Swiss Central Bankers Have Made $3000 Profit per Resident

Retrieved Thursday 3rd of August 2017 07:21:59 PM

Central bankers were supposed to manipulate the economy for your benefit. But **they've become the economy itself**.

The Swiss central bank has amassed more than £550 billion in stocks, bonds and cash. That's slightly more than the country's annual GDP. Last year the horde of investments made more than £2,200 profit per Swiss resident.

The debate is now on for what to do with all that money. Only a small fraction of it gets sent to the Swiss government treasury.

The debate between founding a sovereign wealth fund and spending the profit on infrastructure is heated in parliament. But where did this money come from? Can **central banks** really buy investments and generate profit out of nothing?

If they can, the world's problems are solved. We can live in a fiat-financed utopia. Central bankers will simply pay for everything. The more they buy, the more they profit, the more stuff we get.

So why don't they do it?

For now, central bankers seem to perceive their vast profits as an embarrassing side effect of conducting monetary policy. Only the politicians are salivating over it. In the UK, there's even a pay dispute which led the **Bank of England**'s employees to go on strike. How on earth a central bank can run out of money to pay employees well is a mystery.

But it begs the question – are there any constraints on central bankers? What stops them from simply printing enough money to paper over any given problem whatsoever, let alone a pay dispute? Are there any crises that cannot be met with the answer of printing more money and buying more assets?

The greatest risk

The real danger for Britain is that, having unleashed the awesome power of central banking, an ambitious economist or politician seeks to use that power to its full extent.

What if the British voting public heard about their Swiss peers? Why not have the Bank of England buy an even bigger chunk of Apple shares than the Swiss' $2.7 billion? A few thousand pounds per person is just the paycheque our pensions need. Not to mention all the Crossrail tunnels and bridges it could build. Printing funny money to build tunnels is an excellent pitch.

None other than Alan Greenspan is out warning over the consequences of this thinking. It's one of the greatest examples of the phrase "pot calling the kettle black" in history. But perhaps it takes one to know one.

Greenspan's worry is over the re-emergence of stagflation. The "stag" refers to stagnation – a lack of economic growth. "flation" refers to inflation. Put them together and you have a phenomenon thought impossible by modern economists until it happened – a recurring theme in **economics**.

Misunderstanding inflation

Inflation is supposed to be driven by economic activity. Prices rise because the economy is firing. This ignores basic supply and demand, not to mention that things get cheaper under economic progress.

The falsity of the conundrum between inflation and growth is best shown by Australia's current experience. The boom of low-cost retailers like Aldi and Costco has had a dramatic impact on consumer prices there – a huge benefit to consumers. Meanwhile, housing costs are spiralling out of control and the reach of young people. The Reserve Bank of Australia (RBA) is stuck in the middle, trying to rein in house prices without exacerbating the deflation showing in the data thanks to the low-cost retailers. The tent city springing up outside the RBA's doors makes the issue nice and newsworthy.

So economic growth and inflation are not closely related as central bankers think. The phenomenon of stagflation illustrated this nicely in the 70s when we had inflation and stagnation in much of the Western world. And yet economists cling to it.

We've had neither much inflation nor economic growth for years now. So the question is which one will make a break for it first. Because if they don't do it together, we're in trouble.

Well Greenspan has recognised the similarity of the situation and the policy mix. It's all too familiar from the 70s. And so the results will be the same too. Economic growth will languish while inflation takes hold. We'll get stagflation.

That spells doom for the bond market.

The problem is, so far, none of his and similar warnings have come true. They seemed just as prescient seven years ago. Inflation continues to bumble along. And that means **central bankers continue to have a carte blanche** to mess about however they want. Because inflation is their only accountability mechanism.

What's central banking without the threat of inflation?

Historically, what kept central bankers from attempting to reach utopia through money printing was inflation.

Inflation is the devaluation of money. If prices change because of supply, demand or innovation, that's not inflation or deflation. It's the market at work. But inflation that comes as a result **of monetary manipulation is dangerous**.

The fear of inflation is what kept central bankers in check. But, so far, no matter how many trillions they print, inflation is nowhere to be seen. Even in the land of quantitative easing, Japan, **central bankers can't seem to manufacture it**.

On the one hand, this seems like great news. Having central bankers without their old foe and accountability has been wonderful for the stockmarket, the bond market, the property market and everything else. Which should make you suspicious in and of itself. Can everything do well simultaneously? Maybe.

But where has inflation gone?

There are two answers I'd like to highlight.

Debt and demographics have turned from an inflationary force into a deflationary force. The world is so indebted that more debt doesn't have much of an economic effect. And it's through debt markets that central bankers make themselves heard. So their typical tool to generate inflation is dampened. Meanwhile, demographics are turning buyers into sellers and workers into retirees.

These forces offset the central bankers' inflation. It dampens their accountability mechanism. But it also enables them to buy whatever they want.

While that remains true, there will be plenty more central bank action. The fears of deflation and market crashes will only be realised if the accountability mechanism of inflation returns to restrict central bankers. Until then, we'll have more of the same.

Until next time,

Nick Hubble
Capital %26 Conflict