The Derelict Fed: The Fed is belatedly feeling the heat for the inflation monster it birthed

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In March, inflation surged to 8.5 percent over a yearlong period — the highest in more than 40 years. The Federal Reserve's reign of easy money unleashed the scourge.

While enormously destructive, inflation isn't complicated. It's caused by too much money chasing too few goods and services.

Under dovish Fed Chairs Ben Bernanke, Janet Yellen, and Jay Powell, binge money printing fueled asset bubbles, excessive risk-taking, and malinvestment. In addition, negative real interest rates punished savers.

Debtors, the biggest of which is Uncle Sam, love negative real interest rates. But they're enormously destructive. Interest rates are the economy's most important price, the price of present versus future consumption and investment. In free markets, they dynamically allocate capital to its optimal use. In a world of negative interest rates, a child given a choice would prefer one chocolate bar a year hence over two today. That's nuts, and dangerous.

When Bernanke took the helm on February 1, 2006, the central bank's balance sheet was $832 billion. By April 6, 2022, it had ballooned to $8.938 trillion — a 974 percent increase. It spiked in 2008 and 2020 during the financial and COVID-19 crises when the Fed bought trillions in treasuries and mortgage-backed securities. When the Fed buys assets, it electronically creates dollars. Buying treasuries monetizes deficit spending. Acquiring mortgage-backed securities preferences capital for housing over other sectors.

After the crises passed, the deluge of easy money continued.

Economist Mohamed El-Erian observes: “Like a child successfully throwing tantrums to get more sweets, markets came to expect looser financial conditions whenever there was a strong whiff of instability…. the Fed went from just responding to market volatility to also trying to pre-empt it.” Bailing markets out of risky bets creates a moral hazard. The Fed cannot and should not try to manage financial markets and the economy. That’s beyond its writ. Central bankers, no matter how brilliant and well-intentioned, can’t match the market’s dynamic distributed intelligence.

Notwithstanding the Fed’s reign of easy money, after titanium-spined Chair Paul Volcker broke price inflation’s back in the early ’80s, it remained modest for several decades. However, ultra-low interest rates fueled asset inflation. From January 2013 to January 2022, the Case-Shiller U.S. National Home Price Index increased 94 percent. The Dow Jones Total Market Index increased a whopping 192 percent. During that same decade, the Consumer Price Index only increased 21.7 percent.

As accommodative monetary policy stoked asset bubbles, the Fed perversely worried price inflation was too low. Its statutory mandate is to pursue stable prices, which means zero inflation. Congress, not the Fed, makes policy. It could have instructed the Fed to deliver inflation. It didn't.

In 2012, Bernanke's Fed officially targeted two percent inflation, with prices doubling every 35 years, flouting the law. In 2020 under Powell, the Fed took another step beyond its mandate, announcing a strategy of inflation averaging, meaning it would allow higher inflation to catch up for inflation below its target. **(READ MORE: Inflation Is America's Payment for the Fed's Printing Addiction)**

Powell knew the risks of ultra-low interest rates. From 2017 to 2019, the Fed tentatively started to "normalize" by shedding assets and ratcheting up its benchmark interest rate. In July 2019, however, it lost its nerve and reversed course. With price inflation running at 1.6 percent, Powell worried that an "inflation shortfall," would slow growth. Small business owners, meanwhile, weren't worried about an inflation shortfall.

The shortfall would mushroom into his and America's nightmare.

Presidents Donald Trump and Joe Biden signed COVID relief bills of $900 billion in December 2020 and $1.9 trillion in March 2021, respectively. They dumped jet fuel on the simmering inflation fire.

In 2021, price inflation started to accelerate. Powell and Yellen, however, stubbornly maintained it was "transitory." The Fed continued to add treasuries and mortgage-backed securities to its bloated balance sheet and kept its real benchmark interest rate negative. The M2 money supply increased 9.7 percent from March 1, 2021, to February 28, 2022. If

Powell had acknowledged inflation was surging and tightened monetary policy, it is unlikely Biden would have renominated him.

Americans are being battered by higher prices. Washington and the Fed are belatedly feeling the heat for the inflation monster they birthed.

In April, dovish Lael Brainard, who serves on the Fed's board of governors, declared getting inflation down was the Fed's "most important task," and warned it disproportionately hurts lower-income households. March gas and used car and truck prices were up 48 percent and 35.3 percent, respectively, hurting America's middle class far more than hedge fund moguls. Brainard pledged the Fed would increase interest rates and start to reduce its bloated balance sheet "at a rapid pace" as soon as May. The Fed's tardy and still tepid tightening promise more pain before inflation is reined in.

Democratic Sen. Sherrod Brown says Biden's nominees are needed to fight inflation. If they were hawks, that would be true.

With vice chair of supervision nominee and climate-change religionist Sarah Bloom Raskin withdrawn from consideration, economist Lisa Cook is the worst of Biden's nominees. She was nominated because of identity politics and because she's a brass-collar Democrat, neither of which is a good reason.

Republican Sen. Pat Toomey, a member of the Senate Banking Committee, warns Cook has no real experience in monetary economics, has no views on addressing inflation, and refused to endorse the Fed's decision to slowly pull back its ultra easy money policy. Toomey characterized her thoughts on fighting inflation as "word salad." He worries Cook's record of hyperpartisanship and intolerance make her ill-suited to serve on the Fed's board. She's more likely to politicize the Fed than fight inflation.

Vice chair of supervision nominee Michael Barr's most notable qualification is being one of the Dodd-Frank Act's architects. It gave the Fed more regulatory power and treats banking as a public utility. Nothing suggests he's cut from the same cloth as Volcker.

Americans are paying higher prices because of the Fed's dereliction. It's time for it to aggressively tighten monetary policy to eliminate inflation. How aggressively to tighten is a judgment call and not without risk. When Volcker took the reins in August 1979, inflation was over 11 percent and the unemployment rate was 6 percent. His tightening to break "the Great Inflation" triggered a recession (strictly speaking two), with unemployment cresting at 10.8 percent in November 1982.

However, if the Fed doesn't tighten, punitive raging inflation is certain.

Powell aims to achieve "a soft landing, with inflation coming down and unemployment holding steady." The Fed achieved soft or "soft-ish" landings in 1965, 1984, and 1994. Tight labor markets increase the chances the central bank can do it again.