

# US Fed chairman Bernanke will not prick asset bubbles

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Like his predecessor Alan Greenspan, the new chairman of the US Federal Reserve Board, Ben Bernanke will take no measures to deflate housing or other asset bubbles in the American economy.

Bernanke made his position clear in response to a question that came at the conclusion of his first major speech on monetary policy since taking over from Greenspan a month ago. The central bank, he claimed, “doesn’t really have good instruments for addressing asset price bubbles should they exist, particularly if they are in one particular segment or another.”

He acknowledged that while the Fed needed to “pay close attention” to changes in asset prices because they had an impact on spending and economic growth, it was “generally a bad idea for the Fed to be the arbiter of asset prices.”

“The Fed doesn’t really have any better information than other people in the market about what the correct value of asset prices is,” he told his audience at a symposium held last Friday at Princeton University.

This is the same position adopted by Greenspan when confronted by critics who suggested that the Fed should have taken action to halt the stock market bubble in the 1990s. In fact, Greenspan knew full well that the escalating stock market was a financial bubble. The reason he took no action was not due to lack of information or a belief that the “market knows best” but the opposition that such measures would have generated from leading figures in the financial elite.

When the stock market spiral ended in 2001, Greenspan cut interest rates to record lows in order to prevent a recession. But this has led to a rapid rise in house prices over the past five years—55 percent overall according to the Office of Federal Housing Oversight—and much more in some areas.

If Bernanke is wary of pricking this latest bubble, it is

because of the crucial role that escalating house prices have played financing debt and consumption spending. Household debt has become an increasingly important factor in maintaining American economic growth because of the decline in real wages for the majority of ordinary wage earners.

According to a survey by the Federal Reserve issued last week, the growth in US household incomes has fallen sharply compared to the last years of the 1990s.

Between 2001 and 2004, the median inflation-adjusted income in the US rose by 1.6 percent before taxes, compared to an increase of 9.5 percent in the three years to 2001. This change was “strongly influenced by a 6.2 percent decline in the overall median amount of wages measured in the survey,” the Federal Reserve noted in a summary of its findings.

While Bernanke wants to continue the policies of his predecessor, how long he is able to do so is another matter. Paul Volcker, who was Fed chairman from 1979 to 1987, pointed to the mounting balance of trade deficit—\$726 billion last year—as the main problem confronting the new chairman.

In an implicit criticism of Greenspan, Volcker said in an interview following the speech: “Bernanke is not inheriting the best of situations. How would you like to be responsible for an economy that’s dependent upon \$700 billion of foreign money every year? I don’t know what I would do about it, but he’s going to have to do something about it sooner or later.”

Last April, in a comment published in the *Washington Post*, Volcker warned that the US economy was “skating on increasingly thin ice” and that at some point confidence in capital markets, which was supporting the inflow of funds into the US, could fade. Since then the ice has got even thinner, as the balance of payments deficit has blown out to more than 6

percent of gross domestic product.

In his speech, Bernanke focussed on the central importance for low and stable inflation in the formation of monetary policy. Bernanke is known to favour inflation targeting—a policy in which the Fed specifies an inflation range and then applies policies to keep prices within it. However, his speech did not mention the need to implement this measure. As he told the Congress last year, its implementation would require “extensive discussion and consultation.”

Avoiding a discussion of immediate policies, Bernanke’s remarks consisted of a review of Fed policies over the past 40 years and the relationship of inflation to the overall position of the American economy. This was presented as something of an intellectual exercise, with academics such as the monetarist Milton Friedman paving the way for policymakers in the 1970s and then policymakers, in particular Fed chairman Volcker, setting the pace for academics.

In fact, the setting of monetary policy by the Fed has always been intimately connected to the development of the class struggle. Almost as soon as he took office, Volcker was directly involved in the Chrysler bankruptcy proceedings in 1980 that set the stage for a series of wage cuts in return for loans. He later acknowledged the importance of the smashing of the strike by air traffic controllers and the destruction of their union (PATCO) in 1981. “The most important single action of the administration in helping the anti-inflation fight,” he maintained, “was defeating the air traffic controllers’ strike.”

The next meeting of the Fed will be held at the end of March and Bernanke, as he indicated in his testimony to Congress, is in favour of another interest rate rise.

Whatever decisions he and the other members of the Fed’s open market committee make in the coming period, the needs of American business and finance to maintain downward pressure on workers’ wages and conditions will play a major role.

In a recent report, the Stratfor forecasting group pointed to “tightness” in labour markets. “Unemployment levels are dropping close to their 2000 lows,” it said. “Do not read us wrong, low unemployment is certainly a good thing. But when the labour market gets too tight, workers’ ability to demand higher wages tends to rise dramatically and the

result is labour inflation. Since the American economy is service-dominated, low labour inflation is traditionally the most important ingredient in determining the sustainability of growth.”

In other words, notwithstanding the fact that, as the Fed’s own figures make clear, American workers have suffered significant wage cuts in the recent period, big business and finance is insisting that they made be permanent and, if necessary, even deeper cuts inflicted in order to sustain profits.

See Also:

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[26 October 2006]



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