Fed will move “aggressively” on interest rates if inflation persists

Nick Beams
2 March 2022

US Federal Reserve chair Jerome Powell has said the central bank will go ahead with a 0.25 percentage point increase in interest rates when it meets later this month and will lift rates throughout the rest of the year, possibly by larger amounts, if inflation becomes “entrenched.”

Speaking to the House Finance Services Committee yesterday, Powell said he was “inclined to propose and support” a hike of 25 basis points (bp) and that he expects a “series” of rate rises this year.

Powell said he and other members of the Fed’s policy-making body “have an expectation that inflation will peak and begin to come down this year” but the Fed was prepared to move if it did not.

“To the extent that inflation comes in higher or is more persistent … then we would be prepared to move more aggressively by raising the federal funds rate by more than 25bp” at one or more meetings.

While not explicit, Powell’s remarks made clear that the key determinant in any decision by the Fed to move “aggressively” will be to what extent workers begin to demand higher wages to compensate for rising prices. Inflation is now running at more than 7 percent in the US with predictions that it could go to double digits.

He described the labour market as “extremely tight” and demand was strong.

The Fed was “attentive to the risks of potential further upward pressure on inflation and inflation expectations and inflation itself from a number of factors. We will use our tools as appropriate to prevent higher inflation from becoming entrenched.”

Asked about the impact of the Ukraine crisis on monetary policy, Powell said the “economic effects of these events are highly uncertain.” He said the bottom line is that the Fed would proceed with interest rate rises “but we will proceed carefully as we learn more about the implications of the Ukraine war for the economy.”

The war has already had an effect. Market expectations that a 0.5 percentage rise could take place this month have been dropped and the prediction is there will be at most five interest rate increases this year as opposed to six or even seven. Powell’s testimony was clearly viewed favourably on Wall Street because the three major indexes rose.

The S&P 500 was up by 1.9 percent, after falling 1.6 percent the previous day. The Dow gained almost 600 points, or 1.8 percent and the tech-heavy NASDAQ rose by 1.6 percent. The shift in the S&P 500 was the sixth move of more than 1 percent in either direction in the past seven days. This kind of volatility has not been seen since the start of the pandemic in February-March 2020.

Operating on the shortest of short-term outlooks, the upward movement by Wall Street yesterday appears to have resulted from Powell’s testimony, which effectively ruled out an immediate 0.5 percentage point hike.

Over the longer term, there will be an inflationary surge throughout the world economy because of the war crisis.

The price of oil rose to $110 a barrel yesterday, an eight-year high, bringing the rise over the past week to 10 percent. Russia is the world’s third largest producer of oil, and the price could go very much higher if sanctions are extended to exclude it from the world market.

On Tuesday, the US and other major oil-consuming countries agreed to release 60 million barrels of oil from emergency stocks to keep the price down. However, this is generally regarded by traders and market analysts as being insufficient.

"As a one-off crude release, it is dwarfed by the extraordinary magnitude of Russia's export disruptions," Ehsan Khoma, head of emerging market research at MUFG, part of the Japanese Mitsubishi financial and industrial conglomerate, told the *Financial Times* (FT).

"The market's critically depleted inventories and thinning spare capacity levels in the face of a record long unresolved deficit ultimately leaves one lever to rebalance oil markets—demand destruction."

In other words, the price will only come down as the result of a recession in the world economy that would substantially reduce the demand for oil.

The price surge is not confined to oil. European natural gas prices rose by as much as 50 percent on Wednesday to reach a record high of €185 per megawatt hour. There has been a 600 percent increase in wholesale European gas prices over the past 12 months.

Grain prices are also on the rise as Russia and Ukraine account for more than 30 percent of all the world's wheat trade. Hovis, one of the UK's biggest bakers, has reported that exports from both countries have virtually come to a halt.

Metals and other important industrial components are also being hit. Russia is the second largest exporter of aluminium, which is used in a range of products from cars to cans, and its price is on course to reach a record high.

Russia is also a major producer of palladium used by car makers to remove toxic emissions from exhaust fumes and is a major producer of platinum, copper and nickel. Russia and Ukraine are the major suppliers of the inert gas neon, which is used in the production of computer chips.

Summing up the situation, Natasha Kaneva, an analyst at JPMorgan, told the FT: "We anticipate an extended period of geopolitical tensions and elevated risk premiums across all underlying commodities following Russia's invasion of Ukraine. Russia has a far-reaching impact across global commodity markets, and the unfolding conflict has vast implications, not least higher prices."

But as world society faces the ongoing devastation produced by the COVID-19 pandemic, workers are hit with deepening cuts in their living standards because of inflation, and the danger of world war is rapidly growing, massive amounts of money are raked in at the top.

Over the weekend it was revealed that one of the world's biggest oligarch's, Stephen Schwarzman, the CEO of the Blackstone private equity firm, received a record $1.1 billion in income for 2021, up from the $611 million he received in 2020.

The bulk of this bonanza came from the $941.6 million he received in dividends from his 19 percent share in the company. The boost in its profits, which increased the dividend payout, was the direct result of the Fed's zero interest rate policy. It has handed out virtually free money enabling Blackstone to take its assets under management close to $1 trillion, larger than the GDP of many countries.