Fed commitment to financial stimulus measures becomes open-ended

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While the US Federal Reserve did not further cut its base interest rate or increase its asset purchases at its last meeting for the year held earlier this week, it did provide assurances to financial markets that the massive stimulus initiated as a result of a market freeze in March would continue indefinitely.

In September, Fed officials committed themselves to maintain low interest rates for an indefinite period but the markets were still looking for so-called "forward guidance" on the Fed's asset purchases. At present these comprise the buying of $80 billion per month of Treasury bonds and $40 billion per month of mortgage-backed securities.

They got it when the Fed's open market committee changed the wording of its policy statement. Previously it said these purchases—running at the rate of $120 billion per month or $1.4 trillion a year—would be maintained "over coming months." On Wednesday the committee said the asset purchases would continue "until substantial further progress has been made" toward its goal of around 2 percent inflation and maximum employment,

As the *Financial Times* noted, such targets "may not materialise in the post-pandemic economy for a very long time" while the *Wall Street Journal* commented that Fed officials do not expect to reach their stated goals for years.

During the press conference on the decision, Fed chairman Jerome Powell said the new guidance on asset purchases sent a "powerful message" about the central bank's intentions.

"What we've done is we've laid out a path whereby we're going to keep monetary policy highly accommodative for a long time … until we've reached very close to our goals, which is not really the way it's been done in the past," he said.

"It's not going to be easy to have inflation move up. We're honest with ourselves and with you in the [projections] that even with the very high level of accommodation that we're providing ... it will take some time."

These messages were intended to allay any fears in financial markets that in the event of any uptick in inflation or a decline in the jobless rate the Fed would consider moves to pull back on its stimulus measures.

Even with these guarantees, there was some dissatisfaction that the Fed had not extended its measures either by targeting its bond purchases towards longer-term securities, increasing their prices and thereby lowering their yields, or by increasing the aggregate size of its purchases.

Sections of the market were looking for such a commitment because there is some concern that increased government spending as a result of COVID-19, financed by debt, will, in and of itself, lower the price of bonds, thereby leading to upward pressure on interest rates that will need to be countered with further increases in purchases by the Fed.

The fragility of the financial system was highlighted in comments made to the *Financial Times* by Shamik Dhar, chief economist as BNY Mellon Investment Management.

He noted that historically high prices of both bonds and stocks have been premised on the expectation of years of rock-bottom interest rates and both could tumble if the Fed signalled there was even a chance of higher borrowing costs.

"That's a world where fixed income [that is the bond market] stops being a hedge for equities, and both sell off together. That would be a big shock."

In fact, this is not a matter of prediction but of recent history. Financial markets in the US and around the world effectively froze in mid-March when such a situation developed and the $20 trillion US Treasury bond market—the bedrock of the global financial system—was paralysed.

This led to Fed pumping trillions of dollars into financial markets and initiating the current asset purchasing program that has seen Wall Street reach new record highs. As a result hundreds of billions have been siphoned into the coffers of Amazon chief Jeff Bezos and other financial oligarchs.

The official claim is that what the Fed calls “a very high level of accommodation” is necessary to provide a boost for the underlying real economy. But within ruling circles it is well known this is largely a fiction.

In a comment published in the *Financial Times* this week, former British Labour Prime Minister Gordon Brown warned against the belief that the mass vaccination against COVID-19 would bring a global economic recovery. He warned the G7 economies were unlikely to reach 2019 levels of output by 2022 and the global economy would remain essentially stagnant thereafter.

“The world economy is heading for a low-growth, high-unemployment decade,” he wrote.

“Expecting low interest rates to restore pre-crisis levels of private investment while unemployment crushes demand would be like pushing on a string. The liquidity crisis of 2020 could easily become the solvency crisis of the 2020s and the scars of long-term unemployment could last a generation.”

Brown’s “solution” consisted of an internationally co-ordinated plan by the major powers to boost the global economy.

“What is missing in the management of the crisis is an internationally co-ordinated plan for growth that recognises the limits of monetary policy when interest rates are near zero,” he wrote.

“Only co-operation between the US, Europe and China can change that and that is why January’s US presidential inauguration should be followed by an emergency summit meeting in February.”

Anxious to secure his place in history and looking back through rose-tinted glasses to the summit meeting over which he presided in April 2009 in response to the global financial crisis, Brown wrote that such an initiative could bring synchronised global growth.

But any boost after the 2008 crash was short-lived and by mid-2010 there was an austerity drive all the major economies coupled with deepening attacks on wages and working conditions such as the “restructuring” of the auto industry in the US.

Moreover Brown’s plea of international co-operation and collaboration ignores the deepening conflicts between the major economy powers—most sharply seen in the clash between the US in China but not confined there—over the past decade.