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ON WALL STREET

Bernanke feels the pressure of the nation's rising oil gauge

At his first press conference last April, Federal Reserve chairman Ben Bernanke took a question about petrol – a national obsession from tract houses to the White House – as prices neared $4 a gallon.

"There's not much the Federal Reserve can do about gas prices, per se, at least not without derailing growth entirely, which is certainly not the right way to go," he replied. "After all, the Fed can't create more oil."

For all his other worries, the bearded central banker can take solace from one thing: petrol prices have declined 7 per cent since then, leaving a few more dollars in the compressed back pockets of American drivers.

Now the Fed's commitment to at least two more years of near-zero interest rates is setting off a new round of carping about rising hard asset prices.

Rick Perry, the Texas governor and presidential candidate, last month warned that if Mr Bernanke keeps it up he will border on treason. Mr Perry ought to sit back and enjoy while he can the windfall that $90-a-barrel US oil has given his state. While there are plenty of reasons for commodity prices to remain elevated, loose US monetary policy is not near the top of the list.

Jeffrey Frankel, a Harvard economist, argues that low rates boost commodity prices in three ways. One is to encourage producers to keep oil and minerals in the ground rather than sell them and reinvest the cash at pitiful rates of return. Another is to encourage firms to hoard above-ground inventories, such as grain, since low rates make it cheap to do so. The third way, Mr Frankel says, is to turn commodities into just another risk asset as hedge funds borrow money cheaply and punt in the futures markets. "What they are doing now is appropriate," he says of the Fed's decision. "But I do believe one of the reasons why real commodity prices are so high is low interest rates."

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Yes, crude prices have more than trebled since the Fed set its target rate between zero and 0.25 per cent in December 2008. But if there is a correlation, it is a messy one. For much of 2009 and 2010 oil went nowhere, trading in a narrow range. Then global demand, led by China, began to grow again.

Prices responded. There is no sign that producers are holding back supplies. Since August 2010, when Mr Bernanke first signalled a second round of quantitative easing, Opec's cushion of spare production capacity has shrunk by 40 per cent. Saudi Arabia is now pumping 9.8m barrels a day, up from 8.3m a year ago – leaving 1.5m fewer barrels in the ground each time the sun sets on Riyadh.

As for above-ground stocks, look at the surging corn market. As a percentage of global consumption, stocks this year are expected to fall to the lowest levels since the early 1970s.

The march of investors into commodities is also slowing down. After pumping a record $72bn into commodities in 2009 and $62bn in 2010, through to July of this year investors had added only an additional $21bn, Barclays Capital estimates.

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The trouble is that commodities, however attractive as a risk-on asset, are ultimately subject to the broader dynamics of slow growth that the Fed is trying to combat. The pace of manufacturing is now at its weakest since mid-2009, meaning the bank will stimulate commodity prices only if it manages to reinvigorate output.

Another round of quantitative easing, a term conspicuously absent from Mr Bernanke's speech at Jackson Hole last month, may be a different matter. But as Reuven Glick and Sylvain Leduc of the Federal Reserve Bank of San Francisco show, commodity prices have fallen on days the Fed announced or reaffirmed its programme of buying securities to keep long-term rates low.

In 1997, Mr Bernanke, then at Princeton, was lead author of a paper looking at the kinds of oil price shocks the world revisited this year after Libya descended into strife.

The paper found that "an important part of the effect of oil price shocks on the economy results not from the change in oil prices, per se, but from the resulting tightening of monetary policy."

It's a lesson worth remembering today.

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