Citing global economy, Fed keeps rates near zero

Barry Grey
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The US Federal Reserve on Thursday again delayed its promised increase in the benchmark federal funds interest rate, which has remained at zero-to-0.25 percent since the height of the financial crisis in December of 2008. The US central bank has for months been signaling its intention to begin raising rates this year, but has repeatedly put off such action under intense pressure from Wall Street and global financial institutions.

Thursday’s meeting of the Fed’s policy-making Federal Open Market Committee (FOMC) was the object of intense and nervous concern internationally, coming in the midst of a marked slowdown in global growth and extreme volatility on financial markets. The focus of international attention on the Fed meeting reflects the degree to which the entire world economy has become dependent on infusions of cash from the major central banks into the financial markets.

Trillions of dollars have been funneled to the banks and finance houses that dominate the markets—some $4 trillion from the Fed alone—to pay off the bad debts of the financial elite and facilitate its further enrichment on the basis of speculative and parasitic activities. These massive subsidies for the super-rich have done little to revive the real economy, which has never truly recovered from the September 2008 Wall Street crash. Instead, they have underwritten a nearly three-fold rise in stock prices and a further growth of financial activities such as mergers and acquisitions, stock buybacks and stock dividend increases that divert resources from productive investment. Investment levels in the major capitalist countries are at least 25 percent below pre-crisis levels.

Record-low interest rates and so-called “quantitative easing” programs (central bank bond purchases) have overwhelmingly benefited the wealthiest social layers, fueling a further growth of social inequality on a world scale.

The FOMC statement initially sparked near-euphoria in the markets, sending the Dow Jones Industrial Average up by more than 100 points in the first hour after the release of the statement. When the US cable channel CNBC announced the decision at 2 p.m., there was an audible roar from the floor of the New York Stock Exchange.

However, the rally faded and US stocks ended the day with mixed results. The Dow closed down 65 points and the Standard & Poor’s 500 index fell 5 points, while the Nasdaq ended with a slight rise of nearly 5 points.

It would appear that the initial exuberance over the decision to delay a rate hike was tempered by concerns over the state of the global economy and world financial system as reflected in the FOMC statement. In a marked departure from previous Fed statements, which have rarely referred to international conditions, Thursday’s release, after noting that exports have been “soft” and inflation has run well below the Fed’s target of 2 percent, stated: “Recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term.”

This was a reference to data showing a marked slowdown in industrial activity, exports and inflation in China, which has accounted for half of global growth since the 2008 crash, along with huge losses on Chinese stock markets and last month’s surprise devaluation of the yuan.

The China slump has exacerbated economic and financial problems in other so-called “emerging market economies” that are heavily dependent on commodity exports, including Brazil, Russia, Turkey, South Africa and a number of Asian economies. These countries have experienced a sharp fall in growth, exports and currency values, while their debt loads have become increasingly unsustainable due to the increasing strength of the US dollar.

At the same time, Europe is barely growing and Japan’s economy contracted in the second quarter.

The signs of deepening recession abound. Data released last month showed world trade contracting in the first half of 2015 more sharply than at any time since the height of the crisis in early 2009. Commodity prices continue to plummet, reflecting a decline in industrial activity and demand.

On Wednesday, the Organization for Economic Cooperation and Development (OECD) issued its Interim Economic Outlook, lowering its projections for global growth from three months ago. It cut its 2015 forecast from 3.1 percent to 3.0 percent and its 2016 projection from 3.8 percent top 3.6 percent.

While US growth rates are better than those in Europe and Japan, although far lower than in previous periods of ostensible recovery, manufacturing continues to contract and prices are barely rising, according to government reports, reflecting deflationary pressures in the world economy.

The US Labor Department reported Wednesday that its Consumer Price Index fell 0.1 percent in August, the first decline since January. In the 12 months through August, the index rose a mere 0.2 percent.

The convergence of these developments sparked wild swings on US and global stock markets last month. At one point, after the Dow had fallen nearly 1,000 points within minutes of the start of trading, William C. Dudley, the president of the Federal Reserve Bank of New York, told reporters that international developments had made the case for a Fed rate increase in September "less compelling."

This intervention, by reassuring the financial aristocracy that the Fed would continue to underwrite its fortunes and likely put off a rate increase, had the intended effect of preventing a full-scale collapse of the market.

Among those organizations and individuals who had called on the Fed to refrain from raising rates at its Thursday meeting were the International Monetary Fund, the World Bank, former US Treasury Secretary Lawrence Summers, billionaire investor Warren Buffett and Goldman Sachs CEO Lloyd Blankfein. Last week, the chief economist of the World Bank told the *Financial Times* that the Fed risked setting off "panic and turmoil" if it decided to lift rates.

While sentiment for delaying raising rates as long as possible predominates in financial circles, there are opposing forces who argue that the longer the Fed waits before beginning to increase rates, the greater the uncertainty and the worse the economic and financial fallout. Last week, the chief US economist at JPMorgan Chase urged the Fed to begin lifting rates at its Thursday meeting.

One FOMC member, Jeffrey Lacker, president of the Richmond, Virginia Fed, voted against the decision to keep rates at near-zero, saying he favored an immediate 0.25 percent increase. His vote was the first dissent on the FOMC this year.

In its statement, the FOMC sought to reassure the markets that even if it began to raise rates as early as this October or December, the increases would be small and gradual. The statement declared: "The Committee currently 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."

In a press conference following the release of the statement, Fed Chair Janet Yellen reiterated the central bank's concern over global developments. "In light of the heightened uncertainty abroad," she said, "the committee judged it appropriate to wait," adding, "Given the significant economic and financial interconnections between the US and the rest of the world, the situation abroad bears close watching."

Yellen singled out China and the emerging market economies, citing capital outflows and pressure on exchange rates. At the same time, she issued assurances that the Fed would continue to maintain a "highly accommodative" monetary policy.

This was reflected in projections released by the Fed on US growth, inflation and the federal funds interest rate. The central bank revised downward its projection for growth in 2016 and 2017, scaled back its projection for inflation, and predicted that the federal funds rate would increase more slowly than previously forecast.

While the number of FOMC members predicting no rate increase until 2016 at the earliest rose from two to four, Yellen stressed that a large majority of the committee continued to forecast an initial rate hike later this year.