

Central Banks Are Running Out of Stuff to Buy

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Watching government policies fail is a favourite hobby of mine. The history of economics can't help but be an illustration on the shortcomings of government for anyone willing to listen.

Quantitative easing was supposed to restart inflation so that the economy and its debts could stabilise. Strangely enough, we've had the last two without the first, even though it was supposed to deliver the others.

Now a hilarious new problem is emerging for QE. There's a shortage of things to buy. The central bankers are literally worried about owning too much of everything. If they can't find anything to buy, their beloved QE will end abruptly, triggering chaos.

This is a mind-boggling problem in a hundred different ways. But first, the mechanics.

At the Bank of Japan (BoJ), concerns over the lack of bonds to buy first came up at the end of last year. The Wall Street Journal reported that Japanese banks would run out of bonds in 18 months at the BoJ's rate of purchases.

Since then the BoJ dramatically reduced its actual rate of purchases without changing its supposed target amount. When questioned about the divergence by a Japanese politician, BoJ governor Haruhiko Kuroda didn't have much to say. It's a bit embarrassing to announce you'll buy 80 trillion yen a month and then only buy 60 trillion yen.

At the European Central Bank (ECB), QE has already run out of Irish and Portuguese bonds to buy. But even the elephant in the room is running into trouble too.

The ECB's monetary policy is supposed to be conducted on an "all animals are created equal" basis. But, as George Orwell demonstrated nicely, "some animals are more equal than others". When it comes to government bonds, German bunds are far more equal than their counterparts.

And so the ECB has been buying a disproportionate amount of the so-called bunds. But it's bought too many. All the animals are sick of German favouritism.

At the current rate of purchases, the ECB will hit its limit of German bond purchases in the next year. At that point, it won't be allowed to buy any more.

Where will the ECB turn to if it wants to continue QE? The corporate bond market is already showing signs of exhaustion after the ECB bought more than 100 billion euros worth of more than 900 different bonds. The [central bank](#) owns about 15% of the investment grade European bond market! Yields in their targeted companies tumbled, leaving potential investors in the dust.

Back in Japan, the other asset being gobbled up by central bankers is also causing trouble. The BoJ now owns about two thirds of Japanese exchange-traded funds (ETFs). As a result, its holdings in some companies present a corporate governance risk. Owning a chunk of a company comes with voting rights and responsibilities. Shares, it turns out, are not just some sort of abstract punt, but ownership in a company.

Even on the abstract punt side of things there's trouble. The of the Japanese stockmarket recently complained that the [BoJ dominates trading](#) to the extent that it's quashed volatility. Without volatility, trading volumes fall, which reduces the exchange's revenue.

Illustrating the point that government policies always fail, it's worth noting that the ETF purchasing programme was supposed to spur trading, not reduce it.

But where does all this central bank intervention leave us?

Financial markets aren't markets any more

It's important to remember some context here. Central bankers would've shuddered at the idea of buying mortgage bonds, stocks, corporate bonds and ETFs just a decade ago. It would've been a deep breach of the trust we place in them to conduct

their affairs responsibly.

These days, they've been buying so much of everything they can get their hands on that financial markets are running out!

[What sort of world is this?](#) If central bankers own our financial assets, what does that even mean?

It's so abhorrent to the mind that it's very difficult to think through what actually comes of it.

Inflation? Well, moderate inflation was the goal back when QE first became a fad. We still haven't got the inflation, but QE is now the dominant force in financial markets.

The end of capitalism? If central bankers buy like mad, the accountability function of the stock and bond market disappears. Companies can finance themselves and don't have to worry about their share prices – the value is too important for central bankers to allow a drop.

Why all government policies fail

All government policies are a bad idea. Otherwise the private sector would already be doing them. It's more or less true by definition.

Profit is a signal that you are providing people with something worth more than what it cost you to make it. It ensures that resources are used as beneficially as possible.

If you chart the history of government, it's a case of intrusion on this. Lighthouses, legal systems, healthcare, money and much more used to be private sector affairs. Until the government took over.

In the private sector, [consumer sovereignty reigns supreme](#). Given we're all consumers, it's a very fair and efficient system. And there's no coercion – no can force another person to "agree" to something.

Perhaps most importantly of all, you can't meddle in other people's affairs. You can't dictate which medication they can take, what they can agree to in a contract, what they can buy or how they choose to run their financial affairs. In each and every case, the consumer chooses for themselves only, and not for others.

But when government takes over, there's an enormous change in incentives. You can read about "public choice theory" if you're interested in the academic reasoning. The key thing I want to point out is that others are entrusted with making decisions for you. They decide what you can buy, sell, how and for how much.

Because the incentives of the regulators and politicians are not the same as the consumers, the gap between what people want and what they get grows wider. But without the accountability mechanisms of consumer choice and profit and loss, nothing must change. Nonsense like QE can go on for a very long time...

Until next time,

Nick Hubble
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