“Aggressive” speech by Fed chair Powell targets wages

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22 March 2022

US Federal Reserve chairman Jerome Powell has again emphasised that the key focus of the central bank’s decision to start lifting interest rates and tighten monetary policy is to push down on wage demands.

This was the theme of his press conference last week announcing the shift in the Fed’s monetary policy, and it was further elaborated at an economic conference held on Monday.

In his address to the annual conference of the National Association for Business Economics (NABE) in Washington followed by a question-and-answer session, Powell continually returned to the issue of what he called a “hot” and “very tight” labour market.

Significantly, not once did he allude to the fact that, while nominal wage increases are higher than they have been in decades, they are still well below the level of inflation in the US, now at almost 8 percent and expected to go even higher in coming weeks.

In other words, while workers are having their real wages cut, daily in some cases as prices climb, the Fed’s stated policy is to deepen this process by reducing the demand for labour through its monetary policy.

In remarks to a Senate committee earlier this month, Powell left no doubt about what he was prepared to do if necessary. The example of former Fed chair Paul Volcker in the 1980s, who pushed interest rates to a record high, creating a deep recession and driving down wage demands amid rampant inflation, was one to be followed.

Powell began his remarks to the NABE conference by emphasising that the “labour market is very strong, and inflation is much too high.” It was necessary to return monetary policy to a more neutral level “and then to move to more restrictive levels if that is what is required to restore price stability.”

In the question-and-answer session, he was asked what would prevent the Fed lifting its base interest rate by 0.5 percentage points (50 basis points) at its next meeting in May. Powell replied “nothing.”

“If we think it’s appropriate to raise by 50 basis points at a meeting or meetings, we will do so,” he said.

The *Wall Street Journal* noted that Powell’s remarks struck a “tougher tone” than he had used at his press conference just days earlier when the Fed announced a 0.25 percentage point rise.

“By many measures, the labour market is extremely tight, significantly tighter than the very strong job market before the pandemic,” he said in his prepared remarks to the NABE conference.

Under conditions where the latest burst of inflation comes from the flow on effects of the war in the Ukraine, the Fed would not “look through a brief burst of inflation associated with commodity price shocks” but would act.

The risk was that an “extended period of high inflation could push longer-term expectations uncomfortably higher,” which underscored the need for the Fed to “move expeditiously.”

The reference to “longer-term expectations” of higher inflation is a code phrase for the major fear of the Fed and other central banks that workers will push for higher wages. This is to make up for the cuts in living standards that have already taken place and the further slashing of real wages in the immediate future.

Powell said the Fed was in favour of a “strong labour market” but made clear the key issue was price stability. Wage increases had to be consistent with the long-term inflation goal of 2 percent and policy makers were “very focused on restoring price stability.”

The Fed’s measures, however, will do nothing to bring down the price hikes in oil, gas, food commodities or metals which are now surging, not least because of the activities of speculators who have piled into these markets. The sole aim of interest rate increases, as Powell made clear, is to reduce the demand for labour.

He said the previous scenario of the Fed that inflation would start to come down by the second half of this year had "fallen apart." The Fed's continuous claim through most of last year was that price rises were "transitory." If inflation continued to rise, "my colleagues and I may well reach the conclusion that we need to go more quickly and if so, will do so."

Powell briefly referred to the policy problems confronting the Fed and other central banks. In the past, the Fed had been able to pursue a monetary policy to support the "economy" confident that inflation would not increase. In reality the pumping of trillions of dollars into the financial system was to boost Wall Street. But this had now all changed and no one at the Fed was "waiting for the old regime to come back."

The dilemma confronting central bankers around the world was raised in a *Wall Street Journal* article, which warned the Ukraine war was casting a "stagflationary scenario over the world economy."

According to the Organization for Economic Cooperation and Development, the war is likely to cut more than 1 percentage point from global growth, while pushing up world inflation by a further 2.5 percentage points.

"Central banks need to act on inflation, but what do they do [about] the slowdown? This is a poisoned chalice," Pancicos Demettriades, a former official of the European Central Bank told the WSJ. "They can't do both."

"There is no playbook for central banks, said Katharine Neiss, a former Bank of England economist. "I worry about low growth in Europe against the backdrop of high inflation, a stagflationary scenario."

In remarks that no doubt echo the hopes of finance capital, the Fed will continue the supply of the ultra-cheap money that has fuelled record profits. The head of economic and market research at the investment fund BlackRock, Elga Bartsch, forecast the Fed would not press too hard.

"We think once inflation starts to come off the boil … the Fed eventually will opt to live with somewhat higher inflation than the 2 percent objective," rather than forcing inflation down to the level "at high cost in terms of activity and the labour market," she told the WSJ.

But when Powell was asked at the NABE conference whether the Fed would tolerate an inflation rate of 3 percent, he flatly ruled it out.

Reports in the financial press described Powell's remarks as "aggressive." But there are rumblings within the Fed's policy-making body that what has been done so far is not enough.

At the Fed meeting last week, St Louis Fed President James Bullard dissented from the majority decision saying the initial rise should have been 0.5 percentage points.

"The committee will have to move quickly to address this situation or risk losing credibility on its inflation target," he said in a statement on his decision.

The bond market is also anticipating higher rates. The yield on the 10-year Treasury bond has risen to 2.3 percent with the market experiencing its biggest sell-off since 2016. [As bond prices fall, their yields rise.]

The yield on two-year Treasury debt is now 2.1 percent and the flattening of the so-called yield curve is regarded as an indication that interest rates are going up "quite significantly in the shorter term," according to one market analyst cited by the *Financial Times*.

But if that does take place there could be major consequences. The one-time world's leading bond trader, Bill Gross, told the FT that interest rates above 2.5 or 3 percent could "crack the economy." The financial system had become so used to lower and lower rates that "anything much higher will break the housing market."