US Fed official warns of potential for a financial crisis

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A leading member of the US Federal Reserve Board has warned that the financial crisis that threatened to erupt in mid-March—when markets in all assets essentially froze—could return unless the COVID-19 pandemic is brought under control.

In an interview, the Federal Bank of St Louis, James Bullard, told the *Financial Times* yesterday that the United States was still "in the middle of a crisis."

"Even though we got past the initial wave of the March-April timeframe, the disease is still capable of surprising us," he said. "Without more granular risk management on the part of health policy, we could get a wave of substantial bankruptcies and [that] could feed into a financial crisis."

The coronavirus is surging through southern and western US states, with 50,701 new infections reported on Tuesday, the highest number recorded.

Bullard insisted the Fed's policy of providing trillions of dollars to financial markets, now extended to the purchase of corporate debt, including so-called junk bonds, had to continue. That was because there were "twist and turns" in a crisis and "there can be another shoe to drop, and it could happen here."

While the purchase of corporate bonds, both directly and through Exchanged Traded Funds, was "controversial," the central bank's measures had to be kept in place, as the corporate debt market had been "sorely tested" in March.

"With all these programs the idea is to make sure the markets don't freeze up entirely, because that's what gets you into a financial crisis, when traders won't trade the asset at any price."

Bullard said this was not his base case, "but it's possible we could take a turn for the worse at some point in the future."

The Fed's justification for its extraordinary measures, which go far beyond what it did in response to the financial meltdown of 2008, is that they are necessary to sustain the economy. Their real purpose, however, is to finance the accelerated siphoning of wealth into the coffers of Wall Street.

As the result of the Fed's decision to act as the backstop of all areas of the financial system, the market capitalisation of the US stock exchanges has increased by more than $7 trillion since the freeze in mid-March.

Between the mid-March and mid-June, the net worth of the more than 640 US billionaires rose from $2.948 trillion to $3.531 trillion. The combined wealth of the five richest men in America—Jeff Bezos, Bill Gates, Mark Zuckerberg, Warren Buffett and Larry Ellison—grew by $101.7 billion, or 26 percent.

Having boosted the wealth of the financial oligarchy, in the midst of economic devastation for vast swathes of working people, the Fed is actively considering giving the rich even more support, as revealed in the minutes of its June meeting published on Wednesday.

The discussion at that meeting centred on two questions: how to provide "forward guidance" to financial markets in the form of explicit guarantees that interest rates will remain at their present levels of virtually zero for an indefinite period; and whether to exercise direct control over rates in the US Treasury bond market.

The Fed has already signalled that it expects to keep interest rates at zero through to the end of 2022. According to the minutes, officials expressed a "great deal of uncertainty" about whether a safe reopening of the economy could be achieved. They maintained that whatever eventuated, "highly accommodative monetary policy and sustained support from fiscal policy" would be needed.

But the financial markets want more. As a result of the massive corporate bailout measures under the CARES Act, running at over $3 trillion with more to come, the level of US government debt is rising rapidly. It is expected to reach levels, as a proportion of gross domestic product, higher than during World War II.

Increased debt means a greater supply of Treasury bonds, tending to push down their price and increasing their yields (the two have an inverse relationship). This will exert upward pressure on interest rates in financial markets more broadly.

Consequently, the Fed is discussing measures to control the yield curve on bonds. This would mean the central bank would declare it is targeting a rate on specific bonds and then intervene to buy them, thereby lifting their price and keeping the yield at the designated level.

Currently, two countries have adopted such measures, Japan and Australia. Japanese yield control, targeting ten-year bonds, has been in place for some years. It effectively means that as the government issues more debt, the Bank of Japan buys it.

The Australian controls were introduced in mid-March as one of the emergency measures the Reserve Bank of Australia (RBA) adopted when financial markets froze. The RBA intervenes at the shorter end of the market, targeting the yield on three-year bonds.

The US Fed minutes revealed the issue was under active discussion. “Some participants” in its June meeting said it “could serve as a powerful commitment device.” That is, it would be a means of demonstrating to financial markets that the Fed will keep interest rates at ultra-low levels, despite the massive increases in government debt in the pipeline.

According to the minutes, Fed officials were still undecided on the policy but saw the Australian approach as the “most relevant” to the US situation. “All participants” wanted to see further analysis.

The financial markets had anticipated there would be a more definitive statement on yield control from the June meeting. While they did not get their wish, they clearly expect it will be met in the future.

In a revealing comment on how Fed policy is driven by Wall Street, Deepak Puri, chief investment officer at Deutsche Bank Wealth Management, told the *Financial Times* he expected yield control to be adopted in the not-too-distant future.

“After reviewing the minutes, I feel like it is not at the top of the list of what the Fed is looking to do,” he said. “But I wouldn’t be surprised if the bond market just forces the Fed to have some kind of yield curve control before the end of the year.”

His remarks point to the broader modus operandi at work. In all his testimony before Congressional bodies, Fed chairman Jerome Powell has maintained the present extraordinary measures are temporary and “when economic and financial conditions improve, we will put these tools back in the toolbox.”

The same line was used with regard to the quantitative easing (QE) and ultra-low interest rate policies introduced after 2008. But when the Fed signalled in 2018 that, as a result of a slight improvement in the economic outlook, it intended to lift interest rates to more “normal” levels and reduce the pile of financial assets it had purchased under QE, the markets staged a revolt.

After Wall Street experienced its biggest December fall in 2018 since 1931, the Fed promptly reversed course, declaring interest rate rises were off the agenda and halting its asset wind-down program.

In the past three months, the Fed’s holdings of financial assets have expanded from $4 trillion to over $7 trillion. Further expansion is to come as Wall Street demands that still more money be pumped out to finance what amounts to the equivalent of war profiteering and looting.