

Nervous financial markets await Fed chief's speech

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What is Federal Reserve chair Jerome Powell going to say when he addresses the Kansas City Fed's Jackson Hole, Wyoming, economic symposium, being held virtually for the second year in a row, on Friday morning?

That is the question being asked in financial circles in the US and around the world amid growing uncertainty about the direction of the Fed's monetary policies and divisions in its governing body over how soon and by how much it should start winding back its asset purchases currently running at \$120 billion a month.

A year ago, at the annual conclave of central bankers and economists Powell unveiled a new monetary policy. No longer would the Fed pre-emptively strike out against inflation but would engage in what it called "flexible average inflation targeting."

That is, it would continue its ultra-loose monetary policies – interest rates at virtually zero combined with asset purchases of \$1.4 trillion a year – until inflation had stabilised at around 2 percent and would ignore inflation spikes above that level.

As is always the case, the Fed framed the new policy in terms of the health of the economy. It said its aim was to lift inflation from its low levels to prevent stagnation and to push down unemployment levels, and the policy would continue until there had been "substantial progress" in meeting these objectives.

The real purpose, however, was to provide a guarantee to Wall Street that the massive financial stimulus that began in response to the financial markets freeze in March 2020 at the start of the pandemic, setting off a boom in the stock market, would continue.

When Powell introduced the new policy, the economic situation appeared to provide the necessary rationale for it. The US economy was only just beginning to recover from the pandemic-induced

plunge, millions remained unemployed, and inflation was well below the Fed's target of 2 percent.

But a year on, the situation has changed. Inflation has now risen to 5 percent and there are fears that if it continues this will produce a push for higher wages by the working class – one of the greatest fears of the financial establishment because of the effect it would have on the financial house of cards created by Wall Street speculation.

The official position of the Fed and the majority in its governing body represented by Powell is that the price rises are "transitory" and will subside once the effects of shortages and other problems caused by the pandemic are overcome.

But the critics maintain that the Fed's policies, combined with the increased spending by the Biden administration, will see a return to the high inflation of the 1970s, accompanied by wages struggles, and this will force the central bank to "slam on the brakes" and set off a recession. Therefore, they insist the Fed must make a definite move towards winding back its financial stimulus and end the present uncertainty.

On the other side, the supporters of the present regime maintain that any move to tighten monetary policies will spark a crisis in the financial markets, where debt has risen to record levels based on ultra-cheap money.

They point to the so-called "taper tantrum" of 2013 when interest rates rose on the back of moves by the Fed to start winding back the quantitative easing program introduced in response to the 2008 crisis, and the violent reaction on the stock market when Powell indicated interest rate rises initiated in 2018 would continue during the next year.

Those views would have been reinforced by last week's reaction in the market when the release of the

Fed's minutes showing growing support for the tapering of asset purchases produced a significant two-day fall on Wall Street.

But the continuation of the present regime contains longer-term dangers that threaten the stability of the US and global financial system.

These dangers were highlighted in a column by long-time financial commentator John Plender, in the *Financial Times* last week.

He wrote that central bankers seem "hard pressed to explain why continuing the asset buying program, known as quantitative easing, is necessary." He said there was "broad consensus" that the injections of financial liquidity after 2008 and in 2020 prevented an economic collapse but claims that QE "would boost gross domestic product are less convincing."

In fact, they have no validity whatsoever. The initial claim was that the lowering of interest rates would encourage a search for profits through investment in the real economy. Nothing of the sort took place as the cheap money was not used to finance productive activities but to promote speculation through ever more arcane forms of "financial engineering."

Plender pointed to the rise in debt. According to the International Monetary Fund, the ratio of government debt to gross domestic product has risen from 80 percent in 2008 to 120 percent in 2020 while global non-financial corporate debt reached a record high of 90 percent of GDP in 2019, a total of \$72 trillion. It is now almost certainly at an even higher proportion due to the rise in corporate borrowing in 2020.

Low interest rates have encouraged the "Panglossian belief that the debt must be sustainable."

He noted that in the first four decades after the second world war, recessions were triggered when monetary policy was tightened to tackle inflation, but in the following period, as inflation was contained, financial crises have become the trigger for recessions. But he indicated that a new turn was in the making.

"The trigger may now be a lethal combination of rising inflation and financial instability. The difficulty is that central banks cannot take away the punch bowl and raise rates without undermining weak balance sheets and taking a wrecking ball to the economy."

But if policy makers just continued to muddle on, perpetuating the bust and bailout cycle, this would lead to a "balance sheet recession?—a downturn caused by

debt burdens?—to end all recessions."

Plender concluded by holding out the prospect of averting a crisis if the post-pandemic debt splurge found its way to productive investment. But the record shows that this is not going to take place as financial speculation reaches stratospheric heights, exemplified by the doubling of Wall Street's S&P 500 index since its lows of March 2020.

And there are clear indications that the crisis of March last year, set off by a freeze in the Treasury market when no buyers could be found for US government debt, has not been overcome.

Earlier this week, the FT reported that trading conditions in the \$22 trillion US government bond market had deteriorated with "liquidity, or the ease with which traders can buy and sell bonds, has worsened as a series of jerky price movements and uncertainty over Fed policy has kept investors from making big bets."

The article noted that "reduced liquidity matters because it can lead to big price swings" and recalled the smaller-scale reprise of the March 2020 crisis in February this year when some 40 percent of a US government bond offering went unsold.

Clearly there is a lot hanging on what Powell has to say on Friday.



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