Why central bank manipulation must end

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The thing about lying or cheating is that if you repeat it enough and continue telling others a false narrative, after a while you begin to believe it yourself.

The extraordinary amount of nothing short of cheating by the US Federal Reserve, US Treasury and lawmakers – swiftly followed by the European Union, Japan, Canada and Australia during the dark days of the "credit crunch" that expanded into the global financial crisis – has left big scars.

Substitute the words "subprime and US housing" with "sovereign government bonds" in The Big Short (starring Steve Carell) and you'll find some answers about the origins of the next crash. Jaap Buitendijk

This level of wholesale cheating by printing money, purposely manipulating fixed income return profiles and pushing repurchase facilities in ways unconducive to supposedly free and liberal open markets was nothing short of shaking the devil's hand and accepting a Faustian pact.

The flowery term for this collective behaviour has become known as "financial repression", which really means the government crowds into the private sector and pushes those who save in cash and conservative instruments (such as bank-term deposits or long-dated bonds) into riskier assets, not for those persons' benefit but for the collective good.

Crony capitalism, first coined after the shenanigans of one-time Philippine strongman Ferdinand Marcos, skates very closely to financial repression. For those who dismiss this as an arbitrary or academic sideshow, it will be the main event over the next decade.

Growing fears that the Federal Reserve was losing the short end of the curve were suspended by last week's rate cut. While the spike in repo and other short-term rates can be attributed to a confluence of events that resulted in a large swing in the US Treasury's cash balances, the extent of the move suggests either that reserves may be closer to their "terminal level" than previously thought or that intermediation is constrained.

The real fear that the rate-setting Federal Open Markets Committee (FOMC) has lost control of the short end of the curve and may panic – triggering a crisis or a recession – is in reality unlikely. In its 106-year history, this is not the first time the FOMC has been tested. This is a natural and healthy stress testing by market participants, working out where the cracks in the ice may be found.

More manipulation

But as mentioned numerous times in this column, the problem with such a Faustian pact is that it can only lead to more manipulation. This in turn distorts already-askew market mechanisms, which then encourages repression and more cheating under the guise of unconventional monetary policies.

People often ask me about the root of the next crisis, ominously already dubbed "GFC 2.0" and my answer is simple – go back and watch the Hollywood blockbuster *The Big Short* and substitute the words "subprime and US housing" with "sovereign government bonds", and you will find your own answer.

Australian ultra-high net worth and retail investors face the same challenge – where do they now, and when bad times strike, redeploy savings to weather incumbent storms? The candid answer is that no one knows as the traditional shift from risk on (from equities) to risk off (to bonds) no longer works as it did before financial repression came along and cheated economics.

This sad travail has only one meaningful solution, which is to end the Fed US system as we know it and repeal the monetary responsibilities of the Reserve Bank of Australia (RBA), retaining its sole remit to supervise "banking policy", and that alone, within the Reserve Bank Act of 1959.

Central banking was never meant to end up anywhere near where it has today – it was not divinely ordained on stone tablets and, like many things that began with a good purpose, ended up being gamed and becoming the problem.

After the crises and panics of the very late 18th and early 19th centuries, the Federal Reserve system was established in 1913 to smooth out the excesses of what is referred to in economics as the business cycle.

But even the business cycle was only ever a theory, and not set in stone.

Orwellian bankers

All this manipulation leaves the fates of all investors – affluent or otherwise – in the hands of Orwellian central bankers.

The alternative is what Austrian economist Friedrich Hayek originally championed, which is to let markets naturally determine their own interest rates. After all market forces know best, don't they?

Ending central banking may sound extreme but the current collective glidepath is worse.

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