US Fed opens the way for September rate cut

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31 July 2024

The US Federal Reserve has maintained its interest rate at what it calls the "restrictive" level of 5.25 percent, but has sent a strong signal that it could make a cut at its next meeting in September in line with the demands of financial markets.

Wall Street responded by saying "message understood," with the tech-based NASDAQ index rising by 2.6 percent and the S&P 500 by 1.6 percent.

The prospect of an interest rate cut was not contained in Fed chair Powell's prepared statement for the press conference following the meeting yesterday, but in remarks during the question-and-answer session.

"The broad sense of the committee is that the economy is moving closer to the point at which it will be appropriate to reduce our policy rate," he said. "A reduction in the policy rate could be on the table as soon as the next meeting in September."

To emphasise that a rate cut was very much on the agenda, Powell suggested that at least one member of its governing body was in favour of lowering rates immediately.

Jamie Patton, a high-level operative at a Los Angeles-based asset management firm, told the *Wall Street Journal* the revelation "was big because if they were seriously talking about whether or not to go in July, September seems like a done deal unless we get something crazy between now and then."

While foreshadowing a move in September, Powell declined to be drawn on whether this would mark the start of the series of rate cuts at subsequent meetings in November and December.

The main thrust of the Fed's policy statement and of Powell's prepared remarks was to prepare the ground for a rate reduction with a focus on the so-called dual mandate of the Fed—that is, to maintain price stability and ensure maximum employment "for the American people."

The Fed statement said that the committee was "attentive to both sides of its dual mandate" and cut out the language it has used for the past two years that it was "highly attentive" to inflation risks.

Maintaining the balance between the two aspects of the dual mandate was the central theme of Powell's comments with the focus on labour market conditions.

Supply and demand in the labour market have "come into better balance" and "nominal wage growth has eased over the past years and the jobs-to-workers gap has narrowed," he said. A broad set of indicators suggest that conditions in the labour market have returned to about where they were before the pandemic.

"As the labour market has cooled and inflation has declined, the risks to achieving our employment and inflation goals continue to move into better balance. Indeed, we are attentive to the risks to both sides of our dual mandate."

Like all the other institutions of the capitalist state, the Fed always presents its policy decisions in terms of serving the interests of the people in order to cover over and obscure their real class content.

The Fed initiated its so-called fight against inflation, lifting interest rates to their highest level in 20 years. This was driven by fears that the surge in prices resulting from the pandemic, which was seized on by major corporations to engage in profit gouging, would lead to a major movement in the working class on wages.

That movement took place, but to a great extent it was suppressed with the imposition of sub-inflationary wage agreements by the trade union bureaucracy, resulting in significant cuts in the living standards of workers.

Together with the rise in the unemployment rate to 4.1 percent, an increase of 0.7 percentage points, the Fed is now in a position where it feels it can start to accommodate the demands of financial markets for a return to cheaper money.

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The focus on the labour market in determining the extent of future rate cuts—investors are expecting a September cut to be followed by two more in November and December—was highlighted by comments by Michael de Pass, global head of rates trading at Citadel Securities to the Journal.

"What speeds up the cycle is weakness in the labour market, and what slows down the cycle is stickiness on inflation," he said.

In other words, to the extent that unemployment goes up and there is downward pressure on wage demands, cheaper money can be made available to finance capital. That is the real dynamic, not the needs and interests of the "American people."

There was also another significant interest rate decision yesterday, in the opposite direction to that signaled by the Fed.

The Bank of Japan (BoJ) announced an increase in its base rate to 0.25 percent, the highest level since the global financial crisis of 2008. It also outlined plans to halve its bond buying program in order to tighten its monetary policy.

The move came after significant pressure from the government on the central bank to pull back its ultra loose monetary policy, which is pushing down the value of the yen in currency markets.

There is by no means universal support for the move, because of fears that it will cause a further contraction in the Japanese economy, where growth was negative for the first three months of the year.

"It's extremely disappointing that the BoJ has chosen to act by ignoring weak economic data. It now looks like it moved to counter the weak yen," UBS economist Masamichi Adachi told the *Financial Times*.

"The normalisation of Japan's economy was very precarious to begin with, but the BoJ has made it even more difficult."

The decision may have an impact in currency markets and on the so-called carry trade, in which investors borrow cheaper yen and use them to invest in markets with a higher rate of return. The expected rise in the value of the yen may mean that money starts to flow in the other direction.

There will be another major interest rate decision tomorrow when the Bank of England's (BoE) Monetary Policy Committee (MPC) meets. The expectation is for a cut, but this is by no means certain.

In a speech last month, BoE chief economist Huw Pill pointed to "inflation persistence," noting services inflation and wage growth were rising. He said the MPC had to ensure that monetary policy was sufficiently restrictive to ensure that "the persistent dynamic in recent inflation indicators is squeezed out of the system."

As with other central banks, the BoE will very much be focused on suppressing wages.

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