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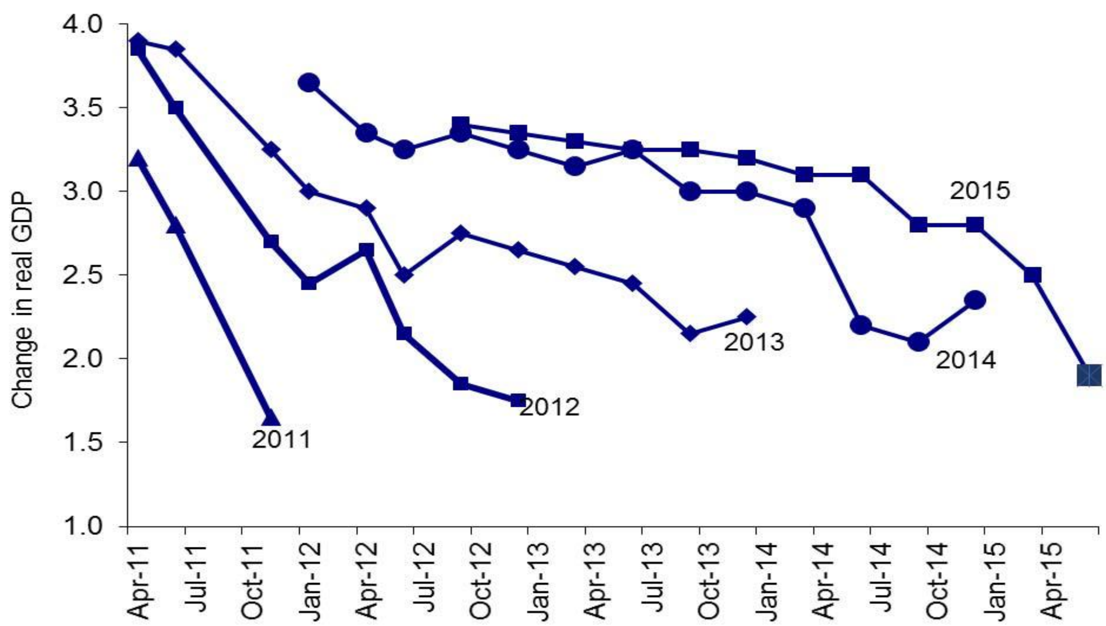
Foolish Consistency

For a number of years, as part of its ever-expanding communications policy, the Federal Reserve has been publicizing its projections of US economic growth. These projections include growth estimates for the current year, as well as several years into the future. As time passes, economic data is accumulated and analyzed, and the Fed repeatedly fine-tunes its prognostications.

In layman's terms, the Fed cuts its growth-rate guesstimate. Year after year.

Federal Reserve Forecasts of US GDP growth (source: Encima Global)



As shown above, the Federal Reserve has stuck to a consistent pattern of behavior. The Fed begins with pie-in-the-sky forecasts, then gradually marks down its numbers until they fit economic reality. For instance, for the years 2012 and 2013, the Fed originally expected growth at just under four percent. The final tally for those years shows our economy expanded at a lackluster 2.3 percent and 2.2 percent, respectively.

For the past five years, the Fed's initial projection of growth has averaged 3.6 percent. Yet the strongest annual growth achieved since the recession was just 2.5 percent, and the average rate has been only 2.2 percent. The most recent year in which our economy grew in excess of three percent was 2005. Undaunted, the Fed continues its pattern today -- missing, missing badly, and always missing in the same direction.

Miscalculations by the Federal Reserve have been so far off target that our central bankers would have been better served ditching all economic analysis for one statistical data point. For the past 25 years, average growth in the US economy has been 2.5 percent. Had the Fed simply assumed this average growth rate in its projections, its margin of error would have shrunk to acceptable levels.

Possible explanations abound, none of them flattering to the Fed. The first is that, for all the economists in the Federal Reserve system, none of them are very good. It could be that the best economists all work in academia, or on Wall Street, where the perks and the pay are more rewarding. As tempting as the idea might be, only a true cynic would fully endorse this explanation.

An alternative theory is that the Fed still believes it has the magic potion to revive the economy; that buying bonds and setting short-term rates at zero are the elixir needed by the 18 trillion dollar, global behemoth that is the US economy. There may even be an econometric model that says it must be so. The trouble is, zero-interest-rate policy has only been tested once in our central bank's history -- the past six years -- and it has failed to deliver the predicted benefits. No matter how strong the theory, six years of futility demands a revised model.

One more theory is that the Federal Reserve may be playing a game of economic cheer-leading. Perhaps the Fed believes it can stimulate our animal spirits with its own version of central-bank hype -- predictions that the economy is poised for acceleration. And who knows, maybe at one time the hype really worked.

If so, those days are long gone. It's about time Fed officials stopped playing this foolish game. It makes them look silly.

The Obamacare Deceit

"If you like your health plan, you can keep your health plan. If you like your doctor, you can keep your doctor." And if there are three types of deceit in Washington -- spin, fudge, and bold-faced lies -- this one may be the biggest whopper since Tricky Dick declared "I'm not a crook".

Still, if you can fool some of the people all of the time, you can forever please the masses with freebies. Ollie loves Obamacare. An early retiree, Ollie is too young to qualify for Medicare and too wealthy for Medicaid. It was his personal decision to stop working and live off his savings when, unexpectedly, the government dropped a huge gift on his doorstep -- affordable medical care. Ollie was thrilled when his health plan costs were slashed, cutting his monthly premium to the price of dinner for two at the local bar and grill.

Of course Ollie still complains a bit. Freebies come at a cost. He had to wait three months to see his new physician, and he pays out of pocket for almost all his prescription drugs. He also enjoys a blissful ignorance: he has no idea what bills await him if he ever needs an acute care hospital.

Some people you can neither fool nor please. Stan hates Obamacare, down to the last detail. He hates that, through the individual mandate, our government can force Americans to buy a service; that the White House twisted legal verbiage into a pretzel over whether a penalty was a fine or a tax. Stan hates that a thousand-plus companies and a million-plus individuals were granted waivers from the program; that defining full-time employment at 30 hours per week created a business incentive to use a 29-hour, part-time workforce.

Surely this is aggravating, but nothing hits home like personal experience. All assurances to the contrary, Stan lost his health plan and his doctor. His new coverage costs nearly three times as much as his prior plan, with reduced benefits. Stan's new plan allows one 'free' office visit per year, does not include prescription drug coverage, and offers a bare-bones blood test mostly designed to reduce costs.

With a higher monthly premium, higher deductible, more out-of-pocket expenses and limited medical clinic choices, Stan's health care plan is inferior to his former plan in every way. And other than paying an even higher price for premium coverage, he basically had no choice. Opting out would have placed him in violation of the law and in the sights of the IRS, and we all know how helpful those public servants can be.

Less coverage and fewer options at a higher price. How is this possible?

That takes us back to Ollie, the early retiree with newfound savings. The gift dropped on Ollie's doorstep was a subsidy from Stan. The reason is simple: Stan makes more money than Ollie. The government mandated the transfer, then played middle-man on the deal, taking its cut through tax surcharges. Obamacare had little to do with improving health care; that was just a guise. It also serves as a warning: In the name of reform, any re-distribution scheme is possible. Just ask Stan and Ollie.

The Virtue of Capitalism

Reprinted from The Wall Street Journal June 15, 2015
From an interview with economist Milton Friedman by television talk-show host Phil Donahue in 1979:

Phil Donahue: When you see around the globe the maldistribution of wealth, the desperate plight of millions of people in underdeveloped countries, when you see so few haves and so many have-nots, when you see the greed and the concentration of power, did you ever have a moment of doubt about capitalism and whether greed's a good idea to run on?

Milton Friedman: Well, first of all, tell me, is there some society you know that doesn't run on greed? You think Russia doesn't run on greed? You think China doesn't run on greed? What is greed? Of course none of us are greedy. It's only the other fellow who's greedy.

The world runs on individuals pursuing their separate interests. The great achievements of civilization have not come from government bureaus. Einstein didn't construct his theory under order from a bureaucrat. Henry Ford didn't revolutionize the automobile industry that way. In the only cases in which the masses have escaped from the kind of grinding poverty you're talking about, the only cases in recorded history are where they have had capitalism and largely free trade.

If you want to know where the masses are worst off, it's exactly in the kinds of societies that depart from that. So that the record of history is absolutely crystal clear that there is no alternative way, so far discovered, of improving the lot of the ordinary people that can hold a candle to the productive activities that are unleashed by a free enterprise system.

Source:
Bloomberg
Encima Global
Wall Street Journal

Tidbits..

Greece plays economic brinkmanship over debt restructuring, austerity; imposes capital controls and temporarily closes banks; status as Eurozone member is threatened.
Puerto Rico, after years of irresponsible borrowing, looks to restructure its debt.
World Bank, OECD cut global growth outlook for 2015.

US housing starts, new home sales reach highest level since recession.
Existing home sales recover to five-year high.
First Quarter Gross Domestic Product revision shows slight contraction in US economy.

Former Federal Reserve Chairman Alan Greenspan warns of financial markets facing another 'taper tantrum'.
Current Fed Chair Janet Yellen remarks that stock valuations "generally are quite high".
Ghosts of 'irrational exuberance'.

Charter Communications to purchase Time Warner Cable and Bright House Networks in cable-TV consolidation move.
Verizon acquires AOL for 4.4 billion dollars.
The same AOL once valued at 150 billion dollars.

Major consolidation in the semi-conductor industry:
Avago to merge with Broadcom in 37 billion dollar deal.
Intel to acquire Altera for 17 billion dollars.
Merger and acquisition activity, over one trillion dollars year to date, nearing all-time record pace.

Bank for International Settlements says low interest rates have hindered global growth.
Federal Reserve's William Dudley warns that interest rate hike will mark 'regime shift'.
Well, that's the point.

General Motors threatened by criminal charges over ignition system defects.
Nike payments for Brazilian soccer sponsorship are subject of Justice Department probe.

Federal Court rules US government acted illegally in financial crisis seizure of insurance giant AIG, yet awards no damages.

Department of Education to forgive student loan debt owed to fraudulent for-profit colleges.
The first round of the trillion-dollar, student debt-relief sweepstakes.

Supreme Court upholds Obamacare subsidies.
Study says Puerto Rico debt, on verge of default, can be purchased by Federal Reserve.
Federal Communications Commission votes to subsidize broadband services for low-income Americans.
More freebies coming out of Washington.