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The Fed Cuts Rates To Bail Out The Treasury



The Federal Reserve's **decision** to cut rates by 50 bps is inconsistent with the FOMC **assessment** of a "solid" labor market, modest growth, and "no sign of a recession or downturn."

If there was no sign of a recession, why cut rates when headline and core inflation remain significantly above the Fed's target?

Furthermore, rate cuts incentivize debt and could drive energy prices higher as leveraged bets and margin calls become cheaper to finance. We must keep in mind that the energy component was the driving force behind lower annualized inflation.

Only if the Fed's objective is to bail out the Treasury can we justify a 50-basis point rate cut, given that the annual inflation for shelter and services is above 5% and unemployment stands at 4.2%.

Despite the Fed's concerns about a slowdown in employment, rate cuts are unlikely to significantly alter the labor market trend, as businesses are unlikely to incur additional debt for hiring, especially given the record levels of consumer credit card debt.

Additionally, the Fed knows that this rate cut will have a limited impact on mortgages and credit supply.

Rate cuts are not a signal of a healthy economy

We have seen two instances when the Federal Reserve has started a rate cut cycle with a 50-basis point cut, in 2007 and 2001. Both times, the rate-cut cycle preceded a recession and a significant rise in unemployment.

It makes sense because rate cuts are not a signal of a healthy economy, but rather the manifestation of a weak one.

Fed rate cuts are there to bail out the government and allow it to borrow at a low cost. The Fed knows that the transmission

mechanism of rate cuts into the real economy is slow or imperceptible when employment, consumption, and investment have already started to show a slowdown.

The Fed was alarmed when they saw the two-year government bond yield reach five percent as the deficit climbed to \$2 trillion and public debt surpassed \$35 trillion.

The rate cut is a disguised bailout for a government that spends \$1 trillion in interest expenses

The Fed is supposed to focus on unemployment and price stability, but they cannot ignore the fiscal nightmare that the government is creating. The rate cut is a disguised bailout for a government that spends \$1 trillion in interest expenses.

It does not matter. Rate cuts may disguise fiscal irresponsibility in the short term but cannot stop the deficit madness. Those who say that debt does not matter as long as interest expenses are manageable should keep in mind that Japan dedicates almost 25% of its budget to interest expenses despite exceedingly low bond yields.

When sovereign bond yields disguise the solvency and responsibility of the debt issuer, the result is not a crash but secular stagnation. The sovereign bond bubble bursts as the currency's purchasing power is destroyed, eroding real wages and deposit savings.

Labor market

To justify the rate cut, the Fed has taken advantage of a poor labor market and the recent massive downward revision of 818,000 jobs. However, Jerome Powell reiterated that he saw a "solid" labor market.

They are either lying about the reason to cut rates or about the strength of the job figures, or both.

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As a result, market participants ignore the alleged prudent messages of the Federal Reserve because the Treasury is telling them another story. In the Treasury's own estimates, debt will rise by \$16 trillion by 2034.

Investors understand that a fiscally irresponsible government, which will continue to incur unsustainable deficits, has cornered the Federal Reserve. Therefore, the only solution ahead is Japanese-style financial repression and secular stagnation.

Powell does not see a recession. I understand why. It is easy to disguise what is already a private sector recession by bloating GDP and job figures with debt, public sector expenditure, and employment.

However, the consumer confidence index, which is well below 2021 and 2019 levels, the Russell 2000 earnings and sales, the business confidence index, and the record levels of credit card debt all speak of a private sector weakness that is more than just a recession

because it has been suffering for four years in an alleged growth economy.

The Fed does not have many choices

I must say that the Federal Reserve does not have many choices. Its independence has been compromised many times, especially since 2021, and now it seems that the governors have given up and simply accepted the fact that the Treasury will increase its imbalances in periods of growth and contraction.

The Federal Reserve has only modestly reduced its balance sheet. It still accounts for 25.6% of the U.S. GDP, or \$7.1 trillion. In 2008, it was \$1 trillion.

With persistent core inflation, elevated deficits, and high public debt, the United States is slowly going down Japan's way

Chairman Powell announced "higher for longer" rates and decisive policy normalization at the beginning of 2024, abandoning the path of balance sheet reduction.

However, he ended the "higher for longer" policy eighteen months after announcing it. All this coincided with an acceleration in government debt accumulation.

With persistent core inflation, elevated deficits, and high public debt, the United States is slowly going down Japan's way. This could lead to an unfavorable state of stagnation.