Helicopter Ben running out of ammo

Federal Reserve Chairman Ben Bernanke earned the moniker ‘Helicopter Ben’ by suggesting that, if people refuse to borrow, the Fed can always follow Milton Friedman’s advice and drop money out of a helicopter. It might soon be time for him to start the rotors spinning.

The theory behind monetary policy is simple. You put interest rates up, people borrow less. You put them down, people borrow more. That theory has never played out in practice and it never will. People borrow money when the think they can make money and, when they’re worried they’re going to lose it, they won’t borrow a cent. The former is a problem for Australia’s Reserve Bank Governor, Glenn Stevens. The later a much bigger problem for the US Federal Reserve Chairman, Ben Bernanke.

He and his colleagues on the Federal Reserve Board have cut rates from 5.25% to 2.25% in the space of 12 months. They’ve attempted to directly introduce liquidity, lent money to non-banks for the first time since the 1930s and taken significant amounts of credit risk on to the taxpayers’ balance sheet. The net effect: Federal Reserve credit has grown by an annualised 2.2% since August.

‘The great de-leveraging’ is in full swing and no amount of interest rate cuts will bring it to a premature end. No one wants to borrow and it’s no wonder. The Case-Shiller house price index, which measures house prices in the 20 largest cities in the US, fell 10.7% in the year to January. Housing approvals hit a 13-year low and, not surprisingly, consumer confidence has fallen to its lowest level since 1973. A recession is undoubtedly underway.

When the excess homes built in the boom are being lived in, the banks have written off all their stupid loans and rent provides a sensible return on an investment property, things will slowly return to normal. More rate cuts look likely but, with the official rate already at 2.25%, Bernanke doesn't have too many shots left to fire. In any case, it won't make much difference.