Concerns grow over Fed interest rate policy

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4 July 2017

A further fall in the US inflation rate announced last Friday is certain to fuel growing concerns in financial circles about whether the Federal Reserve should continue with its policy of tightening interest rates.

Following a rise in the base rate in June, the Fed is set to lift rates again before the end of the year and has laid out a policy for winding down its holdings--$4.5 trillion worth of government and corporate bonds largely accumulated through its program of massive asset purchases following the financial crisis of 2008.

But with inflation showing no sign of meeting the Fed's target rate of around 2 percent, opposition is being voiced to further increases.

The latest data shows that the core personal consumption expenditures index, which excludes food and energy prices and is regarded by the Fed as its key price metric, rose at an annual rate of 1.4 percent in May, down from 1.5 percent the previous month and well below the 1.8 percent for February.

While short-term interest rates have lifted, in the expectation that the Fed will stick to its policy of rate rises, long-term bond rates, which tend to indicate the views of investors on the longer term prospects for the economy, have been falling.

This has given rise to what is known as a "flattening of the yield curve," in which the short and long rates converge, possibly leading to an inversion of the yield curve, with the long-term rate falling below the short-term yield. Such a situation is regarded as a reliable indicator of recession. The last such occurrence was at the end of 2007.

Last week, Joachim Fels, an economic adviser for the $1.5 trillion global bond trading firm Pimco, issued a note warning that, while the Fed was lifting rates in order to have some ammunition to fight a future recession, "the risk is that by raising rates too fast and too far, the Fed brings about exactly what it is so afraid of--the next recession."

He wrote that the US economy was only "one major adverse shock away from a serious deflationary scare," and that there was a "substantial risk that the Fed's opportunistic tightening campaign is a hawkish mistake."

In an editorial comment last week, the *Financial Times* added its voice to those disagreeing with the Fed's present agenda. "As the Federal Reserve marches on with its slow but steady campaign of increases in interest rates, the bond markets are sending a warning about the risks of advancing further," it said, noting the flattening of the yield curve.

"One by one, sound arguments for the Fed continuing its expected series of rate rises are falling away. Real growth in the economy has been weaker than expected of late. Core inflation, and inflation expectations, remain stubbornly below the Fed's target. And now a relatively reliable indicator of future recession is sounding an increasingly strident warning siren."

The Fed's rationale for pressing on with interest rate rises in order to return to what is regarded as a more normal monetary policy is based on an economic model known as the Phillips curve. First developed in 1958, this purports to show a relationship between the unemployment rate and inflation. As unemployment falls, it argues, the push for wage rises increases, leading to a lift in inflation.

The Fed, as the central financial instrument of the corporate-financial elite, is concerned above all with preventing a surge in wages as the labor market tightens and workers feel themselves in a stronger position to resume their struggle for better wages and working conditions. The explosive growth of stock prices and corporate profits over the past several decades, and the record increase in the ratio of corporate profits to labor income over this period, have depended on a relentless offensive against the working class, carried out by the entire political establishment, Democratic no less than Republican.

In this, the trade unions have played the central role, artificially suppressing the class struggle through their unbroken efforts to prevent strikes and isolate and sabotage them when they break out, while maintaining the

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political domination of the capitalist two-party system over the working class. To this point, despite being widely despised by workers, the trade union apparatuses, acting on behalf of the ruling class, have been able to continue to hold back the working class, as reflected in the continued stagnation in wages.

However, fears are mounting within ruling class circles that this long period of suppressed class struggle is coming to an end, with signs of intense social anger and political radicalization of working people increasing.

According to the Phillips model, with the official US unemployment rate at the historically low level of 4.3 percent, wages and inflation should now start to rise and interest rates should be lifted, if only at a slow rate. The Fed maintains that the absence of price increases is due to temporary factors and therefore "looks through" the present data to what it regards as longer-term processes that will eventually push up inflation.

But this view ignores that the fact that what were regarded for a long period as "normal" economic conditions and relations no longer exist. Price changes are, to be sure, affected by temporary fluctuations--a fall in cell phone charges has been cited as a cause of the most recent price slowdown--but the overall trend is down.

Furthermore, there has been no significant increase in wages, with pay levels continuing to fall in real terms. As the International Monetary Fund noted in its most recent assessment of the US economy, more than half of US households have a lower real income today than they did in 2000.

And the unemployment rate no longer signifies what it once did. This is because any newly created jobs are increasingly low-paid, part-time, casual and contract employment, not the full-time jobs which prevailed when the Phillips model was developed in the midst of the post-war capitalist boom.

The breakdown of the Phillips curve, on which the Fed seeks to base its decisions, points to far-reaching changes in the very structure of the US economy.

In analysing these changes, it must always be borne in mind that the driving force of the capitalist economy is not the expansion of economic output as such, but profit. And the mode of profit accumulation has undergone vast changes in recent decades--a process that began with the rise of financialisation in the 1980s, accelerated in the 1990s, and then took a further leap in the wake of the financial crisis of 2008.

Increasingly, the profits of major corporations are no longer derived from direct investment in productive activities, involving the employment of more workers, leading to wage increases, but through the appropriation of wealth produced elsewhere.

This takes place by two means: the siphoning off of wealth by financial means, and the monopolisation of scientific advancements via the establishment of so-called intellectual property rights by hi-tech firms such as Google, Apple and others, and by giant pharmaceutical and bio-tech companies.

At the heart of this process stand the banks, the investment funds and hedge funds, which dominate the shareholdings of major corporations. It has been calculated that whereas in 1990 the 10 biggest financial conglomerates controlled 10 percent of US assets, they now control 75 percent.

These financial behemoths do not directly produce surplus value--they appropriate it from other areas of the economy in a form of parasitism.

And just as in biology the parasite depends on the flow of life resources from the host, so these corporations depend, in the final analysis, on the flow of surplus value from other areas of the economy. Hence their very mode of accumulation--in which money seems to simply beget money--results in an ever more frenzied drive for the extraction of additional surplus value from the areas of the economy on which they feed, through the lowering of wages, more intensive exploitation and the destruction of previous working conditions.

The restructuring of the US economy to meet these demands has shattered the so-called Phillips curve and all other nostrums on which the Fed and other major policy-making bodies based themselves.

But even more significantly for the working class, it means that political perspectives of the past, based on the possibility of some kind of reform of the capitalist system, have been ground to dust. This poses the objective necessity for a socialist program, starting with the struggle for political power, the bringing of the "commanding heights" of the economy under public ownership, and the complete reorganisation of economic relations to meet human needs.

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