US Fed chairman signals shift to anti-inflation policy

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Ben Bernanke, chairman of the US Federal Reserve Board, indicated Tuesday that the Fed would hold interest rates steady in the face of mounting inflation and the depreciation of the US dollar. He departed from tradition, whereby the head of the US central bank refrains from making public comments on currency questions, deferring to the treasury secretary, to say that "in collaboration with our colleagues at Treasury, we continue to carefully monitor developments in foreign exchange markets."

He went on to say that dollar weakness had "contributed to the unwelcome rise in import prices and consumer price inflation," and declared that the Fed would be "attentive to the implications of changes in the value of the dollar for inflation and inflation expectations." Bernanke added that the Fed would "formulate policy to guard against risks to both parts of our dual mandate, including the risk of an erosion in longer-term inflation expectations."

Bernanke's speech, via satellite to a bankers' conference in Spain, gave credence to expectations that the Fed would begin to raise rates over the next year, and sparked a US dollar rally. The speech was seen as shift away from the previous policy of lubricating near-frozen credit markets by sharply cutting interest rates and providing hundreds of billions of dollars in cheap loans to major Wall Street firms.

That policy, aimed above all at averting a major bank collapse and financial panic, came to a head with the Fed's moves last March to prevent Bear Stearns from filing for bankruptcy protection and to forestall other Wall Street failures by allowing major investment banks to borrow directly from the Fed—a move unprecedented since the Great Depression of the 1930s.

The Fed's policy of bailing out Wall Street contributed to the downward pressure on the dollar and an explosive run-up in the price of oil and other basic commodities.

The value of the dollar shot up in the hour following Bernanke's Tuesday speech, rising 0.6 percent against the euro and 0.8 percent against the yen. Oil and gold prices fell significantly.

By shifting gears to place the emphasis of its policy on inflation, rather than the housing slump and credit crisis, the Fed is signaling its recognition that an economic slowdown of considerable duration is inevitable, and making clear that it hopes to utilize the recession to carry out an orderly "unwinding" of the vast edifice of fictitious capital built up during the previous period of wild speculation that was centered in housing and fueled by cheap and plentiful credit.

The unstated corollary of this policy is to place the burden of the financial crisis squarely on the backs of the working class in the form of factory closures, layoffs, wage cuts and new attacks on social programs.

Bernanke somewhat obliquely referred to the recessionary implications of his dollar-boosting, anti-inflationary shift by noting that "the demand for US exports arising from strong global growth has been an important offset to the factors restraining domestic demand, including housing and tight credit." The growth of US exports has largely been the consequence of the cheaper dollar, which lowers the relative cost of exports and increases the cost of imports into the US.

A central concern of the Fed and of financial markets is to preempt what are referred to as "inflationary expectations." This is largely a euphemism for wage increases. The job-cutting impact of recession will be used to undermine workers' demands for wage hikes to offset rising prices.

According to statistics released Wednesday, the cost per unit of labor in the US rose at an annualized rate of

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2.2 percent in the first quarter of 2008, a figure significantly lower than the current inflation rate of about 4 percent. In real terms, wages in the US are falling at a rate of almost 2 percent a year.

It is by no means certain that the Fed's open-ended support for Wall Street combined with a tightening of credit to bolster the dollar and contain inflation will avert further financial eruptions, or even a full-scale panic. In the first place, the deregulation of financial markets enacted on a bipartisan basis by successive US governments has produced a massive overhang of debt, in the trillions of dollars, that is traded on unregulated secondary, or derivative, markets. There are countless financial time bombs lurking in this vast edifice of speculation.

Moreover, financial markets have become globalized, with huge sums, including exotic forms of speculation, circulating around the world. The failure of a major hedge fund or over-leveraged bank in virtually any part of the world can trigger a crisis of global dimensions.

Billionaire investor George Soros, in testimony before the Senate Commerce Committee on Tuesday, warned that speculation on commodities indexes was creating a bubble that could burst in the event of a protracted recession in the US.

While the panic surrounding the failure of Bear Stearns has at least partially subsided, banks continue to make plans for ever-greater losses and write-downs. US banks stashed a record $37.1 billion in future loss provisions for bad loans in the first quarter.

Sheila Bair, chair of the Federal Deposit Insurance Corporation, noted that "While we may be past the worst of the turmoil in financial markets, we're still in the early stages of the traditional credit crisis you typically see during an economic downturn."

In any event, the burden of the debacle on Wall Street is already being borne by workers in the US. One day after General Motors announced the closure of four more assembly plants in North America, United Airlines announced it would slash its operations by 18 percent and lay off 1,100 workers. Similar cuts are being prepared in the rest of the US airline industry.

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