Despite inflation, Fed will not pull back on present monetary policies

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Fed chair Jerome Powell has again reassured financial markets that, despite the significant rise in US inflation, the central bank is not going to pull back its ultra-loose monetary policies that have seen Wall Street reach record highs.

Powell's assurances came in his testimony to the House Financial Services Committee yesterday in the wake of inflation data which showed that prices had jumped at an annual rate of 5.4 percent in the year to June. The rise of 0.9 percent for last month was the highest since 2008.

Powell insisted that, while inflation had "increased notably" and the price rises were higher and more persistent than the Fed had anticipated, the rises were "transitory" and inflation would begin to decline.

However, he said, the Fed was prepared to "adjust monetary policy as appropriate if we saw signs that the path of inflation or longer-term inflation expectations were moving materially and persistently beyond levels consistent with our goal."

In the face of comments from House representatives that price rises were becoming entrenched, Powell called on lawmakers to have "faith" in the Fed's judgment that it was riskier to tighten monetary too early than too late.

"We really do believe and virtually all forecasters do believe that these things will come down of their own accord as the economy re-opens—it would be a mistake to act prematurely."

There is always as element of shadow boxing on the issue of inflation. The central concern is not prices rises as such, but whether inflation is going to lead to an upsurge in the wages struggles of the working class.

This issue was touched on by David Scott, a Democrat representative from Georgia, who said a return to a more stable inflation rate would be advantageous. He pointed out that "wage increases will not keep pace" and price rises would create real hardship for low-income households as well as people on fixed incomes and retirees.

As Powell was giving his testimony, the Fed's own Beige Book, an anecdotal survey of economic conditions, reported that inflationary pressures were increasing.

It stated that while some respondents "felt that pricing pressures were transitory, the majority expected further increases in input costs and selling prices in the coming months."

Powell said the Fed policy of keeping interest rates at virtually zero and financial asset purchases at $120 billion a month—an amount of more than $1.4 trillion a year—would continue and the goal of "substantial further progress" in the economy was "still a ways off."

The commitment brought a favourable response on Wall Street. Both the S&P 500 index and the Dow were up for the day, while the NASDAQ fell slightly. The yield on the benchmark 10-year Treasury bond fell, indicating the belief in financial markets that the Fed is not about to start "tapering" its asset purchases in the immediate future.

The Fed's policies are pouring billions of dollars into the coffers of the banks as they take advantage of ultra-cheap money to fund financial market deals. Goldman Sachs reported that its total revenues for the second quarter were $15.4 billion, an increase of 16 percent from a year ago and well above forecasts by analysts of $12.4 billion.

The chief factor in Goldman's revenue rise was its asset management business where its private equity investments are located. Revenues for this division were $5.1 billion, up 144 percent from a year ago,

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compared to forecasts of $2.8 billion. Goldman reported that it had generated record quarterly net revenues from its private equity investments.

Both Goldman and JP Morgan reported a sharp rise in fees from advising on corporate acquisitions and initial public offerings during the second quarter. JP Morgan announced record investment banking fees of $3.6 billion. Goldman's revenue from fees was also $3.6 billion, only marginally below the record high of $3.7 billion in the first quarter.

Notwithstanding Powell's firm adherence to the Fed's present course, the issue is certain to be the subject of discussion, if not opposition, at the next meeting of its policy making body on July 27 –28. Some Fed officials have already indicated their support for a windback of asset purchases, possibly starting with the mortgage-backed securities.

The fear is that if the Fed continues with the present program and inflation "runs hot," it will have to severely clamp down in the future, possibly leading to a collapse of the financial bubble its policies have created.

The same issues have emerged within the European Central Bank following the decision earlier this month to tolerate a temporary increase in inflation above its target rate of 2 percent.

The overturn of the target of "close to, but below, 2 percent" enables the ECB to maintain interest rates at historic lows for longer and allows for the continued flow of money into the financial system via its asset purchases.

This certain to bring opposition from northern European members of the ECB's governing council, led by Germany. They have expressed the view that the ECB's "crisis" measures, introduced at the start of the pandemic, should start to be wound back because the crisis has passed.

In an interview with the *Financial Times* last weekend, ECB president Christine Lagarde forecast that differences would be raised at the next meeting of the governing council later this month.

"I'm not under the illusion that every six weeks [at monetary policy meetings] we will have unanimous consent and universal acceptance because there will be some variations, some slightly different positioning. And that is fine."

But Lagarde made clear she was not in favour of winding back the ECB's measures even as inflation starts to show signs of rising in Europe. She said monetary policy had to be "especially forceful and persistent" when interest rates were at their lower limit as they are at present. She said "forceful" and "persistent" were "key words" that policy makers should not "undermine or underestimate."

The issues are the same as in the US. Such is the dependence on the flow of money from the central bank, the fear is that any reduction could set off a financial crisis. In 2011, in the wake of the global financial crisis, the ECB raised rates. That decision is regarded as having contributed to the sovereign debt crisis of 2012 which only ended when the then ECB president Mario Draghi said the central bank would do "whatever it takes" to defend the euro.

Concerns continue to be voiced about where the present policies of the major central banks will end.

Commenting in the *Financial Times* earlier this week, analyst Mohamed El-Erian repeated his previous warnings that the longer the Fed continued its asset purchases "the more likely it will be forced into slamming the policy brakes on at some point." This is under conditions where speculative excesses would have built up further and more unsustainable debt would have been incurred.

The critical question for the economy and the markets in the US and elsewhere, he wrote, was whether there is still "a possibility of an orderly exit from what has been a remarkably long period of uber-loose monetary policies?"

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