US stocks surge as Fed signals slower rise in interest rates

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US stock and bond prices rose sharply Wednesday in response to signals from the Federal Reserve's policy-making Federal Open Market Committee (FOMC) that interest rate hikes might be delayed and will likely be smaller than previously indicated once they begin.

The Dow Jones Industrial Average, which was down 124 points when the Fed issued its policy statement at 2 PM, immediately jumped nearly 250 points and ended the trading day up by 227 points (1.27 percent) over the previous day's close. The total swing in points pre- and post-FOMC statement was more than 350.

The other major indexes, the Standard & Poor's 500 and the Nasdaq, registered similarly hefty gains for the day.

Banks, hedge funds and global speculators were nervously anticipating that the FOMC would drop the assurance from its two previous statements that it could be "patient" in beginning to raise the Fed's benchmark federal funds rate, which has remained at zero-to-0.25 percent since the height of the world financial crisis in December of 2008.

Any tightening of the central bank spigot of virtually free credit threatens to bring the record bull market, and the windfalls for the rich and the super-rich provided by astronomical stock prices, crashing down.

In the event, the Fed did remove the word "patient" from the statement it issued at the conclusion of its two-day meeting. But it included new language making clear there would be no change at the FOMC's April meeting and seeming to set the bar higher for beginning to raise interest rates later in the year.

Even more significantly, the Fed issued a new set of estimates for the federal funds rate by the end of 2015, 2016 and 2017 that were sharply lower than the estimates it released last December. The US central bank forecast a rate of 0.625 percent at the end of this year, a drop of 500 basis points, or more than 40 percent, from its December projection of 1.125 percent.

Such a difference in rates can mean billions of dollars in increased profits for bankers and big investors.

The Fed has come under intense pressure from financial interests and major US corporations to slow down its plans to begin raising rates from their record lows to more normal levels. This pressure has intensified along with the sharp increase in the value of the dollar, which has risen, on a trade-weighted basis, by more than 22 percent since last July.

The upward spiral of the dollar is partly the result of the divergence of US monetary policy from that of Europe and Japan. While the Fed has for months been signaling an intension to gradually raise US rates and recently ended its money-printing "quantitative easing" operation, the European Central Bank and the central bank of Japan have been slashing their rates and launching their own "quantitative easing" bond-buying programs. As a result, capital has flowed into the US seeking higher rates, pushing up the dollar.

At the last FOMC meeting at the end of January, the Fed was besieged by complaints from major US corporations, including Microsoft, Caterpillar, DuPont, Procter & Gamble and United Technologies, that its talk of raising rates was undermining their export sales and profits by making the dollar, and their goods, more expensive on world markets. That meeting provoked a sharp sell-off on US markets, because Wall Street and corporate America felt the FOMC statement did not contain a sufficiently strong signal that any increase in rates would be delayed at least until the latter part of the year.

That there has been no let-up in corporate lobbying against an early rate hike was demonstrated by the front-page lead article in Wednesday's *Financial Times*, bearing the headline "Fed rate rise risks 1937-style market slump, says fund chief." The entire content of the article was a warning issued by hedge fund billionaire Ray Dalio that a Fed rate increase could crash the stock market.

The markets appeared to be somewhat surprised and delighted to see, based on the statement issued by the FOMC on Wednesday, that their message had been received. The committee's statement began with a dramatically more somber economic assessment than that made following its

January meeting. At that time, the Fed spoke of “solid growth.” Wednesday’s statement began: “Information received since the Federal Open Market Committee met in January suggests that economic growth has moderated somewhat.”

The statement went on to characterize household spending as rising only “moderately” and describe the housing sector as “slow.” Indirectly referencing the upwardly valued dollar, it noted that “export growth has weakened.”

It then acknowledged that inflation “has declined further below the Committee’s longer-run objective, largely reflecting declines in energy prices.”

New economic projections released by the Fed at the same time as the FOMC statement underscored the central bank’s negatively revised view of the US economy. The Fed downgraded its projection for growth of the gross domestic product by the end of this year from 2.6 percent-3.0 percent to 2.3 percent-2.7 percent. It projected that consumer price inflation in the fourth quarter would be only 0.6 percent-0.8 percent, well below its already low December forecast of 1.0 percent-1.6 percent.

A series of economic reports over the past week suggest that the US economy may be slowing even more dramatically. Retail sales have fallen for three consecutive months. Industrial production barely grew in February, after shrinking in December and January. Manufacturing has declined for three months in a row. And housing starts fell 17 percent in February from the previous month.

Underlying the continuing stagnation in the real economy, despite the officially hyped “recovery,” is the devastating social crisis and decline in the living standards of millions of working people. The boom in stock prices and corporate profits is based largely on speculative activities divorced from any serious growth of the productive forces. Thus, while the official unemployment rate has declined to 5.5 percent, most of the new jobs created since the 2008 Wall Street crash have been low-paying, part-time or temporary.

There are presently 6.6 million part-timers who want to work full-time but can’t find full-time jobs—nearly 50 percent more than in 2007, before the recession began.

These conditions explain the depressed state of consumer spending, including home-buying, which makes impossible any sustained economic growth.

The signs of stagnation and slowdown in the US economy tend to mitigate against an early rise in interest rates. Of particular importance is the Fed’s insistence that inflation must show signs of moving toward the central bank’s target rate of 2 percent before it will begin raising rates.

Under conditions of stagnant growth internationally and continuing slump in the real US economy, as opposed to the financial markets, there is no sign of this happening any time soon. According to the Fed’s preferred gauge, prices rose just 0.2 percent over the past 12 months. Inflation was minus 0.2 percent in January.

The key paragraph in the FOMC statement that set off a buying spree on the stock market was the following:

“Consistent with its previous statement, the Committee judges that an increase in the target range for the federal fund rate remains unlikely at the April FOMC meeting. The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen *further improvement in the labor market* and is reasonably confident that *inflation will move back to its 2 percent objective* over the medium term. This change in the forward guidance does not indicate that the Committee has decided on the timing of the initial increase in the target range.” [Emphasis added].

In a letter to clients, Dan Greenhaus, chief strategist at BTIG, pointed to this paragraph as lowering the chances of a rate hike in June. “What’s important about this part of the statement is that it clearly says the FOMC is looking for ‘further’ improvement, meaning the economy and labor market have not yet met whatever criteria necessary to warrant a rate hike.”

In her press conference following the release of the FOMC statement, Fed Chairwoman Janet Yellen sought to further reassure Wall Street that any rate increase would likely be delayed to the latter part of the year. While not ruling out an increase at the June meeting of the FOMC, she said, “Dropping ‘patient’ from the statement does not mean we are going to be impatient” in deciding when to move.

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