US Fed a “long way” from withdrawing massive financial support for Wall Street

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The US Federal Reserve this week again emphasised it is a “long way” from withdrawing the massive financial support that has fuelled the rise of Wall Street and asset prices over the past year during the COVID-19 pandemic, transferring hundreds of billions of dollars into the hands of the corporate and financial elites.

The Fed’s commitment to continued support—the purchases of Treasury bonds and mortgage-backed securities at the rate of $120 billion per month and the maintenance of the base interest rate at virtually zero—came despite it upgrading the outlook for the US economy and signs that inflation is starting to rise.

The Fed’s policy-making committee said that “amid progress on vaccinations and strong policy support, indicators of economic activity and employment have strengthened.” It noted that inflation had risen but said this was largely due to “transitory factors.”

This was to allay concerns in some sections of the financial markets that rising inflation numbers would bring a tightening of the Fed’s monetary policy.

In his opening remarks to a press conference following the two-day policy meeting, Fed chairman Jerome Powell indicated that recent price rises would not impact on its accommodative measures.

“Readings on inflation have increased and are likely to rise somewhat further before moderating,” he said. They were due to one-time effects, such as upward pressure on prices as the economy re-opened.

Powell emphasised that the Fed would maintain its present policies until maximum employment was achieved and inflation expectations were “well-anchored” at 2 percent.

“We expect to maintain an accommodative stance of monetary policy until these employment and inflation outcomes are achieved,” he said, noting that a “transitory rise in inflation above 2 percent this year would not meet this standard.”

In a further reassurance to financial markets that the Fed was not yet even thinking about tapering its support, Powell said: “The economy is a long way from our goals, and it is likely to take some time for substantial further progress to be achieved.”

The first question in the Q&A session of Powell’s press conference was whether it was time to start talking about tapering. Powell replied that “it is not time yet” and the Fed would let the public know well in advance when it was time to have that conversation, which would begin “well in advance of any actual decision to taper our asset purchases.”

There is nervousness in financial markets and within the Fed itself that Wall Street has become so dependent on the outflow of cheap money that any winding back could bring a repeat of the “taper tantrum” of 2013 that saw significant turbulence in response to indications that the quantitative easing program, initiated after the 2008 financial crisis, could start to be eased.

But there are also concerns that if the Fed does not start to prepare markets for some withdrawal of support, then it may have to sharply tighten monetary policy if inflation starts to rise faster than expected.

One questioner referred to the concerns raised by former Treasury Secretary Larry Summers and others that things may “get out of hand” with the Fed’s new policy stance and there would be a repeat of the 1960s when “inflation got out of control.”

Powell said there were “many, many differences” and one-time price increases as a result of the economy re-opening were not likely to lead to persistently higher inflation into the future. However, if the Fed saw inflation moving above 2 percent in a persistent way then, “no one should doubt that in the event we would

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be prepared to use our tools."

In light of the collapse of the family investment firm Archegos Capital, Powell was asked whether the Fed did not see that multiple banks had large exposures to the firm and if not why not?

Powell provided no clear answer, saying the major banks that had a big risk position with Archegos were not aware that others were in the same position. He said there was "risk management breakdown at some of the firms" and the Fed was looking into it.

He claimed that the Archegos risks were "not systemically important or were not of the size that they would have really created trouble for any of those institutions."

The Archegos collapse may not have posed the same risk as the downfall of Lehman Brothers in 2008, but it was a clear indication of the growing instability of the financial system as a result of the cheap money policies of the Fed and other central banks globally.

The losses from Archegos have been significant. Further data released this week show the total losses incurred by some of world's major banks exceed $10 billion.

Credit Suisse has taken a total hit of $5.5 billion. The Japanese financial firm Nomura, which flagged losses of $2 billion last month, increased that estimate to $2.85 billion earlier this week, resulting in its worst quarterly performance since the financial crisis of 2008. The Swiss bank UBS lost $861 million, Morgan Stanley $911 million and the Mitsubishi finance arm took a hit of $300 million.

As the *Wall Street Journal* noted, the losses of more than $10 billion "make it one of the worst trading incidents in recent years."

A question on financial stability and whether the Fed and other regulators should think about extending their oversight saw Powell venture into an area which has been largely passed over—the significance and implications of the March 2020 financial crisis that led to the support provided to the financial markets ever since.

The crisis took the form of a freeze in the market for US Treasury bonds, supposedly the most liquid market in the world, the basis of the global financial system, which is regarded as a "safe haven" in times of financial turbulence.

Powell remarked that at the beginning of the pandemic crisis "there was such a demand for selling Treasurys, including by foreign central banks, that really the dealers couldn't handle the volume. And so what was happening was the market was really starting to lose function, and … that was a really serious problem which we had to solve through really massive asset purchases."

But more than a year on, the US Treasury and the Fed are nowhere nearer to fully understanding what took place nor what to do to prevent a recurrence of this or a similar event, as indicated by Powell's somewhat jumbled concluding comments on the subject.

"And you know," he said, "we'd like to see if there isn't something we can do … do we need to build against that kind of extreme tail risk, and if so what would that look like?"

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