**Mitchell's Musings 11-4-13: And the Bad News is...**

**Daniel J.B. Mitchell**


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COMPANY TOWN

TV MONITORS in an MTA bus in L.A. last week show a newscast from KNBC-TV Channel 4. Programming also includes bits from Jay Leno on "The Tonight Show" and news in Spanish from Telemundo.

# Fears grow the Fed may need bailout

The central bank's bond-buying binge could put its finances at risk, critics warn.

By Jim Puzzanghera

WASHINGTON — The Federal Reserve has taken unprecedented steps to stimulate the economic recovery from the Great Recession, but the tab has risen to such tremendous proportions — fast approaching $4 trillion — that some worry the central bank ultimately could require its own taxpayer rescue.

The Fed's total assets on its balance sheet have more than quadrupled to $3.8 trillion since 2008 amid a massive bond-buying effort. And there are few signs that the growth will stop any time soon.

That could put the fi-

shutdown this month, have analysts predicting that there's little chance Fed policymakers will vote to scale back the program until early 2014 at the soonest.

If that's the case, the Fed's balance sheet would swell to more than $4 trillion. And as the number gets bigger, the risks also rise.

"The Fed stands to lose a lot of money, and by a lot of money, I mean hundreds of billions of dollars," said Rep. Mick Mulvaney (R-S.C.), who has raised those concerns with Fed Chairman Ben S. Bernanke. "It is not [See Fed, B6]

# Japan firms

No, the bad news isn't that the Federal Reserve needs a bailout, as the lead article on the front of the business page of the *Los Angeles Times* of October 28th suggests. The bad news is the article itself, i.e., the lack of basic economic analysis it contains.[1] It's a scary Halloween story about what is at best yet another manufactured crisis, much like the federal government shutdown and the debt ceiling.

The Federal Reserve is not an ordinary commercial bank that can make bad investments and then ultimately need a bailout to avoid bankruptcy. The Federal Reserve is a central bank. It can create money, unlike a commercial bank. In effect, if bailout even has any meaning at all in the context of a central bank like the Fed, such a bank can bail out itself.

It is true that the Fed has bookkeeping attributes that look like those of an ordinary commercial bank. It has assets (basically, securities it buys to create money) and liabilities (the money or monetary base it creates). So it has a balance sheet with assets and liabilities shown. The securities it buys provide earnings. And there are costs of running the Fed. So it has income and it has expenditures, i.e., an income statement. Balance sheets and income statements are used by private banks as indicators of financial health. But they have little meaning for an institution that can create money. It really can't be unhealthy.

Since the Fed holds securities, those securities could drop in value. In particular, bonds and notes will tend to drop in value as interest rates rise. The thrust of the *LA Times* article is that at present interest rates are very low (thanks to Fed policy!), but rates will probably rise at some point in the future. When interest rates rise, the market value of Fed assets will fall. In that case, it is possible that the Fed could have asset values when marked to market that are below its liabilities.

What the article suggests is that such an eventuality would be a crisis. If a private commercial bank found itself with assets below liabilities, depositors (deposits are the liability of the bank) might rush to pull out their deposits to the point where the bank would fail. For a commercial bank, that type of run on the bank would indeed be a crisis. But ordinary folks don't have deposits at the Fed. Who would run to the Fed to pull out their deposits? What does pulling out deposits from the Fed even mean? Where is the potential for crisis?

[1] The article can be found at http://www.latimes.com/business/la-fi-fed-assets-20131029,0,5946576,full.story.

Now the Fed *is* constrained in various ways by legal requirements imposed by Congress. So there may be legal issues that arise if its assets are below liabilities. But any such constraints are purely artificial for a central bank. Just as the debt ceiling was an artificial legal constraint on the federal government, it is possible to have legal constraints on the Fed that could create a crisis where none need exist. But surely any news analysis of the supposed potential crisis at the Fed should point out such artificial constraints for what they are; legal impediments that can be altered by Congress.

The best you can say for the article is that – as has been pointed out in previous musings – under modern monetary systems, money is ultimately a social convention, something even business news reporters find it difficult to understand. People accept "dollars" because they know other people do. Paper dollars come with impressive signatures and official-sounding statements ("this note is legal tender for all debts, public and private"), and pictures of dead presidents. The dollars in your checking account are simply promises to give you dead-president pieces of paper if you ask for them.

You can say that such money isn't "real" and needlessly fret about it. Such angst is a unique American trait, at least in some circles. You never hear about anyone in Japan fretting that the yen isn't real. No one in Britain frets that the pound isn't real. There are complaints about monetary policy in the euro zone, but no one frets that the euro (which was created quite recently) isn't real.

I'm not sure what "real" means, but it is probably best to say that money is real because people believe it to be so. It may be bothersome for you to say such things about something that people strive to obtain. They work hard for it. Some even steal and murder for it. But that's the system and there it is. The only thing that isn't real for sure is an impending Fed crisis – unless someone wants to manufacture one.