NASDAQ hits record after US and Japanese central banks signal continued stimulus

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The decisions of the US Federal Reserve and the Bank of Japan (BoJ) on monetary policy announced yesterday were both indications of the perplexity in the world's leading financial institutions over how to deal with the "new normal" in the global economy, characterised by low growth, weak investment, contracting trade and low inflation.

In a split 7–3 vote, the Fed decided to leave interest rates on hold, while the Bank of Japan, after a weeks-long review of its quantitative easing program, made adjustments to its policies in light of the failure of its measures to achieve their stated aim of lifting inflation.

The BoJ decision was made in response to problems that arose following policies announced earlier this year.

Instead of simply trying to expand the overall money supply through broad-based asset purchases, the bank said it would now target 10-year government bonds, allowing the yield on longer-term bonds to rise. The decision was in response to concerns expressed by longer-term investors, including pension funds and insurance companies, that falling yields adversely affected their business models.

But the major impact of the statement was the commitment that the quantitative easing program, under which the BoJ injects 80 trillion yen (around $US800 billion) a year into financial markets, will go on indefinitely.

The bank said it would continue to buy assets until inflation "exceeds the price stability target of 2 percent and stays above the target in a stable manner." With inflation currently running at minus 0.4 percent, and showing no sign of rising, this is a pledge that quantitative easing is not a temporary or emergency measure but will become permanent.

Financial markets responded positively to the news with the broad-based Topix index up by 2.5 percent and Nikkei rising by 1.8 percent.

In announcing its decision, the US Fed's Open Market Committee said that while "the case for an increase in the federal funds rate has strengthened," it had decided "for the time being to wait." The split vote, with three members voting for an immediate increase in the base rate of 0.25 percent, and comments by Fed chairman Janet Yellen, indicating that she was looking for a rate rise, point to a possible increase by the end of the year. Financial markets welcomed the decision with the Dow up by 163 points on the day and the NASAQ index reaching a record high.

Yellen made clear, however, that any interest rate rises in the future would be gradual and monetary policy would remain accommodative. While she insisted that the decision did not reflect lack of confidence in the economy and she expected economic growth to continue at a moderate pace over the next few years, projections on the future direction of interest rates by members of the FOMC (Federal Open Market Committee) again saw a downward revision on where they expect rates to be.

The median projected rate for the federal funds rate was reduced by around half a percentage point, indicating expectations of lower growth.

It was during the question and answer session at her press conference that some of the confusion in financial circles made its appearance through the calm exterior which Yellen seeks to present.

In answer to questions on the role of politics and political uncertainty as a basis for the Fed decision—Republican candidate Donald Trump has accused the Fed of keeping rates low at the behest of the Obama administration—Yellen insisted that politics played no part in the central bank's decisions. Another questioner noted that while the Fed had cited the Brexit decision as a reason to keep rates on hold in June, how could it not be the case that political uncertainty in the US was having an impact on investment and the Fed's decisions.

Brushing aside present politics, Yellen replied that "investment spending has been weak for some time and we are not certain what is causing that."

Given that investment is a key driver of the economy, this is a significant admission. It indicates that the Fed has little overall grasp of what is taking place and is simply responding to immediate events.

The perplexity at the top was expressed in other remarks. Yellen said Fed policymakers were "struggling" with a difficult set of issues over what is the "new normal" in the US and global economy.

These comments amount to a virtual declaration that the economic scenario on which the Fed has based itself over the past eight years has been torn to pieces. The "conventional wisdom" was that, after the financial crash and the Great Recession which followed, stimulatory measures by central banks in the US and worldwide would restore economic growth close to its previous path.

This has evidently failed and instead a period of "secular stagnation" has set in, that is, permanent low growth and disinflation.

The historically unprecedented quantitative easing policies of the Fed and other central banks, which have pumped trillions of dollars into the global financial system, have done next to nothing to promote growth, leading only to massive speculation and the growth of a financial bubble that threatens to burst even if there is only a small rise in interest rates.

This prospect was alluded to indirectly by Yellen when she explained the risks which the Fed confronted when considering its policy. On the one hand, she said, there was the prospect that keeping interest rates too low could risk "overheating" the economy, while on the other there was the danger that an increase could set off a recession.

These remarks, in the context of a discussion of a possible 0.25 percent rise in the federal funds rate, point to real fears. They are not based on the belief that such a small rise will lead to a slowdown in the real economy—it would have next to no impact on investment decisions or consumer spending—but that it could trigger a major disturbance in financial markets.

This is evidenced by what happened at the start of the year when, following the 0.25 percentage point increase last December, global equity and financial markets experienced one of their worst year-openings on record in January.

Under conditions where the growth in the real economy continues to slow, the ongoing rise in financial markets is inherently unsustainable. This is because, notwithstanding the illusions that money can indefinitely beget more money, credit, share values and other financial assets ultimately represent a claim on real wealth.

In its latest survey of the economic outlook of the advanced economies, the Organisation for Economic Co-operation and Development has revised down its global growth estimate, citing weak trade growth and lower productivity.

It predicted growth in the UK for 2017 at 1 percent, down from 2 percent, largely due to sharp falls in business investment.

It lowered its US growth forecast for 2016 to 1.4 percent, from 1.8 percent and cut the forecast for Canada from 1.7 percent to 1.2 percent, and marginally lowered its projection for global growth to 2.9 percent.

The report said the world economy "remains in a low-growth trap with persistent growth disappointments weighing on growth expectations and feeding back into weak trade, investment, productivity and wages."

The growing divergence between financial markets, boosted by the actions of central banks, and the real economy is creating the conditions for another financial crisis and even deeper attacks on the wages and social conditions of the working class.