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DR BEN S. BERNANKE'S CONUNDRUM:
IS ANOTHER RECESSION, INEVITABLE ?

The reason that Dr Ben S. Bernanke, the Chairman of the US Federal Reserve, which, in effect, is The Central Bank of The United States of America, did not make any definitive determinations as to what *'medicine'* was best for the struggling, largest-single economy of the world, was, simply put, because he did not know which *'medicine'* would be most efficacious.

It was not that he would not have loved to have prescribed the cure for what ails the country and to have announced his wondrous cure, because he, dearly, would have loved to have done that.

It was not because he did not know the names of the various *'medicines'* in The Fed's medical locker, but it was because he did not know which one of them would have the ability to cure the ills of the economy without killing the host.

All of The Fed's previous policies, over the past few years, did not have the desired, long-term effect on the US economy – to stimulate employment, get consumers to go back to the High Street, encourage businesses to expand, mop up the mountains of real-estate assets, sitting in the books of US banks, etc, etc, etc – so that, for The Fed to get it right, this time around, so to speak, would have been a pleasant change from past miscalculations.

Dr Ben S. Bernanke, last Friday (August 26, 2011), at the opening of The Fed's annual *'retreat'* at Jackson Hole, Wyoming, said that The Congress might need to act in order to stimulate employment in the country.

What a novel idea, one might be tempted to suggest.

He, also, admitted, openly, that the US economy needed further help in the short term.

Another astounding indication of the perspicacity of the Chairman of The Fed, one that, most likely, few people had realised!

In addition, Dr Ben S. Bernanke said that, at The Fed's September Open Market Committee Meeting, which will be lengthened to 2 days instead of the usual one-day meeting, discussion will be held as to what steps, if any, should be taken to assist in boosting the flagging economy of the country.

And that was, just about, it: He said little more of any importance.

He did not even, by innuendo, make any statement that could have been construed as being either positive or negative about the economy of the US, or anything else, for that matter.

The equity markets of the world had been awaiting the pronouncements of the good doctor for more than a fortnight; and, most equity investors had been praying – in some cases, with incantations while kneeling in the midst of a cloud of incense – that he would say something positive, suggesting an action that might be forthcoming and that might give a boost to the economy.

Of course, some Wall Street gurus, on claiming to have studied the speech of Dr Ben S. Bernanke, made airy-fairy statements, with Mr Keven Caron, Market Strategist at Stifel, Nicolaus in Florham Park, New Jersey, stating, very intelligently: *'He didn't give the market the green light for QE3 – he also didn't give the market the red light for QE3.'*

What an astute observation!

<u>The Past And The Present Conundrum</u>

A century or so ago, it was a commonly held belief by many Americans that the US travelled round the sun, rather than the sun, traversing the planet called, earth: They believed that their economy was, just about, self-sufficient and, as such, they paid scant attention to much of what happened in other countries.

In those days, there was free access from one European country to another: There was no requirement for a person to be in possession of a valid passport as is the case, today.

It was not until World War I (1914-1918) that quite a number of European governments introduced passport requirements for security reasons, alone.

World War I was an eye-opener for many an American, most of whom had never wandered further than 20 miles from their homes because there was no requirement so to do.

It was during this part of the history of the US that the government was forced to come to grips with the fact that the world was round, after all, and that there were other economies, out there, other than that of the United States of America.

Then came the realisation that the strength of many of the economies of the world was dependant on a number of important factors, something akin to the baking of the good-ole, mother's apple pie whereby the freshness and quality of the ingredients and the technique of the experienced materfamilias would result in a delicious, mouth-watering desert for which one would kill, just to taste.

But in the hands of an inexperienced cook, where there was the exclusion, by accident or design, of one or more of the important ingredients that is mandatory in the production of the world-famous, American apple pie, making it a world-beater, would result in the final product, being less than desirable.

Thus, in the past century, the US Government was forced to accept that globalisation is not a luxury, at all, but an absolute necessity for the country's own economic health.

And this is where The Land of The Free and The Home of The Brave stands, today.

In the words of that British poet John Donne (1572-1631):

'No man is an island entire of itself; every man
is a piece of the continent, a part of the main;
if a clod be washed away by the sea, Europe
is the less, as well as if a promontory were, as
well as a manor of thy friends or of thine
own were; any man's death diminishes me,
because I am involved in mankind.
And therefore never send to know for whom
the bell tolls; it tolls for thee.'

Since the 1960s, international trade between the US and the rest of the world has risen more than 3 times to a record high – and it continues to rise, year after year after year.

The US economy has come to rely on trade with the rest of the world as part of its economic lifeblood, its domestic consumption, no longer being that which it was about half a century ago although it, still, is responsible for about 60 percent of the country's **G**ross **D**omestic **P**roduct (**GDP**) – a country's income minus foreign investments and/or net income that is earned from abroad.

The US economy is more dependent on its intelligence of international events and trade with the rest of the world than any other major economy or, even, the 27 nations that comprise the **E**uropean **U**nion (**EU**).

The US imports about 50 percent of its total, crude-oil requirements so that, when Libya, the North African nation which used to be responsible for about 3 percent of the world's total, crude-oil exports, it rattled the finances of the world's largest single economy – and the price of petrol at the pumps cut deeply into consumers' disposable income.

Because of the former, historical strength of the US economy, foreign investments increased in the country and, today, about 50 percent of all US Government debt is owed to foreign investors, the most-prominent of all, of course, is the People's Republic of China which is known to be the largest single creditor of the US; the US, having become the world's largest debtor.

As at January, this year, foreign investors owned about $US4.45 trillion of US debt, representing about 47 percent of the total debt, held by the public of about $US9.49 trillion, and about 32 percent of the total debt of about $US14.10 trillion.

The largest holders of this debt were the Central Banks of the People's Republic of China, Japan, The United Kingdom and Brazil.

As at May 31, 2011, the largest single holder of US Government debt was the People's Republic of China, with 36 percent of all foreign-held, US Treasury securities, or about 16 percent of total US public debt.

Therefore, The People's Bank of China, which is the Central Bank of the country, is holding about $US2.26 trillion-worth of US debt products – at least.

The gross debt of the US is equivalent to about 96 percent of the country's GDP. This is a staggering situation and it must come down or …

The People's Republic of China is said, today, to have amassed foreign reserves of about $US3 trillion, that veritable mountain of foreign reserves, being about 3 times greater than Japan's and about 6 times greater than any other country in the world.

<u>The Chances of Another Recession</u>

In order to maintain domestic investment and economic growth, to any great extent, foreign capital is needed as a matter of dire necessity of the Administration of the US.

In addition, in order for the country to prosper and to maintain stability, it is mandatory that the US Government keeps abreast of international developments on a regular basis.

It is estimated that, today, about 10 percent of the national income of the US has been gained by embracing globalisation.

That is about $US1 trillion per year, or, in other terms, about $US10,000 per household of The Land of The Free and The Home of The Brave.

Globalisation, also, has resulted in more trade, flowing to and from the US, and this has resulted in keeping inflation in check in the US, as well as increasing the variety of consumer goods, available to consumers.

The importation of goods from countries with lower production and cheaper raw-material costs than is found in the US means, of course, that US consumers' money has a greater buying power, thus stimulating domestic consumption.

Higher incomes for workers in the US are, naturally, the result of greater exports of US goods and services and, as other trading partners try to compete with the US, it tends to result in improved US products and increased productivity, leading to higher incomes.

In short, globalisation lends itself to increased costs as well as increased benefits, but the benefits must exceed the costs – which is, clearly, the case in the US, today.

Unfortunately, because of the heavy dependence on the internationality of goods and services, the US economy has amassed the largest trade deficit in the history of the world.

It is estimated that the gross foreign debt of the US is not less than $US23 trillion, bringing the total net foreign debt to about $US2.50 trillion.

Thus, as stated, earlier, the US has the distinction of being the world's largest, single debtor nation.

Whereas the US used to be up there as one of the largest trading nations of the world, today, exports from the US have dropped to about 20 percent of total domestic output, down in the past 66 years from about 50 percent of total domestic output.

Today, the People's Republic of China is the largest exporter in the world, having eclipsed Germany by a considerable margin.

The US has failed, miserably, to be able to compete effectively with, inter alia, the People's Republic of China, that country of about 1.30 billion people, being the tailor of the world and among the largest manufacturer of all kinds of consumer products of the world, all of which are exported out of the country.

Soon, it is well expected that the People's Republic of China will become the largest manufacturer of motor vehicles of the world – to the detriment of Detroit, Michigan, which used to be the world's largest producer of motor vehicles.

Detroit is unlikely, ever, to achieve the status about which it could boast of days of yore: The motor capital of the world.

Today, it is one of the murder capitals of the world, instead.

The irony of the situation that faces the economy of the US, vis-à-vis the People's Republic of China, is that the US economy is about 3 times larger than that of the People's Republic of China.

That is the situation, as it stands, today, but it is thought very likely that, in the next 30 years, the economy of the People's Republic of China will exceed that of the US.

The US dollar, still, remains the dominant/reserve currency of the world, but that is under threat, too, from the euro, firstly, and down the road, probably, the renminbi, the medium of exchange of the People's Republic of China.

On the one hand, the US has become more and more dependent on the strengths of many of the economies of the world and, on the other hand, the US has found it increasingly difficult to calculate the temperature of the economic waters of many other nations of the world, especially those of its largest trading partners.

Meanwhile, the European Union, which is about 20 percent larger than the economy of the US, is in trouble, with the economies of Greece, Spain, Italy, Ireland, and Portugal, representing about 19 percent of the entire European Union, all desperately trying to balance their economies lest they be forced to default on international financial obligations.

In addition, even the mighty German economy is faltering, its economy, slowing to a crawl.

The European Union, it should be remembered, is among the most-important trading partners of the US.

And, ironically, the European Union's problems are being exported, round the world, due to the fact that it is the largest importer of goods from Asia.

Lately, manufacturers and exporters of the People's Republic of China have noted a 15-percent-plus reduction in orders from the European Union, which is the largest, single market of the Middle Kingdom, at a time that orders usually flood in, in preparation of the Christmas season in the West.

If this situation continues, it could well result in material risks to the entire world; and, the entire world's economy could well be in tsuris, probably sooner than later.

In the US, as, no doubt, Dr Ben S. Bernanke has come to realise while trying to accelerate economic growth in the country, thus creating employment for the legions of out-of-work, former employees, it is being hamstrung by large trade deficits which, in effect, cause The Fed to pursue restrictive policies, if not directly, then by being politically motivated by Capitol Hill or by telephone calls from Number1600, Pennsylvania Avenue, Washington, D.C.

At the same time, The Fed has to keep inflation in check while, simultaneously, keeping interest rates at nearly zero percent in order to promote spending.

It is a conundrum, to be sure.

Thus, Dr Ben S. Bernanke said very little last Friday when addressing the assembly at Jackson Hole, Wyoming.

The economy of the US is sluggish, with unemployment, being very high, unacceptably high, in fact, between 9 percent and 10 percent, in fact.

The national debt is on an unsustainable path, suggesting that the US Government will have to rein in spending.

The stage may be set, once again, for another economic crisis, similar in nature to the 1929 situation, also known as The Great Depression.

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