Central Banks face interest rate dilemma

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6 February 2024

Amid all the back and forth in the markets and second guessing about where interest rates will go it is clear that central banks, led by the US Federal Reserve, want to ensure that wage rises are firmly suppressed before they start to make cuts.

At the same time, they want to reassure the financial markets that rate cuts will be undertaken.

This is because the longer the present higher interest rate regime continues the greater the danger of financial problems erupting. This is due to the dependence of many areas of the financial system on the near-zero interest rate regime which prevailed for almost a decade and a half after the global financial crisis of 2008.

Smaller and regional US banks have already been hit—three of them failed last March threatening a "systemic crisis"—and there have been warnings of a looming crisis in commercial real estate.

Fed chair Jerome Powell tried to thread this needle in his appearance on the CBS program *60 Minutes* on Sunday night.

He gave an assurance to the markets that the Fed still expected to make around three rate cuts this year, each of a quarter percent, saying that "almost all" members of the Federal Open Market Committee thought rates should be cut.

The so-called "dot plot" in December, in which members of the FOMC chart where they expect interest rates to go, showed they expected that rates would be down by three quarters of a percentage point at the end of the year.

The next projections are not due until the FOMC meeting of March 20, but Powell said "nothing had happened in the meantime that would lead me to think that people would dramatically change their forecasts."

He also sought to dampen market expectations of imminent cuts—at one point there were forecasts of six rate cuts this year starting in March.

"There is no easy, simple, obvious path," he said. "We think the economy's in a good place. We think inflation is coming down. We just want to gain a little more confidence that it's coming down in a sustainable way."

Powell did not spell out what would give the Fed "more confidence." Nevertheless, commentary in the financial media has indicated what is required is evidence of growing slack in the labour market and that wage rises are kept down.

That relationship was underscored by the release of Bureau of Labor Statistics data on Friday which showed the US economy added 353,000 jobs in January—almost double what was expected. That meant Wall Street immediately ruled out any prospect of a March interest rate cut.

The central banks cannot openly state that their central objective in meeting inflation is not, and never has been, the enormous profit gouging by giant corporations, especially in the areas of food, energy and other necessities, but the suppression of the wages and living standards of working class. To admit that truth would expose the fiction that they serve the interests of the public.

However, the ruling classes themselves need to be informed as to what is taking place, so some of the real issues are revealed, at least partially, in sections of the financial press.

In a recent article entitled "Why central bankers are reluctant to declare victory over inflation," the *Financial Times* commented: "Central bankers around the world had begun preparing for rate cuts on the back of steadily weakening inflation. But as the US jobs numbers demonstrate, hot labour markets are the biggest potential barrier to them hitting their 2 percent inflation goals."

What this means is that rates will not come down until central bankers can have confidence that the wage demands of workers, just to compensate for the price hikes imposed by the corporations, have been suppressed.

While it is never mentioned, the chief mechanism for achieving this goal in the US and elsewhere is the role of the trade unions in imposing sub-inflationary pay agreements.

Commenting further on the wage issue, the FT article noted that continued progress in the disinflation story hinged on the fate of labour markets.

“While the initial declines in inflation were driven by external factors, progress now depends on the more difficult task of depressing domestically generated price growth. That will be harder if jobs and wage growth stay too robust.

“Economists say squeezing out the last vestiges of excess price growth might require policymakers to maintain persistently tough policy that further suppresses demand.”

The risk here, despite all the official claims that the financial and banking system is “sound and resilient,” is that the persistence of higher rates can lead to a crisis.

The issue of wages was likewise front and centre at the meeting of the European Central Bank on January 25—so much so that ECB president Christine Lagarde could hardly talk of anything else when she came to discuss inflation.

This was so obvious that one journalist asked at her press conference whether “it is fair to assume that the focus on wages means that you need to see wage growth falling before you are prepared to cut rates.”

Lagarde did not directly respond to the question, but the answer was yes.

As the FT noted, the ECB rate-setters “have made it clear that their key focus in the coming months will be on wage settlements and whether they are compatible with the 2 percent inflation target.”

“The worry at the ECB and elsewhere is that workers will demand big pay rises to restore the purchasing power they lost during the initial spikes in prices.”

Like Powell, her counterpart in the US, Lagarde is particularly concerned about the services sector where wages make up a large portion of total costs.

At the Bank of England, governor Andrew Bailey has raised the prospect of an interest rate cut, but the central bank has warned that while the labour market has cooled it remains “tight by historical standards.”

The same issue came up in the decision by the Reserve Bank of Australia yesterday to leave interest rates on hold and to warn increases could not be ruled out. The RBA said while conditions in the labour market continued to ease, they remained tighter than was consistent with “inflation at target.”

The class struggle is rarely, if ever, mentioned directly in central bank pronouncements. But like an uninvited guest, it is ever present at their deliberations.

In all the commentary, there are frequent references to the mistakes of the 1970s when the then Fed chief Arthur Burns lowered interest rates. This action, it is maintained, fuelled inflation.

However, the overriding concern arising from that historical experience is that rising prices led to an eruption of major struggles by workers around the world for pay increases that shook the political establishment.

Under conditions of the most significant inflation since then, amid growing financial instability, the fear is that unless such struggles are suppressed through the actions of the trade union bureaucracy, supported by the various pseudo left tendencies, the consequences will be even more serious for the entire capitalist order.