Fed toes the line on Wall Street’s demands

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The US Federal Reserve has given financial markets the commitments they were seeking by promising to keep interest rates at near zero for the indefinite future and to maintain its purchases of financial assets that provide the backstop to all areas of the financial system.

The decisions taken at the meeting of the Fed’s monetary policymaking committee on Tuesday and Wednesday were foreshadowed by the change in the settings of its policy framework announced at the Jackson Hole conclave of central bankers last month.

Fed chair Jerome Powell announced at that meeting that the Fed would no longer start to lift interest rates as prices rose and unemployment started to fall, and the markets were looking for so-called “forward guidance” at this week’s meeting as to how this new agenda would be implemented.

Their attitude was summed up in comments by Priya Misra, head of rates strategy at TD Securities, to the *Financial Times* earlier this week. She said it was important that the Fed sound “very dovish” and that it sent a clear message of more support.

“The Fed knows that the market is going into this meeting with expectations,” she said. “They need to feed it with something.”

Those expectations were met. The statement by the Federal Open Market Committee (FOMC) made clear that interest rates would continue to remain at virtually zero until inflation had reached 2 percent and was “on track to moderately exceed 2 percent for some time.”

This means that the zero rate will continue for an indefinite period. As Powell noted in his introductory remarks, the median inflation projection by the FOMC is 1.2 percent this year, rising to 1.7 percent next year and reaching 2 percent in 2023.

But in the 12 years since the global financial crisis, the inflation rate has never gone above 2 percent, and under conditions of the worst hit to the US and global economy since the Great Depression it is highly unlikely to do so in the near future.

The other key issue in so-called “forward guidance” is the extent of the Fed’s stimulus to financial markets.

At present, the Fed is pumping in money to the tune of $120 billion per month—that is $1.4 trillion per year. This comprises $80 billion per month of purchases of US Treasury bonds and $40 billion per month in mortgage-backed debt.

Powell said this was well above the levels of support provided to financial markets in the aftermath of the global financial crisis of 2008. Since the market freeze in mid-March, the Fed has bought nearly $2 trillion in Treasury bonds and around $1 trillion in mortgage-backed securities, as well as starting to purchase corporate bonds.

This support has been the main factor in sending Wall Street back to its record highs earlier in the year and the enrichment of the financial elites—the most egregious expression of which is the rise in the personal wealth of Amazon chief Jeff Bezos to more than $200 billion.

The FOMC statement said that over the coming period the Fed would increase its holdings of financial assets “at least at the current pace to sustain smooth market functioning and help accommodative financial conditions.”

This commitment was emphasised by Powell in his press conference. One of the key demands of the financial markets has been that any reduction in the flow of money must be ruled out. And Powell duly delivered.

The most commonly used phrase in his response to questions, repeated numerous times, was that the Fed had given “powerful” and “very strong forward guidance.” He emphasised that the present regime of ultra-cheap money would continue until the economy was “far along in its recovery.”

And in his prepared statement Powell made clear that

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the Fed was prepared to do even more by adjusting "the stance of monetary policy as appropriate if risks emerge that could impede the attainment of our goals."

He noted that many of the programs implemented by the Fed require the support of the Treasury Department and "are available only in very unusual circumstances, such as we find ourselves in today."

After noting that these lending powers had been used to an "unprecedented extent," he then made the pro forma, obligatory comment that when the time came, "after the crisis has passed, we will put these emergency tools back in the toolbox."

But the history of the past decade and more shows this time never comes. The massive Fed interventions after the financial crisis—the program of quantitative easing—was likewise dubbed an "emergency measure" to be withdrawn at some point in the future in a return to "normal conditions."

But when the Fed raised interest rates four times in 2018 and started to wind down its financial asset holdings this met with such an adverse reaction on Wall Street that it was withdrawn at the start of 2019—a year before the pandemic struck.

As usual, the policy pronouncements were couched in terms of providing support to the economy and households. But the content of the policy, as the continued references to "forward guidance" made clear, was to provide assurances to Wall Street that the Fed stood as the permanent guarantor for its speculation and the siphoning of the resources of society into the coffers of the financial elites.

On the economic outlook, the FOMC said it expected the US economy to contract by 3.7 percent this year, as compared to its June forecast that it would shrink by 6.5 percent. It lowered its estimate for the unemployment rate for the end of the year from 9.3 percent to 7.6 percent, but noted that 11 million people had lost their jobs.

As with all official jobless figures around the world, this is likely to be a considerable underestimation of the real unemployment levels as workers are plunged into a world of total uncertainty with many businesses closing permanently.

Powell said that more fiscal stimulus would be needed—that is, more assistance not to the unemployed but to corporations as with the CARES Act.

The FOMC statement was not unanimously endorsed with two votes in opposition. However, the differences were relatively minor.

Robert Kaplan, the president of the Dallas Fed, said he would have preferred that the Fed "retain greater policy rate flexibility." Neel Kashkari, the president of the Minneapolis Fed said he wanted to keep rates close to zero until inflation reached 2 percent "on a sustained basis"—an even stronger commitment to "lower for longer" than the majority decision.

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