

# US Federal Reserve moves towards cuts in asset purchases

Nick Beams  
19 August 2021

The Federal Reserve is cautiously moving to a reduction of its \$120 billion per month asset purchasing program, towards the end of the year or early next year, according to the minutes of its July 27–28 meeting, published yesterday.

“Most participants noted that, provided the economy were to evolve broadly as they anticipated, they judged that it would be appropriate to start reducing the pace of purchases this year,” the minutes said.

The prospect of a reduction in the scale of Fed intervention into financial markets, which has played a central role in boosting asset prices, above all shares, sparked a reaction on Wall Street. Following the release of minutes, the major indexes, which had remained steady in the first hours of trading, turned down in the last hour.

The Dow dropped by 382 points, or 1.1 percent; the S&P 500 fell by 1.1 percent and the NASDAQ was down by 0.9 percent.

Since the meeting, the more “hawkish” members of the Fed have hardened their position on the need for a reduction in Fed interventions. This is motivated by two fears: that the continuation of stimulus will fuel inflation, leading to a push by workers for higher wages, and that the continued supply of cheap money could further inflate an asset bubble that will eventually burst.

These views were articulated in an interview in the *Financial Times* earlier this week, with Eric Rosengren, president of the Boston Fed. According to the FT report, he said that purchases of Treasury bonds and mortgage-backed securities were “no longer the right remedy in an environment of severe shortages of essential materials and workers.” He added that the current situation was different from the aftermath of the 2008 financial crisis, when the problem was lack of

demand.

“Our big issue right now is not that people aren’t willing to purchase goods and services. The problem is that it’s difficult to be able to find the labour and find the materials to actually produce the goods and services,” he said.

While not directly raising the question of wages, Rosengren did allude to it. He noted that in the housing industry material prices had gone up substantially and it was difficult to find a construction crew to come on site. While lower interest rates increased housing demand, he said, “they don’t necessarily do much to increase employment.” The implication of his remarks is that the shortfall in employment will tend to push up wages—one of the chief fears of the Fed.

Rosengren also pointed to the longer-term consequences of the continued inflation of asset bubbles in the financial system. He said that by pushing lower interest rates, “you’re encouraging people to take on more leverage” and the goal was not to cause a surge in asset prices.

“I do worry that undue leverage and price appreciation, that could potentially be reversed down the road, could undermine the ability to reach our full employment mandate over time,” he said.

In other words, as economic conditions change and monetary conditions tighten, even to a small degree, then the asset bubble could burst, with far reaching consequences for the economy as a whole.

While moving towards a tightening of monetary policy, the members of the Fed’s governing body are by no means united on how fast that should be.

The division was pointed to, in comments to the FT by Lynda Schweitzer, the co-head of the global fixed income at the investment firm Loomis Sayles.

“Those who want to go fast are worried about the

risks in the market, about having so much accommodation out there,” she said. “Those that want to go slow are a bit afraid of disrupting the market, with the Delta variant and supply disruptions [looming].”

The Fed stepped up its intervention into financial markets following the chaos in March 2020, when the \$21 trillion US Treasury market froze, resulting in the doubling of its asset holdings from \$4 trillion to \$8 trillion, in a matter of a few weeks. This has seen the escalation of low-quality debt to record levels.

According to S&P Global Ratings, the sale of “speculative-grade” debt has reached \$650 billion so far this year, and is on track to reach an annual record.

Less creditworthy companies have been able to obtain access to finance, with what are described as “loose lending terms,” and this could lead to a future debt crisis.

According to Gregg Lemos-Stein, a senior analyst for corporate ratings at S&P: “It might not come home to roost in the next year or even longer. But there are clear signs of risk-taking and a lot of lower-rates issuance. We think this will lead to elevated levels of defaults down the road.”

These views were echoed by Moody’s analyst, Christina Padgett, in comments reported by the FT.

“If you take a forward view, there are many more companies that are fragile. They have layered on a lot of debt. What if growth slows beyond what was anticipated when their balance sheet was structured? What if real rates rise, or inflation remains higher for longer than we think?”

Padgett warned that what may appear manageable today “could be unsustainable in a high-cost or lower-growth environment.”

The issue of tapering asset purchases is linked to the question of if, and when, the Fed should start to raise its base interest rate, which is currently at virtually zero.

In its report on the Fed minutes, the *Wall Street Journal* drew attention to this question. It reported that a presentation, prepared by staffers for the July meeting, cautioned that changes in asset purchases could be interpreted as “signalling a shift” in the Fed’s view of the economic outlook, “with implications for the expected path of the federal-funds rate.”

The minutes reported that “many officials” said it would be important, once the Fed began reducing its purchases, to “reaffirm the absence of any mechanical

link between the timing of tapering and that of an eventual increase in the target range for the federal-funds rate.”

In other words, financial markets must be given assurances that the flow of ultra-cheap money, which has created a mountain of debt and speculative bubbles, will continue even as asset purchases are gradually wound back.



To contact the WSWWS and the Socialist Equality Party visit:

**[wsws.org/contact](https://www.wsws.org/contact)**