Divisions emerge over central bank policies

Nick Beams
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Divisions are starting to emerge in the policy-making bodies of the world's two major central banks, the European Central Bank and the US Federal Reserve, over the future direction of monetary policy.

The combined actions of the ECB and the Fed have pumped trillions of dollars into the financial system since the onset of the pandemic last year, but amid increasing signs of inflation and rampant speculation in commodities and financial assets there are concerns over where this is heading.

Long-simmering differences in the ECB came to the surface again this week as two leading members of its governing body put forward opposed assessments as to where the central bank should go.

On Monday ECB executive board member Fabio Panetta, who is aligned with the bank's president Christine Lagarde, said monetary officials should retain the "unconventional flexibility" developed during the pandemic crisis and keep interest rates low.

Dismissing the prospect of rising inflation in an address to a conference of central bankers from Mediterranean countries, he said: "We do not seem to be on track to 'run the economy hot'" and that the "slack in the economy was likely to remain large for some time."

Governments and the public, he continued, should recognise that the present monetary and fiscal policies, aimed at providing a stimulus, were "clearly superior" to those in force before the pandemic when the focus was on reducing debt.

His remarks echoed those of Lagarde who said last week to European Union leaders that they needed to "water the green shoots" of economic recovery and it was too early to even begin talking about ending the central bank's crisis measures.

In March 2020 the ECB launched a €1.85 trillion pandemic emergency program to support financial markets and still has just over €700 billion left to spend before it expires in March 2022.

Just hours after Panetta's remarks, the head of Germany's Bundesbank, Jens Weidmann advanced an opposed perspective in a speech.

Weidmann, who leads a group of northern European representatives in the ECB who have been critical of the ultra-loose monetary policies, said there were "upside risks" for the inflation outlook and the central bank's stimulus program should end "as soon as the emergency situation has been overcome" and 2022 will not warrant designation as a "crisis year."

As the *Financial Times* noted: "His remarks set up a clash with other members of the central bank's governing council about the future path of its policy." The ECB is set to announce the future direction of its policies in September.

On the other side of the Atlantic there are also signs of divisions in the leading bodies of the Fed over whether the present level of financial asset purchases, running at $120 billion a month, should be eased back.

Despite the predictions by some Fed members that interest rates should start to rise in 2023, as opposed to previous forecasts of 2024, Fed chair Jerome Powell has insisted that the present policies will remain in place until there is "substantial further progress" in meeting the Fed's goals. He has maintained that the spike in inflation, which saw prices rise by 5 percent year-on-year in May, after a 4.2 percent rise in April, is "transitory."

But the escalation in house prices in the US has led to calls from some Fed members that the purchasing of mortgage-backed securities (MBS), running at $40 billion per month, should start to be wound back.

On Tuesday it was revealed that house prices had risen by a record amount. The S&P CoreLogic Case Shiller national home price index, which measures house prices in major metropolitan areas rose 14.6 percent in the year ending in April, the highest level of annual growth since the index was started in 1987. This followed a report by the National Association of Realtors that the median price for an existing house had risen by 23.6 percent in May from a year earlier.

In an interview with the *Financial Times* published on Monday, Eric Rosengren, the president of the Boston Fed, expressed concerns about the implications of the boom in house prices.

"It's very important for us to get back to our 2 percent inflation target but the goal is for that to be sustainable. And for that to be sustainable, we can't have a boom and bust in something like real estate."

The house price boom, which is reflected in Europe, as well as in Australia and New Zealand and elsewhere, has been fuelled in large measure by the ultra-low interest policies of all central banks.

With the subprime crisis of 2007–2008 no doubt in mind, Rosengren recalled that "boom and bust cycles in the real estate market have occurred in the United States multiple times, and around the world, and frequently as a source of financial stability concerns."

Rosengren said that when the purchasing of securities was eased, mortgage-backed securities would have to be included in the reduction.

Others have gone further. Dallas Fed president Robert Kaplan has said that MBS purchases should end "sooner rather than later" because of the rise in the housing market, and the St Louis Fed president James Bullard has also called for the Fed to re-evaluate its support for the housing market because of concerns that a bubble was developing.

While Powell has not entered the debate some of his supporters have. San Francisco Fed president Mary Daly told reporters that MBS purchases were "not directly affecting" the interest paid on mortgages.

According to a report in the *Wall Street Journal*, Powell and other Fed officials are reluctant to specifically target the MBS market for a reduction in purchases because it would "suggest the Fed is using monetary policy to address a concern about the stability of the financial system arising from elevated house prices."

In May, a key Powell supporter, New York Fed president John Williams pointed to the broader effects of the MBS program which had "pretty powerful spillovers into other financial conditions such as corporate bond rates and other similar kinds of securities." He underscored that assessment in further comments last week that Fed MBS purchases are not "specifically tied to the housing market."

Another aspect of the speculation set off by the ultra-cheap monetary policies of the Fed and other central banks is evident in commodities markets.

Bloomberg has reported that its Commodities Spot Index, covering 22 raw material processes is up 78 percent from its March 2020 low. The price of oil is now $75 a barrel amid predictions it could return to $100.

Bloomberg reported that commodity traders who poured in cash had been "showered" with money. Cargill, the world's largest trader in agricultural products "made more money in just the first nine months of its fiscal year than in any full year in its history" with net income going over $4 billion. The Trafigura Group, a major oil trader, posted a net profit of $2 billion in the six months to market, nearly as much as it had made in its previous best-ever full year.

The chief concern of the central banks and governments around the world, as these price hikes are already being translated into high consumer prices, is that inflation will fuel the drive of the working class for higher wages. Consequently, while continuing to pump money into the coffers of the financial elites and promoting speculative bubbles, they will be ever more directly relying on the trade union apparatuses to suppress this movement.