Stocks slump as Federal Reserve hints at reducing cash infusions

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US Federal Reserve Chairman Ben Bernanke said at a Wednesday press conference that the US central bank would consider reducing its $85 billion-per-month asset purchasing program later this year, based on an improved outlook for the US economy.

The announcement sparked a sell-off on US stock and bond markets, with the Dow Jones Industrial Average closing down by 206 points, or 1.35 percent. Yields on government bonds spiked as prices fell, with 30-year Treasury notes closing at 3.41 percent, up 0.07 percentage points for the day. Since early May, the interest rate on 30-year Treasury bills is up by 0.60 percentage points.

The sell-off on financial markets in response to the Federal Reserve's improved outlook was characteristic. The financial elite, which is making record profits on the vast sums of money it receives from the Federal Reserve, generally responds negatively to any improvement in the economic outlook that might prompt the Federal Reserve to reduce its handouts.

Bond prices have been plunging since May 22, when Bernanke indicated in congressional testimony that the Fed might slow asset purchases "in the next few meetings" if economic conditions continued to improve.

The statement of the Fed's policy-making Federal Open Market Committee (FOMC), issued just before Bernanke's press conference, said the labor market had seen a "further improvement in recent months," adding, "The committee sees the downside risks to the outlook for the economy and the labor market as having diminished since the fall."

The FOMC lowered its 2013 unemployment rate forecast from 7.4 percent to 7.25 percent and concluded that economic growth would be 2.45 percent in 2013 and 3.25 percent in 2014, significantly higher than current market expectations. The Federal Reserve's economic estimates have consistently been overly optimistic since the start of the financial crisis in September of 2008.

As Bernanke noted in response to a reporter's question, the Federal Reserve's sunny portrait of the economy was based largely on the recent fall in the unemployment rate and a moderate improvement in housing values. In fact, the fall in the official unemployment rate is almost entirely the result of unemployed people leaving the labor force.

Since 2010, the US economy has created an average of only 162,000 jobs per month, lower even than the 166,000 average monthly growth rate of the US working-age population. As a result, the employment-population ratio has remained essentially unchanged for three years.

The modest increase in home values, which are up by about ten percent this year and essentially unchanged from three years ago, is largely due to speculators buying up properties.

Behind the Federal Reserve's hints that it may wind down its asset-purchasing program lie worries that the vast amounts of cash that have been pumped into the financial system have created a speculative bubble of vast proportions, which threatens a financial collapse that could dwarf even that of 2008.

While the Fed's official projections were upbeat, significant sections of the US ruling class are increasingly concerned about signs of a global slump, particularly in Asia and Europe, and the specter of deflation in the real US economy. Consumer prices have fallen for the past two months, and the Core PCE, the Federal Reserve's preferred measure of inflation, has fallen to its lowest level on records dating back over fifty years.

Deflation is the logical outcome of the US ruling class's policy, involving the slashing of social services—with over 700,000 government jobs eliminated since 2009—and a ruthless assault on wages. The Federal Reserve's infusions of cash into the financial system, which under normal circumstances would cause runaway inflation, have served to offset the deflationary effects of these policies while protecting and expanding the vast wealth of the ruling class.

Boosted by the cash handed out by the Federal Reserve and other central banks, stocks and other financial assets have soared—the DOW is up by 140 percent from 2009—while wages have fallen and economic activity has stagnated. Between 2007 and 2011, the US median household income plunged by 11.6 percent, from $57,143 (in 2011 dollars) to $50,502.

The growing contradiction between the dizzying rise in the value of financial assets and the stagnation of production and employment threatens a collapse of the entire system. Recognizing this, the Federal Reserve is attempting to orchestrate a "soft landing" of the financial system by scaling back its asset purchases.

The response of financial markets to the Fed's actions indicates the potential for convulsions arising from Wall Street's addiction to the central bank's free money. The mere suggestion that the Fed "may consider" reducing asset purchases has caused bond prices to go into a tailspin, causing investors to pull $17.6 billion from bond funds in the two weeks ending June 12, according to Thomson Reuters.

The turbulence in bond markets has affected the ability of even nonfinancial companies to raise money, and the increase in bond yields has already begun to feed into mortgage rates, threatening to depress home sales and prices once again.

Meanwhile, Bernanke's talk of an improving labor market, defined as an official jobless rate tending toward 7.0 percent, underscores the reality of a deliberate policy of high unemployment. There is to be no let-up in the use of mass unemployment to drive down wages and destroy working conditions and benefits. This is the "new normal" which an ostensibly recovering American capitalism has to offer the working class.