Fed officials warn of “recessionary dynamic” setting in

Nick Beams
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The US Federal Reserve has stepped up its calls for Congress and the Trump administration to enact further economic stimulus measures, with chairman Jerome Powell forecasting “tragic” consequences if that did not happen.

In a major speech to a business conference on Tuesday, he warned of the risks to the US economy, saying “a prolonged slowing in the pace of improvement over time could trigger typical recessionary dynamics as weakness feeds on weakness.

“A long period of unnecessarily slow progress could continue to exacerbate existing disparities in our economy. That would be tragic…”

Powell made it clear that in his view avoiding such an outcome depended on increased government stimulus measures.

“I would argue that the risks of policy interventions are still asymmetric. Too little support would lead to a weak recovery, creating unnecessary hardship for households and businesses. Over time, household insolvencies and business bankruptcies would rise, harming the productive capacity of the economy and holding back wage growth.”

However, in the light of these remarks, it would be a serious mistake to consider that the Fed has stepped forward as the defender of the American worker.

Its overriding concern is that while it has used its financial powers to boost the stock market by pumping in trillions of dollars, enabling billionaires to increase their wealth by $854 billion since the onset of the pandemic, by itself this would not be enough to prevent the development of “recessionary dynamics” that will ultimately impact on Wall Street and the financial system more broadly.

However, just hours after Powell had delivered his most forceful call to date for increased stimulus, Trump appeared to rule it out, declaring in a tweet that negotiations with the Democrats were off the table.

Wall Street responded with a sharp fall following his remarks with the Dow, the index most closely followed by Trump, falling by more than 500 points. Trump responded by declaring he was in favour of sending out a $1200 cheque to “our great people” and indicated he was ready to approve direct assistance for the airline industry and possibly small businesses. The markets duly rose with the Dow up by more than 500 points.

In an interview with the business channel CNBC on Wednesday, the Minneapolis Fed president Neel Kashkari entered the fray even more strongly than Powell, warning of “enormous consequences” for the US economy if there was not a new stimulus package and that “the downturn will end up being much worse.

“If we don’t support people who have lost their jobs, then they can’t pay their bills and then it ripples through the economy and the downturn is much worse than it needs to be.”

One of the reasons cited by Trump for pulling out of talks on a stimulus package was his claim that the Democrats were seeking money to “bail out poorly run, high crime, Democrat States” and the money they were seeking was “in no way related to COVID-19.”

Kashkari, however, insisted they had to be provided with additional funds. Assistance to individuals who had lost their jobs as well as to small businesses was important as well as providing support for “state and local governments, whose revenues have been hammered by the COVID crisis, that is also important, because they employ a lot of people.”

While his remarks were couched in terms of aiding American workers and households, Kashkari, pointed to the longer-term consequences of “this continuing wave of bankruptcies across the country” and the underlying concerns of the Fed.

He said that so far Americans have been able to continue to pay their bills because of the support provided by Congress. “If they don’t continue that, these losses roll up into the banking sector, and nobody knows how big these losses will ultimately be, and whether or not the banks will need more direct support.”

Evidence of the impact of the severe reduction in income support, when emergency unemployment relief for millions of Americans lapsed at the end of July, was provided in data from the Commerce Department. It revealed that US personal income dropped by 2.7 percent in August.

The total drop in income amounted to $543.5 billion, a larger hit than economists were expecting. It was accompanied by a slowdown in consumption growth for the month to 1 percent and a drop in the savings rate.

The chief US economist at Oxford Economics, Greg Daco, warned in a note that “the main engine of economic activity” was at the risk of stalling. “With compensation growing at a slower pace and government transfers diminishing, consumers dipped into their savings to finance their outlays—this is not a sustainable reality.”

The lack of further economic relief has led to a downgrade in the forecasts for growth in the fourth quarter.

The *Wall Street Journal* reported that economists at the US tax, audit and consulting firm RSM US downgraded their growth forecast for the last three months of the year from 5.1 percent to 2.2 percent on the back of Trump’s tweet calling off the stimulus negotiations. Goldman Sachs economists had already reduced their forecast to 3 percent from 6 percent last month on the basis that another stimulus bill would not pass Congress.

The minutes of the policy making Federal Open Market Committee of September 15–16, released earlier this week, reveal that the concerns expressed by Powell and Kashkari over the need for further stimulus are widespread.

The meeting was generally upbeat over the prospects for a recovery but as the minutes reported “many participants noted that their economic outlook assumed additional fiscal support” and that if that was less than expected “the pace of recovery would be much slower.”

The minutes also reported concern about the effect of additional virus outbreaks that could lead to further “increases in bankruptcies and defaults, put a stress on the financial system, and lead to a disruptions in the flow of credit to households and businesses.” It said that “most participants raised the concerns that fiscal support so far for households, businesses, and state and local governments might not provide sufficient relief to these sectors.”

In the three weeks since the meeting, the situation has only got worse. Coronavirus cases are continuing to rise in a large number of states—putting some of them back at their previous record highs—and the position of American workers continues to deteriorate.