

Fed maintains course while Congress sputters along

Rob Rikoon | Posted: Monday, November 4, 2013 11:00 pm

The hullabaloo resulting from last month's federal government's partial shutdown showed us that Congress has finally gone over the edge, devolving into never-ending adolescent theatrics as opposed to coming to some kind of adult compromise. By demanding that appropriations for funding "Obamacare" be removed from the budget, the ultraconservative wing of the Republican Party knew that it would precipitate a stalemate and that the legislature's primary job of passing a budget would be impossible to fulfill. These politicians are, I assume, intelligent people, not outright dolts as would be easy to conclude from their actions, so there is something more going on behind the curtains.

One underlying issue is that the Republicans have no effective leadership. Simultaneously, the president is unable to get his directives approved through his own party's congressional members — witness his inability to neither mobilize military action in Syria nor win the approval of his first choice, Larry Summers, to be the next Federal Reserve chairman. Both sides can therefore be characterized as aimless. This is not the first time that a vacuum in the American political structure has been taken hostage by a small but extremely focused minority to change the country's direction. It happened in the 1850s regarding slavery.

The most important matter at stake is the direction of the country's domestic policies. Will we try to provide a wide net of care for most people? Will we attempt to build infrastructure? How will the citizenry step up and pay? Higher taxes are sure to come, as is a much lower level of service in health, education and welfare. Both sides have intelligent things to say on this seemingly simple but notoriously devilish matter.

Conservatives want entitlement spending curtailed but no new taxes. Liberals want the reverse. Neither can get their way, nor should they. No matter what your views are on social policy, it is a mathematical certainty that taxes will go up and benefits down. The longer we wait to take these unpopular steps, the deeper the cuts will be and the more burdensome the levies will be.

The movement of the nation's health system toward some kind of simplified payer and more universal coverage is inevitable. Obamacare is one small step in this direction, and while the quality of care might go down and the costs might go up, this is the wave of the future, so get used to it. The law was passed, a subsequent election vote was taken confirming the public's acceptance of its implementation, a Supreme Court challenge to its legality was raised, and it survived all these challenges. Obamacare is a reality and the Republicans know this, so they must be trying to question the underlying principles involved.

The talks over the debt limit that were negotiated in August 2011 and led to the sequestration process, i.e. cutting equal percentages from all parts of the budget, is now the default methodology for settling debt negotiations. It allows every politician a convenient way out from the dark hole of endless arguing, because in the end, without a “grand bargain” (a long-term budget and spending framework), everyone’s programs lose money every year. There is no one to blame for the cuts, so they are politically palatable.

The latest political impasse did not spell an end for the economy nor will the next one. Keep in mind that the U.S. will never knowingly or willingly default on its debt. In fact, the markets’ performance indicates that there is no recession in sight and that resurgence in economic output will occur during the first half of 2014. Unfortunately, the future climate for investments is still largely predicated on the actions of the Federal Reserve. They seem to be agonizing over when and how to reduce their bond purchases, because they know there is a danger to the economy when they start doing so. They cannot avoid cutting back, but they don’t want to be blamed for putting the country back into a recession, so the status quo is in vogue on the financial as well as the political front.

As the Federal Reserve has continuously supplied easy money to the markets for the last several years, it has become a “business-as-usual” policy that is now hard to reverse. It will be difficult to wean stocks from their addiction to this monetary stimulus. There is no doubt the economy needed bold action amid the financial meltdown of 2007 and 2008, but that is no longer the case.

The Federal Reserve’s policy is not going to solve the structural issues facing the economy, and everyone knows this, but they don’t know what else to do to keep the fire stoked. The impacts of keeping the crisis policy in place beyond the appropriate time for tightening are an artificial suppression of market forces, interest rates being kept low and distortion of asset prices upward. This is great for investors as long as it lasts, but it is like a rubber band stretched too far: It’s going to hurt when it eventually reverts back to its natural shape.

By most accounts, the economy is on firm footing, so why is the Fed continuing to press on the accelerator? They are afraid that the congressional and executive branches’ ongoing philosophic impasse means there will be no forthcoming plan for the country other than what they, as a non-elected body, come up with. It is an abdication of responsibility on Congress’ part that it cannot pass a budget or come up with a long-term plan to deal with our debt. It might help if we docked lawmakers’ pay for each day this situation continues, or better yet, maybe Congress should just be disbanded and new elections held if they show they are not up to the task at hand. After all, that is what other forms of democracies do when the government in power loses the people’s confidence. Wouldn’t that be refreshing!

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