Inflation sparks concerns in financial markets

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There is growing nervousness in financial markets over the effect of inflation on the massive asset bubble that has developed in the past year as a result of the multi-trillion interventions by the US Federal Reserve and other central banks.

Inflation warning signals have started to flash with the report last week that US consumer price inflation rose by 4.2 percent in April from a year earlier.

While the Fed has insisted its ultra-easy monetary policies, which have fuelled the asset boom, will continue for the foreseeable future, there are fears that either interest rates in the bond market will start to rise or that the central bank will be forced to slam on the monetary brakes if price rises prove to be structural rather than "transitory" as it has maintained.

Speaking at a conference last Tuesday, Lael Brainard, a member of the Fed's Board of Governors, said the central bank had to be "patient" in pursuing its policies and made it clear the Fed was not even beginning to contemplate removing its support for financial markets.

Having just overseen the Fed's Financial Stability Report, which pointed to "vulnerabilities" in the financial system as investors engaged in increasingly risky strategies in the search for yield, Brainard was acutely aware that even the suggestion of an interest rate rise could have adverse consequences for the stock market and other financial assets.

Speaking in the wake of figures showing a marked slowdown in labour market growth—April data revealed the US economy added only 266,000 jobs in April, well below expectations—she said: "The outlook is bright, but risks remain, and we are far from our goal. The latest employment report reminds us that realised outcomes can diverge from forward projections and underscores the value of patience."

On inflation, speaking before the latest numbers came out, she said remaining "patient" during a "transitory surge" in prices associated with re-opening would ensure that underlying momentum was "not curtailed by a premature tightening of financial conditions."

In other words, the Fed would not do anything to "spook" the financial markets and set off a major sell-off. The Fed is haunted by the prospect of a return of the conditions of March 2020, when markets froze, and the events of February 25 this year, when a tremor went through the financial system because 40 percent of a Treasury bond issue was not able to be sold.

Seeking to reinforce the belief in the financial markets that the Fed will not move to tighten its monetary policies, Brainard said supply-chain frictions and other "reopening frictions" were not likely to generate persistently high inflation on their own.

"A persistent material increase in inflation would require not just that wages or prices increase for a period after reopening, but also a broad expectation that they will continue to increase at a persistently higher pace."

In another effort to reassure the financial markets that persistent inflation would not develop, requiring action by the Fed, she said past experience suggested that many businesses would compress margins and rely on automation to reduce costs.

She cited a survey conducted last December which reported that around half of chief financial officers from large firms and about one-third from smaller firms were "using, or planning to use, automation or technology to reduce reliance on labour."

But the assurances from the Fed have not quelled fears in financial markets that the central bank's "tolerance" of higher inflation may lead to a sudden tightening. The chief economist at the global financial firm ING, James Knightley told the *Financial Times*: "If you've let things run too hot for too long, that leads to over-tightening.

"This new framework could open the door to more prolonged periods of loose monetary policy that need to

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be corrected more quickly and aggressively than the market is pricing."

And there is the added fear that the class struggle will be a major factor as workers, confronted with rising prices under conditions where their real wages have been cut, will start to push for pay increases to make up for what they have lost.

As the *Wall Street Journal* noted, in an article published over the weekend, while prices rose 4.2 percent in April the Labor Department reported that the hourly pay for production workers increased by only 1.2 percent over the same period.

"The department also said that, after adjusting for inflation, wages of production workers and non-managers fell 3.3 percent in April from a year earlier, the largest such decline since an inflation shock and recession in 1980."

The *Journal* article pointed out that a fall in inflation-adjusted wages hits low- and moderate-income households especially hard because they devote a large portion of their pay to covering basic living costs and that if inflation persists and is fuelled by the policies of the Fed and the Biden administration "it could raise questions about the costs and benefits of those policies for working Americans."

This is a roundabout way of saying that the persistence of inflation could see workers be propelled to take matters into their own hands and undertake independent action. The Biden administration is certainly aware of this prospect which lies behind its promotion of the trade unions in order to suppress such action.

Another factor which could stimulate independent action by workers is the growing understanding of the extent to which the financial oligarchs have benefited from the pandemic while the working class, in the US and around the world, has suffered death, disease and worsening living standards.

It is estimated that some $9 trillion has been spent by governments in rescue funds. But this massive outlay of money has largely ended up in the hands of the super-rich. According to the annual wealth rankings published by *Forbes* magazine, the number of billionaires increased to more than 2,700 over the past 12 months as their total combined wealth rose by $5 trillion to $13 trillion.

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