# US Federal Reserve Decision Not to Raise Interest Rates Fails to Calm Markets

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*The decision by the US Federal Reserve not to raise interest rates at its meeting last week has added to the growing uncertainty and volatility in global financial markets and contributed to the sense that the world's major central bank has no real plan or perspective, but is deciding policy on the run.*

The fallout from the Fed's decision has exposed divisions among the financial elites. On the one hand there is the view that the Fed decision was necessary amid concerns that the downdraft from lower growth in China and other so-called emerging markets could tip the global economy into recession. On the other, there is criticism that Fed decisions are being made in response to stock market turbulence, creating the conditions for major problems in the future.

Richmond Federal Reserve president Jeffrey Lacker, the lone dissenter among the twelve Fed officials who made the decision, said exceptionally low interest rates for an economy with increasing consumption was "unlikely to be appropriate." It deviated from the way the Fed had made decisions in the past and was dangerous because such departures were "risky and raise the likelihood of adverse outcomes."

His views were echoed by St Louis Fed president James Bullard, who does not have a vote on the Fed policy-making body, the Federal Open Market Committee (FOMC), which made the decision. He said it was time to increase rates and policy should not be made in reaction to market turmoil.

Bullard said that had he been a voting member of the FOMC, he would have dissented from the decision not to raise the benchmark federal funds interest rate. There was a "powerful case to be made that it's time to normalise interest rates," he declared.

The Fed could not permanently boost stock prices, he argued, adding that the strategy should be to increase rates gradually, which would provide flexibility. The alternative was not to move until absolutely necessary, and that was "very much a volatility-inducing kind of scenario."

The counter argument was advanced by Atlanta Fed president Dennis Lockhart, who voted in favour of the decision. He cited recent market volatility, while indicating that he would be the "first" to vote for an interest rate rise as "things settle down."

Far from settling down, financial markets and the global economy more broadly are being wracked by increased turbulence under the impact of falling growth in China and the fears of capital flight from emerging markets.

In her press conference following the decision, Fed chairwoman Janet Yellen referred to the uncertain international outlook produced by concerns over growth in China and "volatility in financial markets," leading to an increase in risks.

The market initially responded to the decision with a spike, but then fell into negative territory once the implications of Yellen's remarks were considered. It rose again on Monday—the Dow was up by 125 points—evidence of continuing turbulence.

A report published last week in the *Financial Times* made clear that many of the conditions that led to the financial crisis of 2008 have returned. According to the article, the volume of "mega deal" mergers so far this year has reached an all-time high, exceeding the levels reached in the dotcom bubble and in the years leading to the crash. The total value of attempted $10 billion-plus transactions has now reached $1.19 trillion, beating the previous record set in 1999 on the eve of the dotcom collapse.

Lack of investment in the real economy means that companies seek to maintain and increase shareholder value through essentially parasitic operations—takeovers, mergers and share buybacks—in areas such as pharmaceuticals, consumer products, and telecommunications, financed through the low-interest rate regime of the Fed.

The degree to which market valuations have soared was underlined by an analysis of the expansion of the French telecom group Altice, which has taken over the US firm Cablevision. According to one analyst cited in the report, the stand-alone value of Cablevision was about $8 per share, but Altice paid $34.90.

The fact that such deals depend on an unending supply of ultra-cheap cash from the Fed and other central banks is the source of the tremendous pressure generated to continue the low-interest rate regime, whatever might be the longer-term consequences.

However, those consequences are looming larger in the considerations of those calling for a shift in interest rate policy.

Writing in the *Financial Times*, Andrew Sentance, a former member of the Bank of England policy committee, said that seven years into a "recovery," central bankers needed to explain "why the interest rate playing field is still so heavily tilted to borrowers." If interest rates could not rise now, when could they? There was always a reason for not raising rates, but monetary policymakers were timid, lions that had lost their roar.

"Central bankers," he continued, "appear to lack a clear strategy for monetary policy." A realistic policy would be to gradually lift rates, so that the debate would be over the pace and extent of any increase, not whether it should take place at all.

Other critics say the non-action by the Fed, instead of lessening volatility in financial markets, has actually increased it. According to Kevin Adams at Henderson, a British asset manager, the Fed decision was "frustrating" because it means "more uncertainty, more complexity and potentially more confusion."

While the low interest rate regime significantly benefits parasitical financial activities, it has an adverse impact on pension and other insurance funds, which invest heavily in government bonds and other secure assets. But with the return on these assets being kept down to extraordinarily low levels, the viability of these financial institutions, which have formed a pillar of the financial system over decades, is being called into question. Their liabilities are rising, while the returns they receive on their investments are under increasing downward pressure.

Hence the calls for a return to a more "rational" policy. But the reality is that neither the Fed nor any of the other central banks have such a policy at hand. This is because the crisis of 2008 was not primarily the result of a policy failure, but represented a breakdown in the mode of capitalist profit accumulation. With returns in the real economy in decline, the chief source of profit accumulation has become the growth of parasitism in financial markets.

While the value of American shares has increased by $17 trillion since the bottom of the market in 2009, investment remains at historically low levels, as corporations sit on record amounts of cash, estimated to be as much as $2 trillion for non-financial companies.

According to the International Monetary Fund, the central problem in the global economy is that investment levels are still some 25 percent below where they were before the financial crisis, with no sign of any upturn. The deepening malaise of the global economy caused by this breakdown is revealed in global trade figures, a key indicator.

In the immediate aftermath of the financial crisis, global trade plummeted—at one point falling at a rate comparable to the contraction in the early 1930s. But then it recovered. However, the recovery petered out in 2010, and since then it has been rising at an annual rate of just 2 percent, well below the level of 6.5 percent in the years before the crisis.

A recent study by the Reserve Bank of Australia has pointed to one of the central reasons. It noted that business investment is usually the most trade-intensive component of demand. However, "the continuing weakness in business investment … is likely to have slowed growth in global trade in the post-crisis period."

Writing on the *Business Spectator* web site, columnist Callam Pickering noted that global trade growth would remain subdued unless business investment returned to pre-crisis levels and global uncertainty was lower. "Neither scenario is likely in the near term, particularly with regard to business investment," he noted.

This points to the fact that the inability of the Fed and other central banks to devise a coherent policy and their obvious fear that even a small rise in interest rates could set off a financial storm are rooted in fundamental shifts in the very foundations of the global capitalist system.