Fed chair signals rate hike as ECB expands stimulus

By Barry Grey
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The divergence in monetary policy between the US central bank and its European counterpart was starkly on display Thursday. Federal Reserve Chairwoman Janet Yellen, testifying before the Joint Economic Committee of Congress, strongly hinted at a hike later this month in the Fed's benchmark interest rate. Only hours before, the European Central Bank (ECB) announced a further loosening of its monetary policy.

Yellen painted a rosy picture of a US economy enjoying sustained, if only “moderate,” growth, an improving labor market, and inflation that, while abnormally low, promised to rise toward the Fed's target rate of 2 percent in the medium term.

“The US economy has recovered substantially since the Great Recession,” she told the committee, noting that the official unemployment rate had fallen from a peak of 10 percent in October 2009 to 5 percent in October of this year. She did not mention that the labor force participation rate, a more comprehensive measure of employment, remains at near-record lows.

Nor did she acknowledge, as she had in a speech the previous day to the Economic Club of Washington DC, that in October there were almost 2 million workers who were not accounted for in the official jobless rate because they had not looked for work in the previous four weeks, but who said they wanted and were available for work.

In reality, the US economy remains depressed more than seven years after the 2008 Wall Street crash, with economic growth at about half the average rate for the post-World War II period, millions driven out of the labor market, and millions more relegated to low-wage, temporary or part-time jobs.

Yellen’s depiction of the state of the US economy was designed to justify beginning to raise interest rates in mid-December, when the Fed’s policy-making Federal Open Market Committee (FOMC) next meets. The Fed has not raised its benchmark federal funds rate for nearly ten years, and has kept the rate at near-zero since December of 2008. This, along with trillions in tax-payer bailouts and trillions more in Fed asset-purchases (“quantitative easing”), has provided an endless flow of virtually free credit to the banks and the financial elite, fueling a three-fold rise in the stock market and record profits and executive pay packages.

These policies on the part of the Federal Reserve and the Obama administration have effected a historically unprecedented redistribution of wealth from the bottom to the top and an immense growth in social inequality. The so-called “recovery” has been a bonanza for the rich and the super-rich, but a disaster for the working class.

It has been, moreover, a “recovery” based almost entirely on financial parasitism and speculation, at the expense of society’s infrastructure. As the International Monetary Fund noted last April, corporate investment in production in North America and Europe has fallen by 25 percent during the supposed recovery. Meanwhile, entirely parasitic activities such as stock buybacks and corporate mergers are proceeding at a record pace.

Just two days before Yellen’s testimony, the Institute for Supply Management reported that US manufacturing activity fell in November to its lowest level since June 2009. As for inflation, the overall consumer price inflation rate for the past year of 0.25 percent bespeaks an economy hovering on the edge of Depression-era deflation.

Yellen concluded her testimony by saying she “looked forward” to initiating an increase in interest rates, as that would testify to the success of the US economy in overcoming the impact of the financial

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crash of 2008.

But, as she made clear, such a move would not mean an end to the easy-money policy that has fueled the further enrichment of the ruling elite. Over the months of talk of a rate hike, Yellen has been at pains to reassure Wall Street that the increases will be small and gradual and there will be no return to the level of rates that prevailed for most of the post-World War II period.

On Thursday, she told the congressional committee: “Of course, even after the initial increase in the federal funds rate, monetary policy will remain accommodative…the Committee anticipates that even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the [FOMC] views as normal in the longer run.”

She warned that keeping rates at near-zero too long could result in sharper increases down the road and made the additional warning that a continuation of the present policy could “encourage excessive risk-taking and thus undermine financial stability.” That this is a mounting concern was underscored by a report released Monday by Standard & Poor’s noting that an indicator of default risk for junk bonds had risen to levels not seen since September 2009. The report said the “distress ratio” reached 20.1 percent in November and the actual default rate rose to 2.71 percent.

In the course of the hearing, Yellen suggested that getting interest rates off the floor was also necessary to provide the Fed with more ammunition, in the form of future rate cuts, to stimulate the economy should the tenuous “recovery” collapse.

US economic growth remains anemic in large measure because the global economy is slowing, shrinking export markets and demand for goods. At the same time, the Fed’s plans to begin tightening monetary policy are driving up the exchange rate of the dollar, which has risen 12 percent over the past year against a basket of currencies, further depressing US exports.

Moreover, a rise in US rates will exacerbate the crisis of emerging market economies from Brazil to Indonesia to Turkey that are already reeling from the slowdown in China and falling commodity prices. Higher US rates and a higher dollar will speed up the flow of capital out of these countries into the US.

Europe is even more depressed than the US. Gross domestic product growth in the euro zone is negligible, unemployment is in the double-digits, and inflation is barely in positive territory, coming in at 0.1 percent in November.

On Thursday, the ECB announced a further cut in its deposit rate—the interest it charges to banks that deposit money with it—from minus 0.20 percent to minus 0.30 percent. This move is designed to force banks to invest more of their money and take greater risks.

ECB President Mario Draghi followed this up with the announcement that the central bank would extend its current program of quantitative easing, to the tune of 60 billion euros a month, for at least six more months—to March 2017 “or beyond, if necessary.” Draghi added that the ECB was “willing and able” to act further if needed.

In the run-up to the ECB meeting, Draghi had stressed that the current expansion in the euro zone is the weakest in more than 25 years, and the central bank’s chief economist, Peter Praet, had warned of “seeping pessimism” in Europe and a “reluctance to invest” on the part of business.

The financial markets were disappointed that Draghi did not go even further in pumping money into their coffers and responded with a sharp stock sell-off in the UK, France and Germany. In the US, the markets were down by well over 1 percent.

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