The Fed's interest rate U-turn: Some economic and political conclusions

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The decision by the US Federal Reserve on Wednesday to completely abandon its policy announced just six weeks ago to carry out two limited interest rate rises in 2019 has established one economic and political fact of life.

The financial elites, addicted to the supply of ultra-cheap money as they appropriate up the wealth produced by the labour of billions of workers in the US and around the world, dictate economic policy. Their motto is: Wall Street rules.

In announcing what the *Financial Times* called a "momentous U-turn," one of the sharpest in recent memory, Fed chairman Jerome Powell cited slowing growth in China and Europe, rising trade tensions and the risk of a hard Brexit.

But all of these factors were apparent at the Fed's meeting in December, when it lifted interest rates by 0.25 percentage points and foreshadowed two similar rises this year. The decision was even more extraordinary given that official unemployment levels in the US are at lows not experienced in almost 50 years and the Fed's outlook was for a "strong" pace of economic growth in 2019.

What changed from mid-December to the end of January? The financial markets voiced their fury at even the suggestion that the supply of cheap money they use to finance rampant speculation could in any way be impeded, with Wall Street experiencing its worst December since 1931 in the midst of the Great Depression.

The U-turn on rates led to celebrations, with a 1.7 percent rise in the Dow and similar increases in other indexes. The state of class relations was given voice in a *Wall Street Journal* editorial. It began: "Apology accepted. We refer to the one that Chairman Jerome Powell and the other members of the Federal Open Market Committee (FOMC) offered implicitly to financial markets … for misjudging economic conditions in December."

Responding to a question that there was now a "Powell put"—in effect that the Fed will ride to the rescue whenever markets take fall—the bank head declared that his only motivation was "to do right thing for the economy and for the American people, that's it."

Rarely has a bourgeois fiction, or to put it in less polite terms, an official lie, been so nakedly exposed.

Powell's profession of concern for the people was too absurd for even some financial analysts to swallow. Michael Gapen, chief economist at Barclays Investment Bank, told the *Financial Times* it was difficult to interpret the shift on interest rates as "anything other than the Fed capitulating to recent market volatility."

The Fed's decision to be "patient" on rate rises, that is, to effectively rule them out for the foreseeable future, was not the only outcome of the FOMC meeting. Another important decision, again reflecting the dictates of the financial elites, was on the Fed's plan to try to reduce its holdings of financial assets.

Before the financial crisis in 2008, the Fed held less than $1 trillion in assets on its balance sheet. But under the program of "quantitative easing (QE)," it massively expanded them to around $4.5 trillion as it pumped money into the financial system, enabling the very speculation that caused the crisis to continue and fuelling the longest bull-market run in history.

Following the ending of QE, the Fed was faced with the task of reducing its balance sheet to create a more "normal" situation—where the central bank seeks to regulate financial markets from the outside, rather than operating as one of the major participants in them.

Accordingly, it took a decision to reduce its holdings

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of financial assets by $50 billion a month, the implementation of which Powell last year described as being on "autopilot." In the manner of a drug addict being denied their supplies, this produced a frenzied response with claims that the balance sheet reduction program was destabilising financial markets.

Even though it considers such claims to be dubious at best, the Fed said it was "prepared to adjust any of the details for completing balance sheet normalization in light of economic and financial developments." It stated that would avoid "unnecessary market disruption" and was prepared to renew QE should that be required. In other words, total subservience to the markets.

Amid the general celebrations of the Fed U-turn, there were expressions of concern. They centre on the following question: what is the real state of the US financial system, as well as the economy more broadly, if it cannot tolerate two interest rate rises totalling just 0.5 percentage points over the course of the year and any move to reduce the Fed's historically unprecedented bloated balance sheet?

Writing on the Fed's "mysterious pause" in the *Wall Street Journal*, Greg Ip noted that the Fed's monetary tightening "hasn't just paused; it may be over." At present the Fed's base interest rate is in the range of 2.25 percent to 2.5 percent—a real rate of 0.5 percent after inflation of 2 percent is taken into account.

According to Ip, if the Fed considered that "it's done [raising rates] even as the economy performs as expected" that raised the "troubling possibility" that the neutral rate (the rate which produces neither an expansion nor a contraction in the economy) "is only about 0.5 percent, compared with 2 percent in the past."

"If real rates above 0.5 percent are a threat to both economic growth and 2 percent inflation, then that suggests the economy is fundamentally more fragile than in the past," he wrote.

The fragility arises from the fact that the present "recovery" is not the result of an expansion of investment in the real economy and the growth of well-paid jobs, but the outcome of cheap labour and ongoing financial speculation.

There is another very important, political, conclusion to be drawn from the Fed's decision and the power of the financial markets which it expresses.

Amid the deepening hostility to capitalism and growing interest in socialism, especially among young people, a highly orchestrated campaign has been launched by the Democratic Socialists of America, the pseudo-left *Jacobin* magazine and the *New York Times*, among others, to trap this movement within the framework of the Democratic Party.

The campaign centres on the newly-elected Congress member Alexandria Ocasio-Cortez, a member of the DSA, and her proposal to increase taxes on the wealthy to 70 percent, the level that prevailed in the 1960s and 1970s.

Ocasio-Cortez's rhetoric over taxes is aimed at promoting the illusion that social inequality and the vast transfer of wealth up the income scale can be overcome by a "course correction." The DSA claims this can be achieved within the framework of the present political order, without a frontal confrontation against the ruling financial elites and their political representatives in the Democratic and Republican parties.

That political fiction has surely been exposed by the latest Fed decision. If the financial markets cannot and will not countenance even a minor rise in interest rates, what would be their reaction to a 70 percent wealth tax?

Wall Street rules and will continue to rule until it is overturned by a revolutionary socialist movement of the working class, which places the entire financial system and the heights of the economy under public ownership and democratic control. A genuine socialist program must be fought for in a conscious political struggle against all those who seek to block it.

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