Fed continues rate hikes to target wages

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The US Federal Reserve again lifted its base rate by 0.75 percentage points yesterday with Fed chair Jerome Powell telling a press conference the "ultimate level of interest rates will be higher than previously expected."

There was a very sharp shift in the reaction on Wall Street to the decision. When the Federal Open Market Committee, the central bank's rate setting body, released its statement the markets moved up.

This was in response to a new sentence which read: "In determining the pace of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."

This was taken to mean that with an increase of 375 basis points in the interest rate since it began tightening in March, the Fed was looking to ease off as it gauged the effects of the previous hikes. Accordingly share prices rose and the yield on Treasury bonds moved down.

But that sentiment changed very quickly during Powell's press conference, which began half an hour after the FOMC statement was issued, as shares on Wall Street dropped sharply in the last hour of trading.

The S&P 500 index closed 2.5 percent down, with all 11 of its sectors off by at least 1 percent, the Dow dropped 505 points, 1.5 percent, and the interest-rate sensitive NASDAQ index fell 3.4 percent.

While Powell made a reference to the new sentence in the FOMC statement, his focus was an insistence the Fed was not easing up.

In some ways it recalled what had taken place earlier in the year when the Fed said it would stop rate rises at some point, giving rise to expectations it was about to pull back. Powell used his speech to the central bankers' Jackson Hole conclave at the end of August to scotch that belief.

The fact that Powell chose at his press conference not to elaborate on the new sentence but to insist there was no immediate let-up may be an indication of emerging differences in the Fed's governing body. The meeting's minutes to be published later this month could throw further light on this question.

For his part Powell left no doubt where he stood. "We anticipate that ongoing increases in the target range for the federal funds rate will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent," he said.

But there was "significant uncertainty" about what that rate might be. "Even so, we still have some ways to go, and incoming data since our last meeting suggest that the ultimate level of interest rates will be higher than previously expected."

He also noted the Fed was in the process of "significantly reducing the size of our balance sheet" [the Fed's asset holdings are being reduced by $95 billion a month] and this was playing an "important role in firming the stance of monetary policy."

Reducing inflation was "likely to require a sustained period of below-trend growth and some softening of labour market conditions."

Powell concluded by insisting that "the historical record cautions strongly against prematurely loosening monetary policy" and "we will stay the course, until the job is done."

But the crucial question is, what is that job?

The Fed maintains it is in a fight against inflation and its policies are guided by the need to "promote maximum employment and price stability for the American people." This piece of fiction is continuously wheeled out to obscure the real target—the working class.

But despite Powell's efforts, the central agenda emerged from his remarks to the press conference.

"We are taking forceful steps to moderate demand so that it comes into better alignment with supply," he said, and the overarching goal was to bring inflation down to the Fed's 2 percent target.

His review of the state of the US economy, however, made some revealing points.

The economy, he said, had "slowed significantly" from last year, there was a "modest growing of spending and production this quarter," growth in consumer spending had slowed, reflecting "lower real disposable income and tighter financial conditions," housing sector activity had "weakened significantly," reflecting higher mortgage rates, and higher interest rates and slower output growth "also appear to be weighing on business fixed investment."

In other words, according to Powell, demand is down in all areas of the economy, except one, the labour market.

"Despite the slowdown in growth," he said, "the labour market remains extremely tight, with the unemployment rate at a 50-year low, job vacancies still very high, and wage growth elevated."

The labour market, he went on, "continues to be out of balance with demand substantially exceeding the supply of available workers."

Given that, as Powell acknowledged, the labour force participation rate, the percentage of the population in the labour force, is not changing, largely because of the ongoing effects the COVID pandemic, which failed to rate a mention in his remarks, this means the increased supply of workers can only come by increasing unemployment.

The overriding concern of the Fed is that, as Powell put it, "the longer the current bout of high inflation continues, the greater the chance that expectations of higher inflation will become entrenched."

In other words, recognising that the inflationary price gouging by major corporations will continue indefinitely, workers will develop their independent action to break free of the straitjacket imposed by the trade union bureaucracy which has led to continuous cuts in their wages and the intensification of exploitation.

To the extent there are fears in the Fed's governing bodies and in the financial system more broadly they are not because of recession.

Rather, they centre on what the tightening of monetary policy could mean for the stability of the financial system, particularly in the wake of the crisis in the UK last month, and the recent contraction of liquidity in the $24 trillion US Treasury market, the basis of the American and global financial system.

These fears were noted in a comment by Priya Misra, head of global rates strategy at TD Securities, to the *Financial Times* as she pointed to the financial stability concerns that had erupted in the UK in September.

If you looked at the US data, she said, it was very hard to argue that the Fed needed to downshift on its rate rises. "But if you look at the global picture, the UK situation should give them caution to downshift without pivoting."

That is, the Fed should continue with interest rate increases but not at a pace which would cause a crisis on the financial system.

While concerns grow behind the scenes, the Fed and other authorities maintain publicly that the financial system has been "stress tested."

But the deputy Bank of England governor John Cunliffe explained in a recent letter to a UK Treasury committee that such tests in Britain did not provide a safeguard.

The "scale and speed" of repricing in the UK bond market leading up to September 28—the yield on the 30-year UK Treasury moved by 1.6 percentage points in a few days, something never seen before—were not likely to have been accounted for in regulatory stress tests, he wrote.

The same issues are present in the US financial system with growing warnings that liquidity conditions in the Treasury market are starting to approach those experienced in the March 2020 crisis at the start of the pandemic.