor’s new clothes myth
- A Grand Experiment
- The first fully anticipated asset price inflation
- Why anticipated asset inflation does not stimulate business spending
- How asset price inflation virus was created
- Virus attack on emerging market economies and dynamic small economies
- Virus role in stock market “booms” in US, Europe and Japan
- Infection of high-yield credit markets, including European sovereign debt
- How will this asset price inflation end?
- Parallels from 1937 or 1953