The Fed Is Contradicting Its Own Tight Monetary Policy – Part 1

By Nomi Prins - April, 2023

[Matthias Chang comments: I am doing all bankers and stock punters a great favour by uploading this brilliant former Wall Street Banker's article. 98% of bankers in Malaysia don't understand the tricks of the Fed and Wall Street. So, read and learn and don't be arseholes!]

On Sunday, March 12 at 6:15 p.m. ET, the Federal Reserve and Treasury Department began their latest lie…

The banking system was crumbling around them after the failures of Silvergate Bank and Silicon Valley Bank.

So the Fed and Treasury stepped in to stop the bleeding. They announced the creation of a "Bank Term Funding Program."

This emergency lending program made additional funding available to U.S. banks, savings associations, credit unions, and other eligible institutions.

This was to ensure banks had the ability to meet the needs of all their depositors, who were suddenly trying to withdraw funds.

Another purpose of the fund was to instill confidence in the banking system.

This money showed the financial community that the Fed was there in cases of emergency. And that, in turn, would prevent a larger financial crisis.

The fine print said:

The Federal Reserve is prepared to address any liquidity pressures that may arise.

If you think that sounds open-ended, you're right.

As it turned out, this was just the opening gambit of the Fed and U.S. government.

In this two-part essay, I will delve into the gritty details of what the Fed has been doing since these two major U.S. banks collapsed. And I'll explain what their actions mean for you and your money in this critical phase of the Great Distortion.

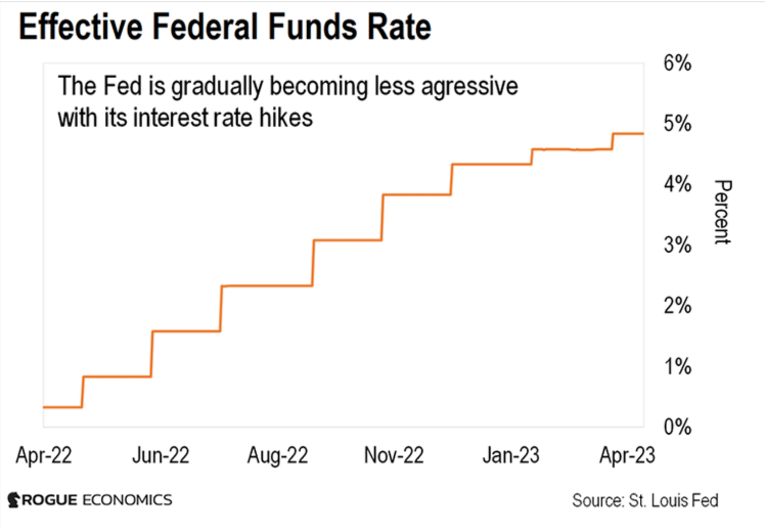
The Fed's a Hypocrite

As you may know by now, the Fed has been raising interest rates since March of 2022. The reason for the rate hikes is to fight inflation and bring it down to the 2% target level.

In just a little over a year, the Federal Open Market Committee (FOMC) raised the Federal Funds rate from 0 to 4.75%. The latest rate hike came on March 22. That's when the Fed raised the rate by 0.25%.

The decision means the Fed is in what I call Stage 1 of its three-stage pivot back to cutting rates. Stage 1 is a decrease in the size of rate hikes. And it indicates that the Fed is becoming less aggressive with its interest rate policy.

You can see the progression and size of the Fed's hikes in this chart:



The Fed will eventually hit what I call Stage 2 of its pivot, or rate neutrality. It means a pause in rate hikes.

Until then, the Fed is on track to keep raising rates – but probably not for much longer. Let me explain…

Here's what Jerome Powell, head of the Fed, said after the latest FOMC meeting in March:

Restoring price stability will likely require that we maintain a restrictive stance of monetary policy for some time.

The historical record cautions strongly against prematurely loosening policy. We will stay the course until the job is done.

Powell's statements at that time implied that we could see rising rates for longer. Yet, he said this as the banking crisis was still unfolding.

You see, hiking rates is one form of tightening the money supply. Higher rates mean money is more expensive to borrow.

While the Fed has been talking tough about fighting inflation, it's also been contradicting itself… Due to the chaos in the banking sector, the Fed had to instil confidence in the financial system and markets. It needed to provide liquidity. So, the Fed turned to another of its policy options. Printing money.

Specifically, it created money to lend to banks. That decreased the cost of money. Fabricating money is also loosening monetary policy. So, the Fed went against its own action of tightening the money supply.

Last Friday, the March's payroll figures registered a slower increase in jobs than previous months. Powell and the Fed watch that monthly report to see if the labour market is cooling off. This is one of the signs they look for in order to pause rate hikes, or enter Stage 2.

Overall, the Fed's money printing and the labour market cooling off are two reasons Stage 2 will happen sooner rather than later. The Fed could even pause rate hikes as soon as May or June…

The Fed Is Engaging in Quantitative Easing

I wrote about the Fed's money printing measures during a financial emergency in my most recent book, *Permanent Distortion*.

Without a significant monetary policy and debt overhaul, another crisis is inevitable. Markets will tank at first, or periodically. Then banks and corporations will again turn to governments and central banks to save them at the expense of the real economy. This is exactly what happened in the wake of the SVC crisis, banks turned to the Fed and government for help – and got it.

In the wake of the recent banking turmoil, the Fed redeployed a policy called quantitative easing, or QE.

That's when the Fed creates cash to buy bonds from banks, inflating the money supply.

According to the Bank of England, QE is how central banks create money digitally in the form of "central bank reserves." To execute QE, central banks buy government bonds and other securities with this money.

QE accomplishes three things:

1. It provides investors and traders liquidity and confidence during periods of turbulence.
2. It creates demand for bonds, which raises their price, and lowers their yield or rate.
3. It increases the price of financial assets other than bonds, such as shares. Here's why. Say the Fed buys $1 billion worth of government bonds from a bank. In place of these bonds, the bank now has $1 billion

in cash. And instead of keeping that cash, or lending it out, the bank can invest it in other financial assets such as shares.

Now, Fed officials aren't calling what they are doing quantitative easing or buying bonds. They are calling it a 90-day emergency lending fund.

But what they are doing is creating cash to give to banks. In return, banks are posting their bonds as collateral. What's more, the Fed is creating a fabricated demand for bonds. This, in turn, causes bond prices to rise… and their yields to drop.

So what you need to know is that the Fed is both raising short-term rates and lowering rates for longer-maturity bonds. At the same time.

Sounds a bit sinister, right? Well, for the Fed, it's business as usual.

That's because what the Fed does really well – is print money.

If the Fed were serious about tightening monetary policy, then it would sell bonds…. or let bonds roll off its books. This practice is called Quantitative Tightening, or QT.

Right now, the Fed is hiking rates while still buying bonds. These are two polar opposite activities. And for now, the Fed is playing both sides.

Tomorrow, I'll explain who the direct recipients of the Fed's latest money printing are… what the Fed's actions mean for your money… and how you can profit from the Fed helping Wall Street while squeezing Main Street.

Part 2

The Fed's Emergency Measures Inflate the Money Supply

Ever since Silicon Valley Bank (SVB) and Signature Bank collapsed last month, the Federal Reserve has been contradicting itself. **Through its emergency lending programs, the Fed has been inflating its book of assets. In other words, the Fed is printing money. A lot of it.**

As much as the Fed doesn't want to admit it, this action is called quantitative easing (QE).

In Part 1, I explained why the practice of QE is at odds with the Fed's interest rate hikes. As a reminder, the Fed has been raising interest rates since March of 2022 to bring down inflation…

I also described the three main things QE accomplishes.

Today, I'll further delve into who the direct recipients of the Fed's latest money printing are… how the Fed's actions widen the gaps between the stock market and the real economy… and one way to profit from the Fed helping Wall Street.

The Fed Is Lying to You

To understand how, let's step back to where the Fed's latest lie began.

By March 16, banks had borrowed approximately $300 billion from the Federal Reserve.

About half of that money, or $143 billion, went to SVB and Signature Bank. That was to shore up depositors whose deposits weren't fully insured. In other words, depositors with account balances above the standard $250,000 FDIC deposit insurance cap.

And the other half?

Well, in shades of its usual secrecy, the Fed did not reveal which or how many banks received the rest of that money.

You see, the Fed doesn't provide detailed information on where the money it prints goes.

For instance, there's no report that says Bank A got X amount of money or Bank B lent out X amount of money to small businesses or individual borrowers. There are also no records of whether these banks buy their own shares of stock.

As such, the Fed doesn't disclose what banks do with the borrowed cash. That's especially true of banks that get money from the Fed through the discount window. Think of the way that banks get their hands on the Fed's money like a fast-food drive-thru window. Of course, the discount window at the Fed isn't really a window…

Instead, it's a central bank lending facility meant to help commercial banks borrow money for up to 90 days. It offers banks readily available, short-term loans. In addition to the discount window process, the Fed provided financing to banks through the Bank Term Funding Program (BTFP). The only difference between the BTFP and the discount window is that the BTFP offers loans up to one year versus 90 days.

Yet, both the BTFP and the discount window allow the Fed to engage in money printing. And they both increase the Fed's balance sheet.

What's more, banks other than SVB and Signature borrowed about $153 billion through the discount window. In less than a week.

That's a new record pace. In a typical week, banks borrow about $4 to $5 billion through this lending facility.

So far, the Fed's money printing in the wake of the SVB collapse is already at half the amount it printed during the financial crisis of 2008. That shows you just how much the Fed can jump in and print money when it deems necessary.

Remember, the Fed's money printing isn't some conspiracy theory. It's the world of Permanent Distortion unfolding in real time. Plus, the Fed and other central banks use the process of printing money to cover their own mistakes. Here's how…

How Money Printing Covers Fed and Government Incompetence

By hiking rates quickly, the Fed allowed banks, pension funds, and other financial firms to see the value of their government bonds drop.

For instance, both SVB and Signature Bank held billions of dollars' worth of Treasury and other high-quality bonds on their books. What caused those banks to fail was gravity. When the Fed hiked rates, the value of these bonds fell. So the total value of their bonds wasn't enough to cover the amount of money that depositors sought to withdraw.

The result was a classic bank run and collapse. That's why the Fed decided to create money for the banking system. When the Fed prints money, it buys bonds from financial institutions. And when the Fed buys bonds, it increases bond prices. This, in turn, reduces bond rates.

(**Note**: This is basic bond math. When prices of bonds go up, their rates go down.)

Now, it's likely some smaller or weaker banks have used the Fed's money for depositors withdrawing funds. It's also possible that some banks used the money to buy shares in the stock market. We can't be sure of the exact amounts.

And the Fed sure isn't going to tell us.

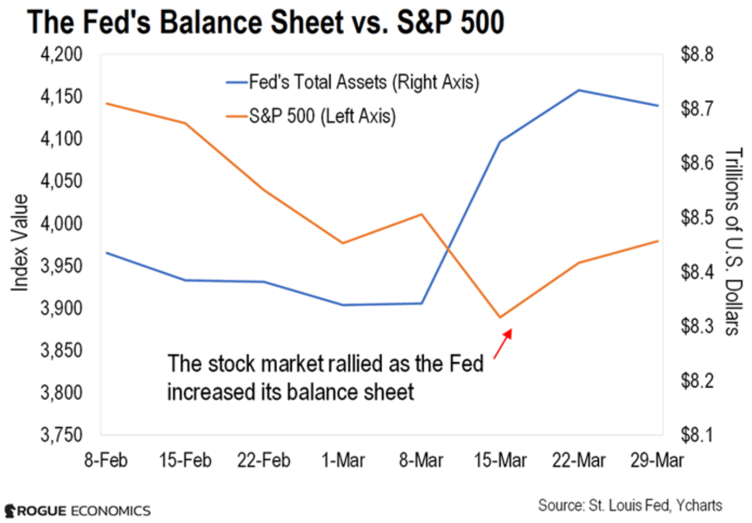
The good news is, you can profit from the Fed's shadiness…

The Fed's Discount Window Impacts You and Your Money

First, you must understand one thing. The Fed injects money into the financial system with no strings attached as to where it goes after. Savvy market players watch what the banks do with that money. And banks use that money to buy assets that can appreciate quickly – like stocks.

That's why the stock market rises in tandem with large bouts of QE.

You can see this in the chart below. As banks accessed the Fed's discount window, a mini-stock rally occurred.



When the Fed prints money during a crisis, the markets rally. Wall Street can use that money to speculate in the stock market.

One way to take advantage of this new period of Fed money printing is to buy the **SPDR S&P 500 ETF (SPY)** in increments every Friday.

Why in increments? Because the Fed is still in an uncertain stage of its policies. On one hand, it's raising interest rates. On the other, it's printing money and engaging in QE. These are contradictory actions**. And until it stops raising rates entirely, the Fed will trigger volatility in the markets.**

Nobody can fully predict what the Fed will do. So to hedge yourself against more uncertainty, practice dollar cost averaging. That's when you buy smaller amounts of a position in defined intervals.

This way, you'll gain slow exposure to the exchange-traded fund. And if you see any dips or rallies along the way, you can build up an average of these price levels. Best of all, you won't have to worry about timing the markets.

You also might also be wondering, why Friday? Well, the market usually dips on Fridays. That's when large investors cash out of options positions to take any profits or cut any losses for the week.

This is not a hard and fast situation, as any event or piece of data can change this trend. However, it's a rule of thumb I've followed since my days in Wall Street.