Wall Street rises on Fed monetary policy decision

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Wall Street has welcomed the latest decision by the US Federal Reserve on monetary policy announced on Wednesday, with market indexes bouncing back sharply from their falls at the beginning of the week.

The S&P 500 index rose by 1.6 percent to finish the day close to its record high. The Dow was up 382 points or 1.1 percent and the tech heavy NADAQ surged 2.15 percent.

As expected, the Fed's policy-making body decided to increase its taper of asset purchases from $15 billion a month to $30 billion, starting in January next year, meaning that the program will end in mid-March.

This means the way will then be open for the Fed to start lifting its base interest rate from near zero, with three rises projected by Fed officials in 2022. The favourable market response was due to the belief that the Fed is starting to move against inflation, now at a 40-year high of 6.8 percent and expected to rise further at the beginning of next year.

The key issue for the Fed on inflation, as it is for Wall Street, is what effect price pressures will have on wage demands.

In his prepared remarks to his press conference following the meeting, Fed chair Jerome Powell said inflation was "running well above our 2 percent longer-run goal and will likely continue to do so well into next year." While initially connected to dislocations caused by the COVID-19 pandemic, price increases "have now spread into a broader range of goods and services."

Powell noted that wages were rising at their fastest pace in many years and while they had "risen briskly ... thus far, wage growth has not been a major contributor to the elevated levels of inflation."

But he said the Fed was "attentive to the risks that persistent real wage growth in excess of productivity could put upward pressure on inflation."

Powell elaborated further on the wages question in response to a question at his press conference, saying that a scenario which sees the goods economy working itself out and supply chains working again left behind "the other things that can lead to inflation."

"In particular, we don't see this yet, but if you had something where wages, real wages, were persistently above productivity growth that puts pressure on firms, and they raise prices."

It would take something "persistent and material" for that to take place. It had not happened yet, but, with what he called "hot labour market readings," it was "something that we're watching."

Powell indicated that unlike the previous situation, when there was a relatively long gap between the end of the quantitative easing following the 2008 crisis and the lifting of interest rates, he did not expect a "very extended wait" between the end of asset purchases and lift-off. He claimed this was because the economy was in a much stronger position.

The median position on the Fed's so-called "dot plot," in which officials indicate where they believe rates will go, was there would be three rises in 2022.

Powell indicated rates could even start to rise before the Fed considered that its goal of maximum full employment had been met. While he did not say as much, any such decision will be determined by whether there is a significant wages push by workers.

Moreover, given that inflation is largely a response to supply issues, there is considerable doubt about what effect three interest rate increases of 0.25 percentage points each will have on prices. This means that rate rises would need to be much higher to bring down inflation, possibly pushing the economy into recession.

While the Fed's decision has been described as "hawkish," the market took reassurance from the fact

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that Powell has indicated the central bank will take into account the reaction to its decisions.

In other words, there will be no repeat of what took place in 2018 when the Fed lifted interest rates on four occasions. It also indicated that the rises could continue in 2019 and there would be a reduction in the Fed's holdings of financial assets at the rate of $50 billion a month—a move that Powell said was on "auto pilot."

At that time, Wall Street responded with the largest December fall since 1931, in the depths of the Depression. Powell rapidly reversed course, taking interest rate rises off the table in January 2019 before cutting them in the middle of the year.

Powell said the issue of the Fed's balance sheet had been discussed but no decision had been reached and there would be further discussions at future meetings. The central bank now holds more than $8 trillion in financial assets after they doubled following the March 2020 market meltdown.

Powell made it clear the Fed was prepared to "adjust the pace of purchases if warranted by changes in the economic outlook." In other words, it will be ready to step in again if the financial markets demand it. He maintained that "even after our balance sheet stops expanding, our holding of securities will continue to foster accommodative financial conditions."

On the economic outlook, he said growth was expected at a "robust" pace this year "reflecting progress on vaccinations and the reopening of the economy." That is, notwithstanding the continued spread of the pandemic, which has now claimed more than 800,000 lives in the US as a result of the homicidal policies of the Biden administration, profits would continue to rise.

The only acknowledgement of the pandemic in his prepared remarks was to say that "the rise in COVID cases in recent weeks, along with the emergence of the Omicron variant, pose significant risks to the outlook,"

But despite the effects of the virus, Fed officials "continue to see rapid growth."

However, the bond market appears to be telling a different story. While yields on two-year Treasury notes have risen in response to inflation and expected interest rate rises, the yield on 10-year bonds has remained at historically low levels.

It now stands at 1.46 percent compared to a level of 1.75 percent in March. This is being interpreted as an expectation that economic growth could be short-lived and even relatively small interest rate rises will lead to a significant slowdown of the economy.

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