# Fed pledges to continue flow of ultra-cheap money to Wall Street

**Nick Beams**
**17 March 2021**

The US Federal Reserve has again provided an assurance to financial markets that it will not increase interest rates any time in the next two years, despite revising upwards its forecast for US economic growth.

The median estimate from Fed officials is that the US economy will grow by 6.5 percent this year, up from its forecast of 4.2 percent in December. It also forecasts that inflation will rise to 2.4 percent this year, up from the forecast of 1.8 percent in December and above the Fed's target of 2 percent.

But it insists this will not mean a rise in interest rates. In introductory remarks to a press conference yesterday, following a two-day meeting of the Federal Reserve's policy-making body, Fed Chair Jerome Powell said "overall inflation remains below our 2 percent long-run objective."

There could be upward pressure on prices due to supply bottlenecks as the economy begins to reopen, he said, but "these one-time price increases are likely to have only transient effects on inflation." The expectation is that it will decline to 2 percent next year before moving back up again by the end of 2023.

To underscore that the Fed is not going to immediately respond to a rise in prices or a fall in the unemployment rate, Powell said the central bank's goal is for inflation expectations to be "well anchored" at 2 percent. He the Fed expects to "maintain an accommodative stance of monetary policy" until its employment and inflation outcomes are achieved. A "transitory" rise in prices "would not meet this standard."

Powell repeated earlier commitments that the Fed's purchases of Treasury bonds and mortgage-backed securities at the rate of $120 billion per month, implemented as a result of the financial market crisis of March 2020, will continue until "substantial further progress" has been made in achieving the Fed's objectives.

"The economy is a long way from our employment and inflation goals, and it is likely to take some time for substantial further progress to be achieved," he said. Forward guidance for the Fed's base rate and its balance sheet guidance "will ensure that the stance of monetary policy remains highly accommodative as the recovery progresses."

There were some minor indications of a shift among Fed officials towards an increase in rates. Four out of 18 officials indicated that they expected a rise in rates in 2022, compared to only one last December, and seven said they expected a rise in 2023, compared to five in December.

Asked at his press conference about a possible "taper" in Fed policy, Powell said that any change in the central bank's orientation would be signalled well in advance.

The Fed's latest statement appeared to satisfy financial markets, at least for the moment. The S&P 500 index and the Dow closed with modest gains. The tech-heavy Nasdaq index was also up. There was also a slight decline in the yield on 10-year Treasury bonds.

The yield in the bond market has been rising since the start of the year, sparking concerns of a tightening of financial conditions. So far the Fed has indicated that it regards the rise in yields as a sign that the economy is improving, and Powell has said the Fed will intervene only if it sees signs of a "disorderly" movement in the bond market.

In a response to a question, he ruled out any targeted intervention in the central bank's asset purchases and said its activity would be across the range of bonds.

The overriding message to Wall Street was that the speculation can continue because the Fed will not cut off the flow of ultra-cheap money any time soon.

Another indication of the extent of that speculation came yesterday with a report that investment in special purpose acquisition companies (SPACs) had already surpassed last year's record fund-raising in just the first quarter of this year.

SPACs are cash-only firms launched into the stock market with the aim of taking over a start-up firm in order to make a quick profit. So far this year, these so-called blank cheque companies have raised $79.4 billion globally, most of it in the US, compared to $79.3 billion for the whole of 2020.

While Wall Street continues to rake in money had over fist, there are growing concerns in some circles that a crash is coming.

In a recent article published in the *National Interest,* former IMF official Desmond Leach, now a resident fellow at the free market American Enterprise Institute, warned that the US economy is now a giant bubble.

He wrote that America's monetary and fiscal policy experiment was being conducted against the backdrop of an "everything asset and credit bubble, which is very much larger and more pervasive than the earlier US housing and credit market bubble" that led to the 2008 crisis.

The danger was not so much the rise of US equity valuations to levels last seen on the eve of the 1929 crash, nor even that "the dubious bitcoin market now has a valuation in excess of $1 trillion." Rather, it was the fact that "very risky borrowers, especially in the highly leveraged loan market and in the emerging-market economies, can raise money at interest rates not much higher than those at which the US government can borrow."

*Financial Times* columnist Martin Wolf published a comment yesterday headlined "Economies can survive stock market crash." He began by citing the warning by long-time financial investor Jeremy Grantham at the start of the year that the bull market that began in 2009 had matured into a "fully-fledged epic bubble," and could be recorded as "one of the great bubbles of financial history."

Wolf acknowledged the symptoms of financial mania, including the rise in amateur traders, frenzied interest in obscure companies, soaring prices for speculative assets such as bitcoin and "hot" companies like Tesla, and the rise of SPACs, which he likened to the South Sea bubble of the early 18th century, except on a "vastly bigger scale."

But then, in what could be characterised as whistling past the graveyard, he said that while a "stock market correction" was possible, by itself it was nothing much to worry about, especially if the effects of a stronger than expected economy countered a rise in interest rates.

"Far more serious," he argued, "would be a debt crisis that damages institutions, freezes markets and creates mass bankruptcies."

But the notion that a crisis can somehow been confined to the stock market has already been refuted by the events of March 2020, which made clear that not only equities, but the entire financial system is dependent on cheap money. While the eruption of the COVID-19 pandemic led to a fall in stocks—the Dow, for example, experienced its second largest one-day fall in history—the crisis was concentrated in the $21 billion US Treasury market.

This market is the basis of the US and global financial system, and for several days it froze as investors and speculators engaged in a "dash for cash," selling off Treasury bonds, the most secure investment in the world, and leaving some market participants wondering if the US government would be able to finance itself.

The crisis came to a halt only through the massive intervention of the Fed, amounting to more than $3 trillion, in which the central bank threw a safety net under all areas of the financial system.

But the causes of the freeze have not gone away. This was seen last month, when a $68 billion auction of seven-year Treasury bonds was undersubscribed by 40 percent because there were no buyers--a warning of what could take place in the future as the US government issues still more debt to finance the Biden administration's $1.9 trillion stimulus package.

While pointing to the possibility of such a crisis, Wolf concluded that "happily, this looks containable, given the tools available to policymakers."

However, a report on the March crisis, issued last November by the Financial Stability Board, comprised of central bank and finance ministry officials, concluded that while the measures taken by the Fed and other central banks restored market functioning, "the financial system remains vulnerable to another liquidity strain, as the underlying structures and mechanisms that gave rise to the turmoil are still in place."

The Fed's decision yesterday does nothing to alleviate the situation. Rather, it shows that it is completely locked into the virtually limitless supply of money to the markets and the further inflation a massive asset bubble.