Fed chair’s confirmation testimony focuses on wages

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The US Federal Reserve will use interest rate hikes and other measures to tighten monetary policy to push down on wage demands if other methods fail and inflation continues to climb. That was the central message delivered by Fed chair Jerome Powell to the Senate Banking Committee at his confirmation hearing for a second term yesterday.

In his opening remarks, Powell told the committee the Fed was prepared to use its tools “to prevent higher inflation from becoming entrenched.” By “entrenched,” he meant a situation in which price rises lead to increased wage demands by workers.

The minutes of the Fed’s December policy-making committee released last week made clear this is already a central concern, with numerous references to a tighter labour market.

The minutes were replete with phrases such as “participants pointed to a number of signs that the US labour market was very tight, including near-record rates of quits and job vacancies, as well as a notable pick-up in wages growth.”

There were also expressions of concern by a “couple” of participants about the increased use of cost-of-living adjustments in wage negotiations, with others noting the “risk” of wage growth in excess of productivity that “could trigger wage-price dynamics.”

In its report on the Powell hearing, the *Wall Street Journal* pointed to the key issue of wages growth.

The article said Fed officials “are now signalling they don’t want to under-react as wages rise, which could fuel a more traditional inflationary cycle. They are giving more weight to the prospect that the aggressive fiscal- and monetary-policy responses to the pandemic over the past two years may have altered traditional recessionary dynamics, buoying wage growth that normally takes longer to recover after a downturn.”

Powell made a somewhat coded reference to this situation saying that “the post-pandemic economy is likely to be different in some respects” from the past and “the pursuit of our goals will need to take these differences into account.”

The Fed is operating in a completely different situation from that which has prevailed in the past three decades and more. Inflation is now running at its highest levels since the early 1980s with the latest price data due out today expected to show the headline rate of inflation at around 7 percent.

Powell said he hoped there would be a return to “normal supply conditions” this year, but “if we see inflation persisting at high levels longer than expected [and] we have to raise interest rates more over time, we will.”

The problem which confronts the Fed is that the ultra-loose monetary policies pursued by the central bank have created a financial system that is completely dependent on the flow of virtually free cash. This policy dates back to the decision by Fed chair Alan Greenspan in October 1987 to pump money into the markets following the stock market crash of that month.

In the wake of the global financial crisis of 2008 the Fed increased its holdings of financial assets from around $800 billion to more than $4 trillion and more than doubled them again to just under $9 trillion following the market meltdown of March 2020.

Powell, who is a virtual certainty to be reappointed as he enjoys support from both sides of Congress, said the economy no longer needed aggressive stimulus measures. It was “really time for us to move away from those emergency pandemic settings to a more normal level,” he continued.

But the question is whether the stock market, which has reached record highs on the flow of money from the central bank, can tolerate the supply being cut off. On the last occasion that the Fed sought to return to a more normal monetary policy in 2018, lifting interest rates and moving to reduce its holdings of assets, the markets fell sharply in December of that year causing Powell to beat a hasty retreat.

Since then, the level of debt has only grown. According to the Global Debt Monitor published by the Institute of International Finance, total global debt was just under $300 trillion for the third quarter of 2021, or 350 percent of global GDP, up from around $250 trillion, equivalent to 320 percent of global GDP in 2018.

While insisting the Fed would act on inflation, Powell was also concerned not to frighten the markets, indicating that monetary policy tightening would not be too rapid. “It’s a long road to normal from where we are,” he said. And Wall Street appears to have taken the message on board with major indexes recording a rise yesterday.

Besides the issue of monetary policy, the other issue to be raised at the hearing was the market trading of Fed vice-chair Richard Clarida who resigned from his position after it was revealed he had not reported the full extent of his activities.

Last October two regional Fed presidents, Dallas’s Robert Kaplan and Boston’s Eric Rosengren, resigned after it was revealed they had been actively trading in markets while at the same time participating in the setting of the Fed’s monetary policy.

Clarida, the outgoing vice chair, whose term was due to expire at the end of this month, had previously disclosed that he had moved between $1 million and $5 million from a bond fund to a stock fund on February 27, 2020, just a day before Powell announced that the Fed was preparing emergency measures.

The Fed claimed that the move was a result of a “pre-planned rebalancing” and had prior approval from its ethics office.

However, last week amended disclosures revealed that just three days prior to the already reported transactions, Clarida had sold between $1 million and $5 million from the same stock fund. That is, he moved money out of the stock fund, and then moved it back in, making a profit on both transactions, making it clear the Fed’s explanation of his actions was a complete fiction.

Clarida said the failure to report the full extent of his transactions was the result of “inadvertent errors.”

In response to questioning from Democrat Senator Elizabeth Warren, Powell said the Fed was close to announcing a revamping of its ethics rules. He said the Fed took “very seriously” the need to protect its credibility and the new system would be the “toughest in government and toughest I’ve seen anywhere.”

But his real attitude to the revelation of what amounts to criminal activity was summed up in his response to Clarida’s resignation. “Rich’s contributions to our monetary policy deliberations ... will leave a lasting impact in the field of central banking,” he said.

As for the Senate Banking Committee, it showed little interest in pursuing the issue. This was hardly surprising given that it was revealed that in early 2020 four senators had sold off millions of dollars’ worth of stock investments, before the market plunged, after receiving classified briefings from intelligence agencies on the serious nature of the COVID-19 pandemic in January.