Wall Street falls as Fed chair points to accelerated taper of asset purchases

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Testimony by US Fed chair Jerome Powell to the Senate Banking Committee yesterday set off the second significant fall on Wall Street in three days as he indicated that the central bank was moving to tighten its monetary policy.

After a sharp fall on Friday, markets rebounded on Monday on the back of assurances by the Biden administration and governments around the world that no effective action would be taken to deal with the Omicron variant of COVID-19.

But a selloff began on Tuesday in the wake of remarks by the Moderna chief executive, Stéphane Bancel, in an interview with the *Financial Times*, that existing vaccines would be much less effective against Omicron than earlier strains.

The day's trading ended with the S&P 500 and the Dow both down by 1.9 percent while the NASDAQ dropped 1.6 percent.

After the initial decline, the selloff accelerated following remarks by Powell that the risks of inflation had risen, and it would be appropriate to consider finishing its taper of asset purchases sooner than expected. This went against the general market expectation that the Fed would be more "dovish" in response to the spread of Omicron.

"The economy is very strong and inflationary pressures are high, and it is appropriate in my view to consider wrapping up the taper of our asset purchases, which we actually announced at the November meeting, perhaps a few months sooner," he said.

This indicates that the Fed could increase its wind down of asset purchases at its December 14-15 meeting from $15 billion per month to $30 billion, meaning they would finish in March rather than in June.

The date when the Fed could consider lifting interest rates would be brought forward as Powell has made clear on numerous occasions that there will be no upward move until after the Fed has stopped its asset purchases.

In another indication that the Fed is under pressure to lift rates, Powell said rising inflation was a central concern.

He said price rises that have lifted inflation to its highest level in 30 years—the headline rate in the US was 6.2 percent last month—had spread in recent months and there was a threat of "persistently higher inflation."

Backing away from his previous assertion that price rises were "transitory," for which he has come under fire from commentators, company executives and financial analysts, Powell said, "I think it's probably a good time to retire that word and try to explain more clearly what we mean."

However, his subsequent remarks manifestly failed to achieve that objective.

Many price rises, he said, could be traced to shortages caused by the pandemic, which would decline next year, but he added that "it's also the case that pricing increases have spread much more broadly" in recent months, indicating there are other forces at work.

Powell also touched on, somewhat indirectly, one of the major concerns of the Fed. This is that persistent price rises will lead to an increased drive by workers for higher wages. He said it was unlikely that labor market conditions would return to those which prevailed before the pandemic in terms of the number seeking work.

"Greater concerns about the virus could reduce people's willingness to work in person, which would slow progress in the labor market and intensify supply-chain disruptions," he said.

As a *Wall Street Journal* article noted, "That means the Fed could conclude that it needs to raise interest

rates sooner than would otherwise be the case because it suggests a tighter labor market."

The Fed is now being caught in a tightening bind. On the one hand it wants to ensure that the flow of ultra-cheap money into the financial system continues, lest a too rapid withdrawal precipitates a collapse of the debt-fueled speculative bubble.

On the other, it is being pressured to tighten monetary policy in the face of rising inflation because of fears that an upsurge in wage struggles by the working class, coupled with demands for effective action to deal with the pandemic, will bring the same result.

This bind is also impacting on other central banks, notably the European Central Bank and the Bank of England. Data released yesterday showed that inflation in the eurozone climbed to 4.9 percent for the year to November, by far the highest level since records for the region began in 1997. Germany, the area's largest economy, led the way with an inflation rate of 6 percent. In the UK inflation is on the rise and is expected to soon reach 5 percent.

ECB president Christine Lagarde has insisted that the price rises are temporary, and it would be "wrong" to tighten monetary policy. But, as in the US, there is a growing concern that price rises will not be a short-lived shock and will feed into wage demands.

Treasury Secretary Janet Yellen also gave testimony to the banking committee and repeated her warnings that the still unresolved issue of an increase in the US debt ceiling posed a threat.

The US Treasury had been using extraordinary measures to try to conserve cash and could run out of money if the debt limit is not raised.

"Right now, there's uncertainty about where we will be on December 15 and there are scenarios in which we can see it would not be possible to finance the government," she said.

An article by longtime *Financial Times* commentator John Plender, written before the news of Omicron broke, on the reappointment of Powell as Fed chair, said he could be facing problems rating "close to 10 on the Richter scale."

Plender pointed to the rise of government debt, which will stand at 103 percent of gross domestic product at the end of this year compared to 40 percent at the time of the 2008 financial crisis.

"It will thus be difficult for the Fed to raise rates in response to inflationary pressure without causing markets to collapse and precipitating recession. Monetary tightening could beget a perpetual cycle of financial instability, followed by more quantitative easing to prop up the markets and support the economy," he wrote.

This raised the question of whether so-called "normalisation" of monetary policy was a "chimera" and cast doubt on the dollar's role as the world's pre-eminent reserve currency.

While its demise was not an immediate prospect, he concluded that markets should "wake up and recognise that US government IOUs are very unsafe assets."