the Stranger

Americans Are Not Prepared for the Coming Mother of All Stock Market Crashes

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The economic situation today is truly unprecedented and, for the lives of ordinary Americans, really dangerous. And those who want you to blame Donald Trump for the present state of things are hiding many important factors from you. Trump is, at best, a tool; only the fooled will see him as the prime mover of what will certainly be, in the near future, a crash whose depth and extent the world has never seen and, the way things are (more about that in a moment), is unprepared for. When this bad business explodes, 2008 will look like a cakewalk.

The situation is not hard to explain, but it is expressed in different ways. For example, center-right ***Politico*** posted an article by George Selgin, a top figure in the right-wing and Koch-founded Cato Institute. Its title says it all: "The Fed's dangerous 'new normal'" Now, as a leftist critic, I can tell you that Selgin, a Hayekian, is not expending wasted worry in this article. Americans are plain crazy to ignore the recent developments at the Fed, which are only half the picture (the other is the buyback bubble). Though Selgin ignores the bubble, he knows when the stock market crashes, which is going to happen because history tells us so, the Feds will have no tools to fix it because it has been running a booming economy as if it were in a state of emergency. This needs a little explanation.

Selgin writes:

When quantitative easing began [a program that pumped cash into the financial institutions after the crash of 2008, so as that stock market values did not reach their actual value, which was (and still is) mostly worthless], then-Chairman Ben Bernanke promised that after the recession ended the Fed would revert to its “normal” self — meaning that the central bank would go back to a modest-size balance sheet and stop encouraging banks to hoard reserves. Later, the Fed released a normalization plan explaining how it would “unwind” its swollen balance sheet — letting it shrink as its bond holdings matured — and otherwise get back to business as usual.

Now that Powell has announced an end to that unwinding, is the Fed almost back to normal? Hardly. Far from resembling its pre-crisis self, it looks and operates much as it did in the worst days of the recession, bloated balance sheet and all. When Lehman Brothers failed, the Fed held $900 billion in assets, consisting mainly of short-term Treasury bills. Quantitative easing added another $3.6 trillion, all in long-term Treasury and mortgage-backed securities. When its unwinding ends in September, the Fed’s assets will still top $3.8 trillion.

What all of this means is that the Fed is basically going to pump more cash into the stock market during a stock market boom, not a bust. This will only increase the value of shares and maintain, for a short period, the appearance of an expansion. But what happens when all of this explodes? How will the Fed pull the economy back from the edge of a depression? It will have trillions of paper on its books, cheap money everywhere, and no policy outside of the management of the money supply.

Do not just blame Trump for this situation. Indeed, during the presidential debates with Hillary Clinton, one of his few correct economic assessments was that the Fed was propping up the stock markets. No, Wall Street wants this. Jamie Dimon, a high-stakes gambler as banker, wants this. Even the cuddly capitalist Warren Buffett wants it. They are all in on it.

Why can we expect a crash? Because the current economic system is driven by forces that are identical with the one that caused the **South Sea Bubble of 1720**, and the Panic of 1873, and so on. True, a reprieve (between the Crash of 1929 and the **S&L crisis of 1986**) from violent boom/bust cycles was established in much of the second half of the 20th century, but that came to end with the elimination of a post-war political economy that directly managed crisis-prone markets.

The only difference between our situation and those of the South Sea mania nearly 300 years ago is the state back then had the means (government debt) to handle the crash. The same can be said of the 2008 crash. The crater caused by the buyback crash, however, will be too deep for a Fed cuffed by obligations from the crash of 2008 and a stock market boom triggered by the election of Trump. The Cato Institute knows that an enervated Fed will spell the end of monetarism, an economic program that keeps things simple (the management of interest rates), and requires that the Fed be independent (or, put another way, be protected from democracy).

If monetarism goes, then the only peaceful political solution to the crisis will be a massive social Keynesian program like the Green New Deal. If this happens, those who hated Obama's mild stimulation packages will look back at those days with nostalgia. A brave New Deal will necessarily place democracy at the center of society, not markets.