Despite bleak report on US economy, Fed makes minimal moves to avert deflation

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The Federal Reserve issued a bleak report on the US economy on Wednesday but announced only modest measures to combat the threat of deflation. Following a two-day meeting, the US central bank's policy-making Federal Open Market Committee (FOMC) acknowledged that US economic growth, employment growth and the pace of household spending had all slowed since its last meeting in April.

It also noted that the housing sector remained "depressed."

The FOMC said it expected economic growth to remain "moderate" over coming quarters and then pick up only "very gradually." As a result, its statement declared, unemployment—officially at 8.2 percent—will decline "only slowly."

In a separate report issued later in the afternoon, the Fed revised downward its forecasts for economic growth and revised upward its projections for unemployment from its April projections. The US gross domestic product (GDP) will rise in 2012 by only 1.9 percent to 2.4 percent, the central bank predicted, a significant downgrade from the already sluggish 2.4 percent to 2.9 percent it had forecast two months ago. Such a rate of growth rules out any significant decline in the jobless rate.

The Fed revised downward its forecast for growth in 2013 to 2.2 percent to 2.8 percent from its previous projection of 2.7 percent to 3.1 percent. For 2014, it predicted growth at 3.0 percent to 3.5 percent.

The new forecast put unemployment this year at 8.0 percent to 8.2 percent, an increase in the Fed's April projection of 7.8 percent to 8.0 percent. For 2013, the central bank sees unemployment remaining at 7.5 percent to 8.0 percent. This compares to its prior projection of 7.3 percent to 7.8 percent. The Fed forecast an unemployment rate above 7.0 percent throughout 2014.

In another sign of mounting deflationary pressures, the Fed lowered its projections for inflation, saying it expected inflation to rise by no more than 1.7 percent this year.

Even this grim assessment might prove unduly optimistic, the FOMC suggested, noting that "strains in global financial markets continue to pose significant downside risks to the economic outlook."

Had it wished to be more specific, the Fed could have pointed to spreading recession and ongoing financial turmoil in Europe and sharply slowing growth in the so-called emerging economies of China, India, Brazil and Russia.

In the US, the Fed meeting was preceded by two consecutive monthly employment reports showing less than 100,000 net new jobs, far less than needed to keep pace with population growth, and reports of slowing manufacturing, rising home foreclosure proceedings and an increase in joblessness in 18 US states, the highest number in 9 months.

The day before the FOMC report, the Labor Department reported that the number of available jobs dropped by 325,000 in April to the lowest total in 5 months. It was the biggest single-month decline in job openings since September 2008—the month of the Lehman Brothers collapse and global financial panic. Job openings and hiring fell the most in manufacturing and in the industrial Midwest.

The FOMC said the Fed would continue to hold the federal funds interest rate—the key short-term rate—to 0 to 0.25 percent at least through late 2014. The central bank has kept the federal funds rate at near zero since December 2008.

The only additional step the Fed announced was an extension of its program of selling short-term Treasury securities and replacing them with longer-term Treasury bonds. So-called “Operation Twist” had been slated to expire at the end of this month, but the Fed said it would continue it until the end of 2012, buying and selling an additional $227 billion of government securities over that period.

The aim of this program is to keep long-term interest rates low, ensuring a continued flow of cheap credit to the banks and corporations and holding down mortgage rates. It is widely acknowledged that this form of monetary stimulus does next to nothing to create jobs, one reason being the lack of any requirement on the banks and corporations to use their easy money to provide loans to small businesses and consumers or hire new workers. Up to now, such monetary stimulus has mainly fueled stock prices and corporate profits and enabled the banks and major companies to compile a cash hoard of more than $2 trillion.

The Fed disappointed the financial markets by not announcing a third round of so-called “quantitative easing,” essentially the printing of dollars to buy bonds and expand the central bank’s balance sheet. However, in the FOMC statement and in a subsequent press conference, the Fed made clear that it was prepared to take such action should the US employment situation continue to deteriorate or the European debt crisis threaten a new financial panic.

In the press conference, Fed Chairman Ben Bernanke said the central bank “would consider additional asset purchases.” He also reiterated his demand for a plan to impose sweeping austerity measures, citing the need for a “sustainable fiscal path over the longer term.”

The Fed’s aim is to provide sufficient monetary stimulus to avert a deflationary spiral, but not dramatically decrease unemployment. It, like the White House and Congress, is adamantly opposed to any government program to hire workers, such as a public works initiative. High unemployment is being deliberately used by the corporate-financial elite to destroy the wages and conditions of workers and increase the rate of exploitation.