Outgoing Fed chair Yellen brushes off financial warning signs

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In the immediate period before the 2008 global financial crisis, the International Monetary Fund pointed to the highest level of global growth in three decades and economic authorities around the world hailed the "great moderation"—increased growth, financial stability and contained inflation.

Yesterday's press conference at the conclusion of the two-day open market committee meeting of the US Federal Reserve brought to mind these events. Outgoing chairwoman Janet Yellen, who steps down in February, pointed to stronger growth in the US, synchronised growth in the rest of the world, not seen for a number of years, and brushed off any concerns the continued rise in the stock market could point to financial problems.

Asked about the continued rise in the markets and the explosion in the cryptocurrency bitcoin—its price has increased 17-fold this year—she said stock market valuations were "elevated" but economists were not great at deciding what valuations were appropriate.

"When we look at other indicators of financial stability risk there is nothing flashing red there, or even orange," she said. Bitcoin was dismissed as a "highly speculative asset and "not a stable store of value."

As expected, the Fed increased its base interest rate by 0.25 percentage points to 1.5 percent, the third rise in this year, and indicated it expects three rises in 2018. The markets took the decision in their stride—it had been factored into calculations—and the Dow finished 80 points up for the day. In the longer term, as some analysts have observed, the Fed's gradual increases in interest rates have not led to tighter monetary conditions.

Two reasons are cited. The market is convinced that after years of low interest rates the Fed will not do anything to cause a downturn in financial markets and that with the European Central Bank and the Bank of Japan continuing their loose policies the supply of ultra-cheap money, which has financed the stock market boom, is not going to be cut off.

On the economic outlook, the Fed lifted its estimate for US growth from 2.1 percent next year to 2.5 percent. However, it changed its wording on the labour market. Previously it had said that the labour market would strengthen further. Yesterday's statement said it would "remain strong," indicating the Fed expects the growth in jobs could slow.

One of the cornerstones for the official rationale of Fed policy is to lift inflation to near but below 2 percent. Figures released yesterday showed that inflation for the past year came in at just 1.7 percent, below market expectations.

But Yellen continued with the official mantra that the low level of inflation was due in the main to "transitory" factors. However, most independent analysis indicates that it is a result of structural changes in the US economy which have resulted in stagnant or very low wages growth due in large part to the expansion of part-time working. This has led to a breakdown in the previous relationship in which a fall in the official unemployment rate led to a rise in wages.

Amid her presentation of a sunny outlook for the US economy, Yellen did sound a couple of warning notes. She said productivity growth was "disturbingly low" and pointed to her "personal concern," expressed in previous remarks, that the rising ratio of debt to GDP was not sustainable.

On the issue of bitcoin and its impact on financial markets, Yellen was reminded by one questioner that in 2007 her predecessor in the post of Fed chair, Ben Bernanke, had dismissed concerns that the growing bubble in the sub-prime market could impact on the broader financial system.

Yellen said the cryptocurrency was not legal tender and “bitcoin at this time plays a very small role in the payment system.”

So far regulatory authorities have offered some limited resistance to attempts to allow speculation in the cryptocurrency to spread. Last March, the US Securities and Exchange Commission blocked an attempt by the Winklevoss twins to list an exchange-traded fund. The twins, who accused Mark Zuckerberg of stealing their idea for Facebook, have seen their bitcoin fortune escalate to almost $2 billion.

Such is the financial pressure for recognition, that it may only be a matter of time before this new avenue for financial speculation is further opened up, just as in the 1990s, demands from the financial markets resulted in the dismantling of the regulatory system that had been put in place after the 1930s, culminating in the repeal of the Glass-Steagall Act by the Clinton administration in 1999.

The opening of trading in bitcoin futures by Cboe Global Markets in Chicago this week and the commencement of futures trading by the much larger CME group next week point in this direction. And pressure from the wave of speculative capital is growing.

An article in the *Financial Times* yesterday reported that hedge funds trading in cryptocurrencies had returned “a whopping 1641 percent this year through November, handily beating any other hedge-fund investment strategy.”

According to Hedge Fund Research (HFR), funds that traded either in cryptocurrency, the underlying blockchain technology, or both, returned 1522 percent.

The president of HFR told the *Financial Times*: “Investor interest in funds offering exposure to blockchain technologies and cryptocurrencies has surged in recent months as these innovations continue to move towards the mainstream.”

He said the organisation had launched new indices to reflect the “explosive growth of investor interest” in these strategies. Hedge fund exposures in this area would continue to grow, even as he acknowledged that trading involved “substantial volatility, both real and structural.”

By itself the bitcoin mania would be simply a bizarre phenomenon. But it is symptomatic of a much broader process—the way in which financial speculation has become the key driver of wealth and profit accumulation in the US and global economy, thereby preparing the conditions for another financial crisis.