Fed Chair Jerome Powell treads a fine line in Jackson Hole speech

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Amid deepening divisions with US ruling circles over the direction of monetary policy, Federal Reserve Chairman Jerome Powell tried to tread a fine line in his address to the annual Jackson Hole economic symposium on Friday morning.

The divisions, which are reflected in the Fed's governing body, are between those who favour a continuation of the Fed's ultra-loose monetary policy, fearing a too rapid ending could trigger financial turbulence, and those who maintain it is helping to fuel inflation and creating a dangerous bubble in financial assets.

In his remarks, Powell tried to give something to both sides. The Fed has said it will continue its purchases of financial assets—government bonds and mortgage-backed securities—at the rate of $120 billion a month, until it sees "substantial further progress" in reaching the goals of average inflation of 2 percent and maximum employment.

With headline inflation now ranging between 4 and 5 percent, he said the test had been met on inflation, and with clear progress towards maximum employment, he was moving to support a cutback in asset purchases.

At the last meeting of the policy-making Federal Open Market Committee (FOMC), held in July, he said, "I was of the view, as were most participants, that if the economy evolved broadly as anticipated, it could be appropriate to start reducing the pace of asset purchases this year."

But it appears that Powell has pushed back against those on the FOMC who are in favour of having the Fed declare at its September meeting that it will start the reduction. The general opinion in financial markets is that any such decision will be announced in November, with implementation to begin early next year.

In the lead-up to the Jackson Hole gathering, held virtually for the second year in a row, more "hawkish" members of the Fed's governing body, including Dallas Fed President Robert Kaplan, Kansas City President Esther George and St Louis President James Bullard, gave interviews in which they called for an easing of asset purchases as early as October.

Seeking to strike a balance between these views and at the same time assure Wall Street there would not be any sudden cut in the supply of ultra-cheap money that has sent stocks to record highs, Powell's speech was marked by on-the-one-hand, on-the-other-hand statements.

In remarks that were music to the ears of the stock market, he said: "If a central bank tightens policy in response to factors that turn out to be temporary, the main policy effects are likely to arrive after the need has passed. The ill-timed policy move unnecessarily slows hiring and other economic activity and pushes inflation lower than desired. Today, with substantial slack in the labour market and the pandemic continuing, such a mistake could be particularly harmful."

At the same time, he indicated when the Fed would move. He warned that "if wage increases were to move materially and persistently above the levels of productivity gains, businesses would likely pass those increases on to customers, a process that could become the sort of 'wage-price spiral' seen at times in the past."

Powell said at present there was no evidence of wage increases that might threaten "excessive inflation," but the Fed would "continue to monitor this carefully."

One of the most important features of the speech, so far as Wall Street was concerned, was the separation of any easing in asset purchases from the question of a rise in its base interest rate, which has been at virtually zero since the onset of the pandemic in March 2020.

Powell said the timing and pace of a reduction in asset purchases "will not be intended to carry a direct signal regarding the time of interest rate liftoff, for which we have articulated a different and substantially more stringent test."

Not surprisingly his speech was welcomed on Wall Street. The market had opened the day higher, but then climbed still further after the speech had been delivered. The S&P 500 rose by 0.9 percent to a new record high, and the tech-heavy NASDAQ rose by 1.2 percent, also hitting a new record.

The situation in the markets stands in marked contrast to that facing the working class. The Supreme Court's decision to strike down the ban on evictions means that millions face the prospect of being turned out of their homes in the coming days and weeks. At the same time emergency unemployment assistance is about to be cut off.

While the Powell speech was the occasion for financial market celebration, the monetary policies of the Fed are provoking concerns that they are leading to a disaster. In the lead-up to the Jackson Hole conclave, the British magazine the *Economist* published an editorial calling for the reversal of quantitative easing (QE).

Citing a recent UK parliamentary committee's assessment that the Bank of England had a "dangerous addiction" to buying bonds, it said that on current forecasts the balance sheets of central banks in the major economies would reach $28 trillion by the end of the year, a quarter of which was attributable to QE during the course of the pandemic. It warned that the bloated balance sheets of central banks were a "threat to public finances."

In the US, on the eve of the central bank symposium, former Treasury Secretary Lawrence Summers was even more critical. He wrote an op-ed piece for the *Washington Post* in which he likened the Fed's present policy mindset to that which produced the experience of Vietnam and now the debacle in Afghanistan.

"Making policy incrementally—focusing on adjusting current policy to avoid near-term pain, rather than stepping back and assessing whether the current state of affairs makes sense—can lead to terrible outcomes," he wrote.

He said the buying of Treasury bonds and other securities was warranted in 2008 and 2009 and again in the spring of 2020, when bond markets were "in danger of collapse," but made little sense today.

There was no case that the best way to promote more spending in the economy was by buying financial assets, and "at a time when bubble risks are surely very high, the goal of policy should not be further inflating asset prices."

Taking issue with the claim that inflation is transitory, he said the economy's two largest markets—for labour and housing—"suggest that significant inflation will be sustained," underscored by reports of shortages from supermarkets to semiconductors.

"The Fed used to believe in pre-empting inflation. Then it announced it would not act until there was evidence. Now it is in a posture of not even beginning to reduce the most generous monetary accommodation in history until presented with conclusive proof of excessive inflation," he wrote.

Summers went on to assert that the Fed was maintaining its present course on QE not because anyone had analysed it was appropriate in the current conditions, but because it felt the need to maintain credibility given previous commitments, and due to a reluctance to accept immediate pain associated with changing course, coupled with the belief that it could manage the situation down the road.

This assessment is only partially true. The issue confronting the Fed is not simply immediate pain—a passing condition. The underlying fear is that such has been the escalation of debt and fictitious capital, stretching back over decades and accelerating since 2008 and again after the March 2020 financial crisis, that any significant withdrawal of support could see this mountain come crashing down.