Amid trade war rhetoric from White House, Fed holds interest rates steady

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The US Federal Reserve on Wednesday decided to hold its key interest rate at its current level. The announcement came at the conclusion of a two-day meeting of its policy-making Federal Open Market Committee (FOMC).

While the decision had been widely anticipated, the cautious statement issued by the FOMC indicated that the central bank's deliberations were dominated by uncertainty over the course of both the US and world economy as a result of the belligerent "America First" trade and monetary policies outlined in rapid-fire fashion by the newly installed Trump administration.

The Fed held its benchmark federal funds rate to 0.50-0.75 percent, the level it set at the preceding meeting of the FMOC in mid-December. At that meeting, the Fed raised the federal funds rate by a quarter percentage point, only its second rate increase in more than 10 years and the first since a similar increase in December of 2015.

At the December, 2016, meeting, the Fed took the financial markets somewhat by surprise when it indicated it would likely carry out three rate hikes in the course of 2017, as opposed to the two increases anticipated by market analysts. The statement issued by the FOMC at the time, and the ensuing press conference given by Fed Chairwoman Janet Yellen, broadly hinted that the central bank was inclined, while keeping interest rates at historically very low levels, to tighten somewhat faster than previously intended in response to the Trump administration's talk of fiscal stimulus and massive corporate tax cuts.

December's FOMC statement included the significant declaration that "Market-based measures of inflation compensation have moved up considerably," Fed talk for a faster-than-desired rise in wages. The central bank's indications of more rapid monetary tightening reflected a readiness to retard employment growth so as to prevent a major wages push by the working class.

Significantly, despite the fact that nominal wages in 2016 rose 2.9 percent, the biggest yearly wage increase since the official end of the recession in mid-2009, the FOMC statement released Wednesday said, "Market-based measures of inflation compensation remained low." This would seem to indicate a backtracking from the more hawkish stance outlined in December and suggest that the Fed may forego a new rate increase when it meets next in mid-March.

One major factor behind such a shift is the impact of rate increases on the value of the US dollar. The dollar rose rapidly on world currency markets following Trump's election last November, hitting a 14-year high. This was in part a continuation of a trend resulting from Fed monetary tightening alongside a continuation of extreme monetary stimulus by the central banks of Europe, Britain and Japan. Higher rates tend to drive up the value of the national currency. But it was also a response to expectations that a Trump presidency would bring with it higher inflation and higher interest rates.

The strong dollar, however, negatively impacts US exports, making them relatively more expensive on world markets. Last week, the government reported that US gross domestic product (GDP) rose by only 1.6 percent in 2016, down from 2.6 percent in 2015 and the lowest rate in five years. GDP for the fourth quarter of 2016 slowed dramatically to 1.9 percent, in large part due to a sharp decline in exports.

Trump officials seized on the report to denounce US trade agreements and trading counterparts and agitate for its trade war agenda. The new administration from its first hours in office has embarked on a course of virulent trade and currency warfare to increase US

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exports at the expense of America's economic competitors, nominal friends and foes alike.

This has included the official scuttling of the Trans-Pacific Partnership trade deal worked out by the Obama administration, denunciations of Mexico, China and even Germany as currency and trade offenders, open encouragement of the dissolution of the European Union, the promotion of bilateral instead of multilateral trade agreements, and the virtually unprecedented step of openly calling for a weaker US dollar.

One day before the FOMC assembled for its meeting in Washington, the head of Trump's new National Trade Council, Peter Navarro, told the Financial Times (FT) that the euro was an "implicit Deutsche mark," which Germany deliberately undervalued to "exploit other countries in the EU as well as the US."

According to the FT, "Navarro said one of the administration's trade priorities was unwinding and repatriating the international supply chains on which many US multinational companies rely, taking aim at one of the pillars of the modern global economy."

Such a policy of extreme economic nationalism goes hand in hand with currency warfare. Shortly before his inauguration, at which he attacked the "political establishment" for allowing foreign countries to siphon off the wealth of America, Trump gave an interview to the Wall Street Journal in which he said, "Our companies can't compete with [China] now because our currency is too strong. And it's killing us."

For many decades, US officials have publicly supported a strong dollar, even when they favored a decline in the currency's market value, in large part because of the role of the dollar as the world's main reserve and trading currency and the potentially explosive international consequences of sharp fluctuations in its value.

Trump brushes this aside, in keeping with his "America First" policy. On Tuesday, in a meeting with US pharmaceutical company executives, he accused China and Japan of devaluing their currencies and declared, "Every other country lives on devaluation. They play the devaluation market and we sit there like a bunch of dummies."

Such talk has had an impact. It has contributed to a fall in the dollar of 3 percent in January. On Tuesday, the dollar fell 0.7 percent against a basket of 16 other currencies, sliding to its lowest level since November.

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