

Fed hikes interest rate to crush wage demands

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The US Federal Reserve has raised its base interest rate by 0.75 percentage points (75 basis points) with the aim of hitting wage demands by workers battling against the highest inflation in four decades.

The increase was in line with market expectations following an article in the *Wall Street Journal* on Monday, based on a leak, that the large hike was under consideration after it had been specifically ruled out at the Fed's previous meeting of its policy-making committee in May.

In his opening remarks to the press conference at the conclusion of the two-day Fed meeting yesterday, chair Jerome Powell sought to give the impression the central bank was in control despite the about turn.

He said the Fed understood the hardship high inflation was causing and was moving expeditiously to bring it back down. "We have both the tools we need and the resolve it will take to restore price stability on behalf of American families and businesses."

But this assertion was contradicted in the statement of the Federal Open Market Committee announcing the monetary policy. It removed a sentence in the May statement which said officials expected inflation to return to 2 percent and the labour market would remain strong as it increased interest rates.

Asked about the excision, Powell said it reflected the sense that the Fed could not reduce inflation to 2 percent by itself and was not accurate.

This admission served to highlight that the Fed's latest decision is not about reducing inflation—the result of supply side constrictions flowing from the COVID-19 pandemic, the pumping of trillions of dollars into the financial system over the past decade and a half and the NATO proxy war against Russia—but is aimed at suppressing wage demands.

Powell repeated remarks, made on many previous occasions, that the labour market was "very tight."

He indicated that the impetus for the decision to lift

rates by 75 basis points—the biggest single hike since 1994—resulted from two reports at the end of last week.

The confidence survey compiled by the University of Michigan indicated consumer sentiment had fallen to its lowest level on record on the back of concerns inflation was becoming anchored and the report last Friday it had jumped to 8.6 percent in May.

The decision, comments by Powell, and projections by Fed officials on growth rates make it clear the central bank intends to try to crush this movement by slowing economic growth and pushing the economy into a recession if that proves necessary.

When inflation began to rise in 2021, Powell and other Fed officials maintained it was "transitory." Now this fiction is being replaced by one equally as bogus, that there is the possibility of a so-called "soft landing."

But, as former US Treasury Secretary Lawrence Summers has insisted, interest rates are a blunt instrument, and incapable producing a smooth glide path.

Even Powell was forced to backtrack somewhat, saying the path to a soft landing without a recession "is not getting any easier" as it was becoming clear that "many factors that we don't control are going to play a very significant role in deciding whether it's possible or not."

But the use of the blunt instrument of interest rate hikes had to continue regardless.

"The worst mistake we can make would be to fail, which is not an option. We have to restore price stability," he said.

That is, wages are the key target and, as Powell put in his opening statement, "supply and demand conditions in the labour market" need to "come into better balance."

He noted that at present there were two job vacancies for every person seeking employment and the goal was to restore the conditions prior to the pandemic. This

was a situation in which real wages were in continual decline.

There are already indications of lower growth. Powell noted that growth in fixed business investment is slowing and “activity in the housing sector looks to be softening.” He maintained that consumer spending remained strong, but the latest reports indicate that retail sales are starting to move down because consumers have less disposable income to spend in the face of the rising costs of gasoline and other essential items.

In their projections on the economy, Fed officials forecast lower growth. Their median prediction was for growth to slow to 1.7 percent by the end of this year and to stay at that level in 2023. This compares with their previous forecast in March of 2 percent growth over the next two years.

Projections by officials on interest rates—the so-called “dot plot”—reveal a sharp rise in the Fed rate.

The median projection would lift the Fed’s base rate to around 3.38 percent by the end of year, meaning there will be further increases totalling 1.75 percentage points over the next four meetings. Back in March, the projection for the end of the year was for a base rate of around 1.88 percent. Officials also expect the unemployment rate to rise from its present level of 3.6 percent to 4.1 percent by 2024.

Announcing the decision, Powell said he did not expect moves of this size to be common and added that the decision at the Fed’s July meeting “could well be about a decision between 50 and 75” basis points.

This was intended as a reassurance to the markets that rises as high as a full 1 percentage point, which have been mooted in some quarters, were not under consideration. Wall Street duly responded with all three major indexes—the Dow, S&P 500, and the NASDAQ—finishing up for the day.

But there was a similar response in May when Powell said a 75-basis point rise was “not something the committee was actively considering” only to fall sharply the following day.

Besides its impact in the US, the latest Fed decision will have far-reaching international ramifications, putting additional pressure on all central banks to continue and even accelerate the interest rate hikes they have already begun in response to the global inflationary upsurge.

This week, the governor of the Reserve Bank of Australia, Philp Lowe, warned that more interest rate hikes were in the pipeline, following a rise of 0.5 percentage points earlier this month. It was “unclear at the moment” how much further they would need to rise to reach the target of 2 percent inflation, with Lowe forecasting that inflation could rise from its present level of 5.1 percent to 7 percent.

The European Central Bank (ECB) is also facing a series of problems. As the Fed delivered its rate hike, it held an emergency meeting seeking to counter fears that it is on the verge of another debt crisis as it begins to lift interest rates in July and stops buying more bonds.

The decision to call the meeting came only a week after the ECB’s governing council had met to set its monetary policy and was the first such gathering since the March 2020 financial crisis at the start of the pandemic.

The central concern is so-called “fragmentation” in which the interest rates on the sovereign bonds of the more indebted southern members of the euro zone move sharply above rates on German bonds.

The difference between the interest rates on Italian and Spanish bonds and German debt has risen to levels not seen since the start of the pandemic. The fear is that if this continues it will lead to a crisis for the single currency as occurred in 2012.

Announcing the meeting, the ECB said the pandemic had left “lasting vulnerabilities in the euro area economy.” It said it would speed up work on developing a new instrument to deal with the surging borrowing costs for the weaker economies but provided no detail of what that would involve.



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