Fed Chief Yellen reassures Wall Street on interest rates

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In testimony before the Joint Economic Committee of Congress Wednesday, Federal Reserve Board Chairman Janet Yellen indicated that the US central bank would keep interest rates at their current near-zero level for the foreseeable future.

Her statement was an effort to reassure the stock market that the decision of the Fed to cut back its purchases of vast quantities of Treasury and bank securities did not represent an effort to curb the rampant speculation that has driven up stock prices by more than 100 percent since they hit bottom after the 2008 Wall Street crash.

The Fed has been pursuing a policy known as "quantitative easing," pumping tens of billions a month into the financial markets, divided roughly equally between Treasury bonds and the virtually worthless mortgage-backed securities still on the books of the major banks and investment funds, which the Fed purchases at face value. At its peak, the bank was purchasing $85 billion a month in these assets.

At the beginning of this year, the central bank began to taper down its purchases by $10 billion a month, reducing its outlay to $75 billion in January, $65 billion in February, and so on. Yellen has previously suggested that direct Fed purchases would be reduced to zero by the end of 2014, unless there was major disorder in the financial markets.

In her appearance before the congressional committee, to discuss the Fed's semi-annual Economic Outlook, Yellen reassured Wall Street that even though the Fed was cutting back its purchases, "it is still adding to its holdings, and those sizable holdings continue to put significant downward pressure on longer-term interest rates, support mortgage markets, and contribute to favorable conditions in broader financial markets."

She also made it clear that other subsidies for Wall Street would continue, in particular, the near-zero interest rates that have fuelled financial speculation. Yellen sought to distance herself from the language used in a Fed statement in March, providing more explicit "forward guidance" on when the central bank might begin raising interest rates. At the time it was issued, the statement was viewed as a public warning that interest rate hikes were imminent, and the stock market plunged.

Yellen emphasized that the March guidance from the Fed's Open Market Committee "did not represent a shift in FOMC policy intentions." She went on to declare that even after the restoration of what the Fed would regard as "normal" levels of unemployment and inflation, "economic and financial conditions may, for some time, warrant keeping the target federal funds rate below levels that the Committee views as normal in the longer run."

This statement is an extraordinary demonstration of the degree to which the direction of the US economy is entirely subordinated to the immediate requirements of the financial aristocracy. The highest priority of the central bank, Yellen was saying, is to ensure that financial markets continue to rise, so that the wealth of the multimillionaires and billionaires continues to increase.

The Fed chairman sought to justify this policy of propping up Wall Street by claiming that the US economy was continuing to recover from the slump that followed the 2008 financial crash. She claimed that the sharp slowdown in GDP growth in the first quarter of 2014 was "mostly reflecting transitory factors, including the effects of the unusually cold and snowy winter weather."

However, on the day of her testimony, four private economic forecasters said that the reported 0.1 percent increase in GDP in the first quarter—the lowest since the recession officially ended in 2009—would likely be revised to show an actual decline in GDP during that period. JP Morgan Chase estimated that GDP contracted at a 0.8 percent rate in the January through March period, while Macroeconomic Advisers put the decline at 0.6 percent, Barclays Capital 0.2 percent and BNP Paribas 0.1 percent.

Yellen was questioned in a deferential and half-hearted fashion by both Republican and Democratic lawmakers on the joint House-Senate panel. Both parties sought to raise underlying political concerns, but in coded language aimed at avoiding raising any alarm bells with the broader public.

Republicans questioned Yellen about the inflationary implications of the vast money-creating schemes of the Fed over the past six years, which has seen the central bank accumulate an enormous investment portfolio, more than $2.5 trillion, all of it flowing into the coffers of Wall Street.

Naturally the Republicans were not opposed to this subsidy to the super-rich. Their concern was that the policy of quantitative easing would spark inflation and, in turn, demands from the working class for higher wages.

Democrats were equally concerned about the danger from below, but couched their questions to Yellen in the form of demagogic condemnations of rising income and wealth inequality. The Obama administration has made similar demagogic statements over the past several months, even though Obama's own policies, particularly the bailout of Wall Street, are principally responsible for deepening inequality.