US Fed meets amid fears of global recession and financial turbulence

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26 July 2022

The US Federal Reserve's monetary policy setting committee starts a two-day meeting today at which it is expected to announce a further 0.75 percentage point (75 basis points) increase in interest rates despite growing concerns that the US economy could soon enter a recession if it is not already in one.

Consumer sentiment is at a record low and yesterday the biggest US retailer, Walmart, issued a statement that higher prices for food and fuel were causing consumers to pull back spending in other areas. The *Wall Street Journal* (WSJ) characterised the announcement as "an ominous sign for the US economy that has relied on resilient household spending power through inflation."

While Fed officials appear to have pulled back from a full percentage point increase, the further increase in the Fed rate to be announced tomorrow afternoon will add to the pressure on central banks around the world to also lift their rates in order to protect their currencies and mitigate the transmission of inflation via higher import prices.

The US interest rate hikes, which began in March, are being driven by the rise in inflation which hit an annual rate of 9.1 percent in June and the determination of the Fed, acting as the enforcer of the interests of the corporations and finance capital, to ensure that a wages movement of the working class in response to the price hikes is crushed by slowing the economy.

While there are some indications that commodity price increases which sparked the inflationary spiral are falling, there are warnings that the inflationary surge is spreading throughout the economy.

Former Fed vice chair Donald Kohn told Bloomberg that "inflation is entrenched and spreading."

This view was echoed by Goldman Sachs CEO David Solomon as part of the survey conducted by the WSJ on the outlook of business chiefs.

"We see inflation as deeply entrenched in the economy," he said. "In my dialogue with CEOs operating big global businesses, they tell me that they continue to see persistent inflation in their supply chains. Our economists, meanwhile, say there are signs that inflation will move lower in the second half of the year. The answer is uncertain."

That uncertainty has led to significant swings on Wall Street with the market moving up one day in the belief that the Fed may pull back its monetary tightening in the face of recession threats only to move down the next.

But there are growing calls that the Fed must not carry out a "stop-go" policy and continue with the rate hikes even under conditions of recession.

Former US treasury secretary Lawrence Summers, who has said an unemployment rate of 10 percent for a year is needed to halt inflation, told Bloomberg Television his instinct was "you'd not see rates cut as soon as people think."

"The Fed has to be careful. If you look at the history of the 60's and 70's, there were moments when monetary policy eased a bit and things didn't tend to work out so well," he said.

All central banks are now engaged in monetary policy tightening as 50 basis point increases become the norm, with some increases even higher, as took place earlier this month when the Canadian central bank lifted its rate by 100 basis points, the biggest by any G7 economy since 1998.

According to the *Financial Times* (FT), in the three months to June, 62 policy rate increases of at least 50 basis points were made by 55 central banks, with another 17 increases of 50 basis points or more so far this month.

The underlying motivation for the rate hikes, which in and of themselves will do nothing to bring down prices, was outlined by Jennifer McKeown, head of global economics at Capital Economics, in comments to the FT.

Central banks, she said, had to move quickly to get rates out of “stimulative” territory, “particularly in an environment where wage growth and inflation expectations are rising and there is a risk that inaction would allow wage-price spirals to develop.”

In other words, rates must be lifted rapidly to crush the growing international wages struggles of the working class under conditions where living standards are being cut daily.

Last week, the European Central Bank (ECB) joined the 50-basis-points club when it abandoned its previous “forward guidance” of a 25-basis-point increase and indicated further rises would come.

The larger than expected rise was the result of a deal with the so-called hawks on the ECB’s governing council, who had been pressing for it. In return they signed off on the so-called Transition Protection Instrument under which the ECB will buy up the bonds of the more indebted countries, particularly Italy, if the interest rates on government debt sharply diverge from those of Germany.

The “anti-fragmentation” policy is aimed at trying to prevent a recurrence of the crisis that developed in 2012 when the continued existence of the euro was threatened.

Speaking in support of the new measures, which will not have a limit decided in advance, ECB President Christine Lagarde said the central bank was “capable of going big.” She said the ECB would rather not use the new program “but if we have to use it, we will not hesitate.”

On the same day as the new policy was announced, the Italian government, headed by former ECB president Mario Draghi, collapsed, increasing the danger of fragmentation amid fears that elections, scheduled for September, may not produce a stable government, let alone one capable of carrying out the kind of austerity measures being demanded to ensure financial support.

Added to the prospect of continuing financial and economic turbulence is the issue of gas supplies to Germany from Russia. While Russia resumed supplies of gas via the Nord Stream 1 pipeline last week after its closure for maintenance, supplies were only running at 40 percent, casting doubt over whether sufficient reserves can be accumulated for the winter months.

Yesterday, the situation worsened when the Russian gas producer, Gazprom, announced that exports through the pipeline would be cut to 20 percent of normal because of problems in the return of a turbine undergoing repairs in Canada, due to the sanctions regime imposed on Russia.

At the same time, the Ifo Institute, a major economic research organisation, warned: “Germany is on the threshold of recession.”

Summing up the problems confronting the ECB, Krishna Guha, head of policy and central bank strategy at the US investment bank Evercore, told the FT, “the combination of a brewing giant stagflationary shock from weaponised Russian natural gas and a political crisis in Italy” was about as close to a “perfect storm as can be imagined.”

As Wall Street continues to gyrate, major investors have cut their allocations to equities to the lowest level since the collapse of Lehman Brothers in 2008, according to an article in the FT last week, reporting on a survey conducted by the Bank of America.

Michael Hartnett, chief investment strategist at the bank, said investors had reached a “dire level” of pessimism over concerns that the tightening of monetary policy could lead to a broad slowdown in the global economy.