Federal Reserve reaffirms commitment to cheap money for Wall Street

Andre Damon
20 March 2014

Federal Reserve chair Janet Yellen reassured Wall Street Wednesday that the US central bank would continue to keep interest rates near zero even if the unemployment rate continued to fall, in her first press conference since taking office in February. Her remarks followed a two-day meeting by the Federal Open Markets Committee (FOMC) and the release of its official monetary policy statement.

The Federal Reserve had insisted since December 2012 that it would consider raising the federal funds rate once the unemployment rate fell to 6.5 percent, but in its latest policy statement, the central bank dropped its references to any particular level of unemployment as a criterion for raising interest rates. “The purpose of this change is simply to provide more information than we have in the past, even though it is qualitative information, as the unemployment rate declines below 6.5 percent,” Yellen said.

The official jobless rate, now at 6.7 percent, has fallen faster than Federal Reserve officials had anticipated, not because jobs are more plentiful, but because millions of workers have given up looking for work amid dismal labor market conditions.

The number of people not in the labor force has increased by two million in the past year alone, and, according to the Economic Policy Institute, 5.66 million “missing workers” have dropped out of the labor force over the past five years. If these missing workers were counted as unemployed, the unemployment rate would be around 10 percent.

The Fed downgraded its assessment of economic conditions compared to its December forecast, with its official statement noting that, “growth in economic activity slowed during the winter months.” The Fed predicts that the economy will grow at a rate of 3 percent or less this year, compared to its December estimate of up to 3.2 percent. As expected, the Fed announced that it would reduce the size of its “quantitative easing” asset purchases by another $10 billion, bringing the rate of its purchases of Treasury notes and mortgage-backed securities to $55 billion in April.

Yellen’s comments constituted a reaffirmation that the Federal Reserve continues to be committed to its zero-interest rate policy “for a considerable time.” But despite these assurances, financial markets were not happy with the press conference. All three US stock indexes plunged while Yellen was speaking, with the S&P 500 down by 11 points, the Dow Jones Industrial Average down by 114 points, and the NASDAQ down by 25 points.

The market selloff was attributed to an official survey, issued together with the FOMC report, indicating that Fed officials envision beginning to raise interest rates earlier than had previously expected. The survey predicted that the Federal Funds rate would be 1 percent by the end of 2015, up from earlier projections of 0.75 percent, implying that the Federal Reserve may begin tightening interest rates in the summer.

The panicked market response, even amid assurances that the Federal Reserve would not begin raising interest rates despite the fall in the unemployment rate, is an indicator of the extent to which the entire functioning of the US economy is dependent on continual cash infusions from the central bank.

While the Federal Reserve remains committed to its zero-interest rate policies at least for the next year, there are increasing concerns that the Fed’s enormous cash infusions are fueling a financial market bubble. Over the past year, for example, the NASDAQ has risen by one third, even as the real economy remains depressed.

Yellen has sought to reassure the public—like all of her predecessors—that there is little reason to suspect another financial meltdown, telling Congress earlier this month that, "I'd say my general assessment at this point is I can't see threats to financial stability that have built to the point of flashing orange or red."

The vast growth in the stock market has significantly increased the wealth of the super-rich. In 2013, Warren Buffett, the head of Berkshire Hathaway, had his net worth increase by $12.7 billion; that of Jeffrey Bezos grew by $12 billion, while Mark Zuckerberg of Facebook saw his wealth nearly double, from $11.3 billion to $23 billion.

But behind this enormous expansion in paper wealth lies the fact that the US economy continues to be significantly depressed. December and January was the worst two-month period for jobs growth since 2010, and the US economy added only 175,000 jobs in February, barely enough to keep up with population growth. Earlier this month the Bureau of Economic Analysis downgraded its estimate for real US economic growth in the fourth quarter of 2013 to 2.4 percent, down from its first estimate of 3.2 percent released at the end of January.

There are still 651,000 fewer jobs than before the recession, even though the working-age population has grown by about 8 million during that time. The labor force participation rate is down by 0.5 percent from a year ago and has fallen by about 3.5 percentage points since 2007.

Yellen emphasized that even after the Federal Reserve begins to raise the federal funds rate from the present near-zero level, interest rates may not return to the previous historical norm. The FOMC statement noted, "the Committee anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run."