BEN BERNANKE INTERVIEW

Liz Ann Sonders interviewed Ben Bernanke at the Schwab Impact conference on November 4, 2014. Here are tidbits and snippets from the interview:

THE LEHMAN WEEKEND

The critical turning point of the 2008-2009 financial was the "Lehman weekend," which resulted in panic. After Lehman Brothers and AIG failed, the cost of bank funding shot through the roof as folks started pulling money out of commercial paper markets and money market funds. Congress finally realized they needed a comprehensive response, and they passed the Troubled Asset Relief Program (TARP), which was the most successful but least popular program instituted during the crisis. TARP stabilized the financial system and ultimately made profits for taxpayers. When Bernanke called a Senator for support on TARP, he asked him how his constituents felt about the matter. The Senator responded that voter sentiment was running about 50-50: 50% said "No!" and the other 50% said "Hell, no!!" Congressmen are still losing their seats over that vote.

While "conventional wisdom" believes the Fed let Lehman fail, the Federal Reserve did all they could to find a firm to acquire Lehman including Bank of America and Barclays. Bank of America took a look but passed on the acquisition and acquired Merrill Lynch instead. The Barclay's U.K. regulators nixed the deal. The Fed did not have the authority to put capital into Lehman, so without any buyers or resources, they had no alternative but to let Lehman fail.

AIG basically ran a hedge fund on top of an insurance company. AIG's cash needs could be collateralized by the insurance company assets. There would have been a total collapse of the financial system if AIG had not received an $85 billion loan. President Bush backed the decision for the loan but told Ben Bernanke and Hank Paulson that they had to explain the loan to Congress. Hank Paulson began the presentation by saying, "Ladies and Gentlemen of Congress, we need to make an $85 billion loan to AIG." He then turned to Bernanke and calmly said, "Ben, please explain."

It was a very tough time. However, after TARP, the Fed had many more tools to address the issues than they did prior to the Lehman failure and AIG bailout. The FDIC guarantees on money market funds helped stem money market fund outflows and stabilized money market funds. The bank stress tests helped stabilize the banking system.

Bernanke knew that a deep recession would occur following the financial crisis. While there was some fiscal help, the Fed was central to stimulating the recovery with low interest rates. Bernanke's goal was to prevent another Great Depression. More than five years after the crisis, the economy is now seeing some success from the actions taken. The United States is a good place to invest in and live in. Our real strength is good demographics compared to other developed economies as we allow more immigration and have higher birth rates. We also boast technological advantages with the top technology universities in the world and the new technological innovations developed in Silicon Valley. The entrepreneurs across our country bring new innovative ideas commercial with our capital markets making financing available. While the U.S. still faces many challenges, we have great strength to deal with them.

DEALING WITH STRESS

When Bernanke was asked about the emotional aspect surrounding the Lehman failure, he admitted that it was a “very scary” time with high stress. It was like a car accident. After the Lehman collapse and AIG failure, Wachovia, Morgan Stanley and Goldman Sachs immediately came under pressure. Bernanke dealt with the stress by focusing on the task at hand. He had to try to find answers amidst the political back and forth challenges.

Bernanke was then asked if the financial crisis represented his worst-case scenario. He said, “No, the worst-case scenario would have been the collapse of the financial system and a protracted Depression for the country.” He added that it was difficult to make Congress understand the risks without overstatement, so he presented Congress with talking points that were believable, such as the Depression of the 1930s, the Scandinavian collapse, 8-9% unemployment, and he described major stock market declines such as Japan’s 40% decline. Bernanke had the advantage as he had studied the Great Depression and other financial crises as an economic historian. He went on “60 Minutes” to explain to the American public what was occurring. Being a teacher helped him effectively communicate the message.

QUANTITATIVE EASING

From Sept. 2008 to the Spring of 2009, the markets remained roiled with the economy dropping like a rock as we were losing 600,000 jobs a month. To help stabilize the economy, the Fed held short-term interest rates near zero. With little room to stimulate the economy with further rate cuts, the Fed began purchasing trillions of dollars of assets in March of 2009, which became known as quantitative easing or QE1. The recession ended mid-year with the stock market rebounding 40% by the end of 2009 from its lows in March of 2009. Bernanke joked that quantitative easing worked in practice but not in theory, although subsequent rounds of quantitative easing have experienced the law of diminishing returns. The theory was that quantitative easing would drive down long-term yields to promote housing and corporate investments. Another view was that quantitative easing was a signal that the Fed was prepared to do “whatever it takes.” In the United States and the United Kingdom, which both used QE to stimulate their economies; the economies of both nations are now doing better. However, in Europe, which did not embark on QE, the economy is teetering on deflation. European politics kept the European Central Bank from buying sovereign debt as there is no single debt issuance like in the United States.

While the U.S. Fed can only buy government and GSE assets as part of QE, the Bank of Japan recently instituted “shock and awe” by announcing they would also significantly increase their exposure to equities in their latest round of QE. This is a very aggressive attempt to break deflation. When the program is completed, their central bank’s balance sheet will be three times larger than the Fed’s balance sheet as a percentage of GDP. Bernanke is supportive of Japan’s QE program. After two decades of deflation, inflation in Japan is now higher than in Europe so their QE program appears to be working. However, a recent consumer tax has caused their growth to turn negative, which is partially offsetting their monetary policy.

While QE was highly criticized by economists and Congress who were worried that it would result in inflation that would crash the system, Bernanke confidently stated that we will not have inflation due to QE. Bernanke added that the inflation concerns “made no sense; there was slack in the economy.” He continued, “We were never concerned about inflation; that was just bad economics; inflation was never a risk and is not a risk now.” He said the Fed has all the tools to maintain low inflation. He added that QE was an important factor that kept the U.S. out of deflation, which was the major concern. The economy is now recovering and creating 200,000 jobs a month with modest inflation moving towards the Fed’s 2% inflation target.

DUAL MANDATE

Bernanke was asked about the Fed’s dual mandate of keeping inflation low and unemployment low. He said the Fed focuses on core inflation (excluding the volatility of oil and food prices) to help them with their inflation forecasts. He added that while other central banks have just price stability as their mandate, they also take into consideration the state of the economy. He noted that over the last six years, both sides of the Fed’s mandate were pushing in the same direction. With deflation a threat and high unemployment, monetary stimulus was needed. The Fed now needs to closely monitor inflation. While high inflation is also not good, the Fed’s 2% inflation target provides a buffer from deflation without being high enough to hinder economic decisions.

THE CREATION OF THE FEDERAL RESERVE

Bernanke recounted how the Federal Reserve was created in 1913 after the Panic of 1907, which led to a run on banks and a stock market crash. J.P. Morgan (the man, not the bank) had to step in to stabilize the markets. This embarrassed Congress, so they created the Federal Reserve as a central bank to stabilize the financial system during a crisis in the future. The Federal Reserve was created as the lender of last resort so runs on banks would cease and avert panic. The 2008/2009 financial crisis has led the Fed to become more focused on financial system stabilization (their original mission). During the post-war era, the Fed had been more focused on monetary policy inflation containment rather than the stability of the financial system.

During the 1930’s, the Fed did not do its job and one-third of all banks failed. This led to the Great Depression as panic deepened. Bernanke did not want to repeat that during the 2008/2009 crisis. While Bernanke and other government officials were operating in a “war of fog” during the crisis, they were intensely improvising to try to find new solutions to prevent another Great Depression.

Their efforts appear to have worked as the financial system is back on its feet and taxpayers made a profit from TARP loans. While the economy endured a severe recession, no depression occurred. QE was used to prevent deflation with the economic recovery now underway.

TAX REFORM

Bernanke believes the recent election results will likely result in corporate tax reform as there is bi-partisan support to eliminate tax loopholes and reduce tax rates. He believes a territorial tax, which would tax earnings where the money is made would eliminate tax inversions, as the money would not be taxed twice on repatriation. The challenges to tax reform will likely come from corporations that will fight to retain specific loopholes for their businesses.

TOO BIG TO FAIL

When asked if he watched the movie, "Too Big to Fail"…Bernanke said he had not since he had seen the original. He joked when they could not get George Clooney to play Bernanke, he lost interest in the movie. Bernanke groused that Paul Giamatti's portrayal of Ben Bernanke in the movie earned Giamatti a Golden Globe while Bernanke received nothing.

BASEBALL FAN

Bernanke was asked about being a big baseball fan, which he readily agreed that he was. He asked, "Where else can you get statistics that go back to 1880?" He told the story of getting to attend batting practice for the Washington Nationals. He was introduced to Jaysen Werth, the tall, bearded outfielder for the Nats who makes more than $125 million. The person who introduced Bernanke to Werth said, "This is Ben Bernanke, the Federal Reserve chairman. " Werth, coolly looked at Bernanke, and said "Yeah? So what is the deal with QE3 anyway?"

PRESIDENT BUSH AND TAN SOCKS

Bernanke also was asked about President Bush during the crisis. Bernanke said President Bush was a "stand-up guy" and "not because he appointed me." When Bernanke was on Bush's Council of Economic Advisers before being appointed to the Fed, he had to make a presentation to President Bush in the Oval Office. After the presentation, he said President Bush came over to him and pulled up Bernanke's grey suit pants to point out the tan socks he was wearing did not go with a grey suit. Bernanke replied that he bought the tan socks at The Gap where he got four pair for $10, pointing out his frugality. President Bush admired the frugality. The next day, there was another presentation in the Oval Office. When President Bush entered the room, everyone in the room had their pant legs rolled up and were wearing tan socks!

SLEEPING DURING THE CRISIS

Bernanke was asked how he slept at night during the financial crisis. He said sleep was not easy, and he spent many nights on the couch in his office so he could be there as phone calls came in from around the world during the crisis. To relieve stress while he was working seven days a week, Bernanke would take walks, read or go to baseball games when he could spare a few hours. Now that he is retired from the Fed, Bernanke reads the newspaper and says, "Gee, that is a serious problem, I hope somebody does something about it. "

SELFIES

When asked about the loss of anonymity, he proclaimed that "Selfies have become a real problem!" Actually, he feels that folks have been very supportive of him and his staff which he greatly appreciates.

FRUSTRATION WITH CONGRESS

When asked if it was frustrating dealing with Congress, Bernanke said, "Yes." He explained that most Congressmen are lawyers, and they never asked a question to get an answer, but rather to pull Bernanke on their side of an issue that was not related to the Fed. Bernanke felt it was important to explain what the Fed did during the crisis and why, but Congress limited his answers to two minutes. Bernanke wishes he had done more on the educational side as the Federal Reserve is still receiving political blowback for the crisis even though a system collapse would have benefited no one.

PASSING THE BATON

Bernanke was asked about passing the baton to Janet Yellen, whom he highly praised. Given her extensive experience, all Bernanke did was wish her luck as he swore her in. He said there is no formal tradition to passing the baton. Alan Greenspan's only advice to Bernanke when he took over was to always face the clock when invited to breakfast during Federal Reserve meetings so he could tell when the meeting should be over. He then told the story that when he took his job in the White House on the Council of Economic Advisers, a sign was left on his desk that said "In case of emergency, open the bottom drawer." The bottom drawer contained a bottle of Scotch. He quipped, "It could not hurt to bring more liquor to Washington. "

LEGACY

When asked about the Bernanke legacy, he said we still have to see how it all plays out. He does feel that the Federal Reserve has made a great deal of progress and has a new tool kit if they should ever need it again. He believes the Federal Reserve will manage the exit from QE without significant problems. He was instrumental in increasing the transparency of the Federal Reserve by being open so that the market can adapt to monetary policies designed to help people get jobs and keep inflation low. The Fed now holds press conferences to discuss their actions and intentions The Fed has also been restructured to address financial stability issues as well as monetary policies, which not only strengthens our financial system but returns the Fed back to its original purpose.