US Federal Reserve hikes interest rates

No post-Katrina letup in assault on wages

Bill Van Auken
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Confounding predictions by many financial analysts and brushing aside pleas from some politicians, the US Federal Reserve Board dismissed the economic impact of the Hurricane Katrina disaster and imposed yet another incremental hike in interest rates.

The Fed raised its short-term interest from 3.5 percent to 3.75 percent, the 11th consecutive increase since June 2004. The hike was passed with a rare dissent by one of the Fed's 12 voting governors. It marked the first time in more than two years that the body has had a non-unanimous vote.

In an accompanying statement, the Fed acknowledged Hurricane Katrina's "tragic toll," declaring, "the widespread devastation in the Gulf region, the associated dislocation of economic activity, and the boost to energy prices imply that spending, production and employment will be set back in the near term."

It quickly added, however, "while these unfortunate developments have increased uncertainty about near-term economic performance, it is the Committee's view that they do not pose a more persistent threat."

The so-called "unfortunate developments" dismissed by the Fed as a mere "near-term" problem include an estimated 900,000 people suddenly jobless as a result of the storm's devastation, more than 350,000 families made homeless and a major American city indefinitely paralyzed.

The Fed's response to this disaster contrasts sharply with its decision in the face of the September 11, 2001 terrorist attacks on New York City and Washington, when it convened an unscheduled meeting and voted to cut interest rates by half a percentage point, while vowing to take whatever measures were needed to revive the financial markets. Then, the "near-term" threat to the fortunes of Wall Street's top investors was a matter of urgency.

Similarly, in March 2003, on the eve of the US invasion of Iraq, the Fed cut rates in the face of what it acknowledged could be "short-term" disruptions in energy supplies, leading to higher oil prices in the US. The aim was to cushion the blow to the economy by easing up on monetary policy.

Now, the US central bank has taken the opposite approach, tightening monetary policy under conditions in which it admits that the economy will be set back by Hurricane Katrina, which came in the wake of a 70 percent increase in crude oil prices over the previous year and amid predictions that prices for heating oil and gas could be 50 percent higher this winter than last.

Why the difference in the Fed's response? Financial analysts and the media have responded to the hike by saying the chief banking institution is more concerned about inflation than the possibility of the economy plunging into recession.

In reality, the principal target of the rate hike is the wages and living standards of the working class. Its purpose is to preclude the possibility of government outlays in the rebuilding of areas devastated by Katrina and the consequent economic stimulus sparking an increase in the real wages of American workers.

In going ahead with yet another interest rate increase, the central banking institution sent a clear message that there will be no retreat from the ruthless class policy of the American ruling elite. The masses of working people are to bear the full brunt of fuel price hikes and the overall destruction wrought by Katrina.

Federal Reserve Board Chairman Alan Greenspan spelled out his concentration on holding down wages in testimony before the House Financial Services Committee in July. While assuring the House panel of a generally "favorable outlook," Greenspan warned that there remained "significant uncertainties that warrant careful scrutiny."

Chief among them was "the trend in unit labor costs, or its equivalent, the ratio of hourly labor compensation to output per hour." The Fed chief noted, "Over most of the past several years, the behavior of unit labor costs has been quite subdued. But those costs have turned up of late, and whether the favorable trends of the past few years will be maintained is unclear.” He pointed with consternation to statistics indicating that “hourly wages as a share of national income had risen near the end of 2004.”

What are the endangered “favorable trends” to which Greenspan refers? They include the steady fall in the real income of working people in the US—a decline that has continued unabated for five years in a row, alongside a sharp rise in productivity, with output per hour up 15 percent between 2000 and 2004. These trends also include the persistent growth of poverty, up last year from 12.5 percent to 12.7 percent, with a million more people falling below the poverty line.

The persistent lag of wages behind inflation and productivity, resulting in lower living standards, widening social inequality and the growth of poverty, are the foundation of the elevated profit margins of American big business.

The Federal Reserve Board is seeking to maintain these relations and counter any movement to reverse the wage losses of previous years by hiking interest rates. It is using unemployment as a club against the working class to ensure that its wage demands remain “subdued.” As the *Wall Street Journal* commented Wednesday, Greenspan “appears clearly more willing to risk a rise in unemployment than a jump in inflation.”

The steady rise in interest rates will have an increasingly severe impact on the living standards of average working people, who are burdened with a record level of household debt—now at an all-time high, equivalent to 85 percent of the gross domestic product.

Household debt has soared by 60 percent in just five years. According to some estimates, the average household is now spending as much as one dollar out of every five of after-tax personal income to service debt. The Fed’s rate increases will gouge an even larger share out of working class families.

The Federal Reserve Board’s action is in line with the response of the ruling establishment as a whole to Hurricane Katrina. One of President Bush’s first official acts in the face of the disaster was to suspend the Davis-Bacon Act, thereby allowing employers to pay sub-standard wages on federally funded reconstruction projects.

Meanwhile, Republican legislators are expressing increasing qualms about appropriating massive funds for rebuilding New Orleans and the Gulf Coast. Some Senate leaders have called for corresponding spending cuts for any money allotted for the reconstruction effort.

House Minority Leader Tom DeLay (Republican-Texas) denounced any attempt, in light of the hurricane disaster, to take off of the agenda plans to make tax cuts for the wealthy permanent. “That is not an option,” he said. DeLay likewise questioned whether Congress would approve future supplemental spending for Katrina relief, declaring, “We don’t know that there’s going to be another supplemental.”

Rep. Jack Kingston (Republican-Georgia) voiced the unstated sentiments of many within the ruling elite, declaring, “The question is do we really want to flood New Orleans with money.” According to the *Washington Post*, “Kingston said he has detected a building hostility toward New Orleans among his constituents, based on reports that local officials mismanaged the crisis.”

Driven by considerations of profit, defense of the vast personal wealth of the financial elite and barely concealed class and racial hatreds, the policy of the American ruling class appears to be based on a gross underestimation of the economic impact of the Katrina disaster.

The damage to refineries and off-shore facilities will force the US to import even more oil, driving up its already record current accounts deficit. At the same time, the government is counting on running up US government debt—with foreign holdings already standing at more than $2 trillion—to finance the rebuilding of the Gulf Coast.

Meanwhile, the disaster has effectively shut down what by tonnage is the largest single US port, through which the bulk of US agricultural commodities must pass. The likelihood that this port will not be back to normal for months spells major increases in transportation costs and potential ruin for small farmers, as well as layoffs for workers in industries that depend upon the port.

There is every likelihood that the greatest economic devastation from Hurricane Katrina still lies ahead.