European Central Bank hikes interest rate with more to come

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The European Central Bank (ECB) has increased its base interest rate by 0.75 percent (75 basis points), the largest hike since the first days of the euro, and warned that more rises are to come.

In remarks at a press conference following the meeting of the central bank's governing council yesterday, ECB President Christine Lagarde said interest rate increases would continue for up to five of the next policy-making meetings.

"We took today's decision and expect to raise interest rates further, because inflation remains high and is likely to stay above our target for an extended period," she said in her opening statement.

Energy price increases, responsible for 38 percent of the inflation surge, and rising food prices, combined with supply chain bottlenecks, were the main factors, but their effects are spreading.

"Price pressures have continued to strengthen and broaden across the economy, and inflation may rise further in the near term," she said.

In response to a question, she said, "[w]e want all economic actors to understand that the ECB is serious" about countering high inflation.

But in response to another question, she made clear that monetary policy was not going to reduce energy prices. That being the case the issue which arises is: Why are the rate hikes being carried out in the name of "fighting inflation"?

The issue was not addressed directly in Lagarde's opening statement nor by questions from journalists at the press conference. But all the participants know that the aim of the policy is to prevent so-called "second round effects," that is, the drive by workers for wage rises to counter the massive attacks on their living standards.

This issue was only approached somewhat tangentially when one journalist asked what level of recession it would take for the ECB to reverse its policy. Lagarde replied that the present monetary policy was still stimulating the economy—another warning that more rises are to come. The ECB was "determined" to do its job, she said.

Asked whether it was going too far, as evidenced by the tightening of conditions in credit and bond markets, Lagarde said the ECB was "far away" from the rate needed to bring down inflation to its target rate of 2 percent.

On the economic outlook Lagarde said after a rebound in the first half of the year, "recent economic data point to a substantial slowdown in the euro area, with the economy expected to stagnate later in the year and in the first quarter of 2023. Very high energy prices are reducing the purchasing power of people's incomes and, although supply bottlenecks are easing, they are still constraining economic activity."

Besides the energy price increases, the fall in the value of the euro, which has dropped to below parity against the US dollar—a slide of 12 percent over the past year—has also "added to the build-up of inflationary pressures."

Asked about how this affected the ECB's policy, Lagarde gave the standard response of central bankers saying it did not target the currency, but the level of the euro was taken into consideration on the inflation front.

She said in the context of the global economy risks were primarily on the downside, in the near term. And then, in an expression of the thinking in European ruling circles, she said that in a downside scenario prepared by ECB staff, "a long-lasting war in Ukraine remains a significant risk to growth, especially if firms and households faced rationing of energy supplies."

Addressing the central but largely unstated focus of all central bank policy— the wage demands of the working class—Lagarde said the labour market had remained “robust” and this, together with “some catch-up for higher inflation, are likely to support growth in wages.” But she noted that recent wage agreements indicate that “wage dynamics remain contained overall.”

As is taking place around the world, the ruling financial elites are relying on the trade unions to suppress wage claims in the face of the highest inflation in 40 years, coming on top of three decades of real wage reductions.

In a note published at the end of last month, the finance firm ING said demand-side inflation in the eurozone remained weak and the output gap— the difference between what the economy is producing and its potential—was negative. Household consumption was below pre-pandemic levels, and retail sales had been on a declining trend since last November.

With eurozone inflation now above 9 percent, it said the latest data for negotiated wage growth for the second quarter came in at just 2.1 percent, meaning “there is no evidence of a wage-price spiral … but that the eurozone is mainly facing an unprecedented squeeze in real incomes.”

Across the Atlantic, in the US, there are growing calls for the Federal Reserve to continue to drive up interest rates even further in response to an upsurge of workers’ struggles for wage increases.

This week Fed Vice Chair Lael Brainard, generally regarded as a dove on monetary policy, added her voice to those of other Fed officials calling for no let-up in the rate hikes, even as the threat of recession grows.

Speaking to a banking industry conference, before which she would have no doubt consulted with Fed Chair Jerome Powell given her position as number two at the central bank, Brainard said the Fed had to retain its nerve even as there was evidence of a slowdown in the economy resulting from previous rate increases.

“We are in this for as long as it takes to get inflation down,” she said. But, as Powell and others have acknowledged, interest rate increases will do nothing to reduce the price of gas or unlock constricted supply chains.

They are directed at suppressing wage claims, an issue to which Brainard referred as she noted that the US labour market continued with “considerable strength,” which was hard to reconcile with a “more downbeat tone of activity.”

In other words, the supply of labour, which Powell has insisted must be increased to overcome labour market “tightness,” must be increased. Within the capitalist economy this can only be done by driving up unemployment.

The extent of what is required has been outlined in a paper by three leading economists, one from Johns Hopkins University and two from the International Monetary Fund, cited by Jason Furman, the chairman of the White House Council of Economic Advisers under the Obama administration, in an article in the *Wall Street Journal*.

The economists concluded that to get inflation down to the Fed target of 2 percent would require an average rate of unemployment rate of 6.5 percent in 2023 and 2024, a significant increase from the present level of 3.7 percent. Former Treasury Secretary Lawrence Summers has made similar comments, even calling for an unemployment rate of 10 percent for a year.

What this means in social terms is the layoff of hundreds of thousands, potentially millions of workers, thereby increasing the labour supply and further pushing down wages—the focus of the central banks in their so-called battle against inflation.