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[www.afgazad.com](http://www.afgazad.com)

[afgazad@gmail.com](mailto:afgazad@gmail.com)

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Nick Beams

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## ***After inflation hike, US Fed set for major interest rate increase***

The rapid rise in US inflation, which has hit an annual rate of 9.1 percent, has put an interest rate hike of 1 percentage point (100 basis points) squarely on the table for the next meeting of the policy making body of the US Federal Reserve at the end of this month.



Acting US Federal Reserve Chair Jerome Powell announces interest rates increase on March 16, 2022 (Source: CSPAN)

The inflation rate acceleration, which is sending shock waves through the global economy, came in well above market expectations of an 8.8 percent rise. Reflecting broader market sentiment, economists at the Japanese financial firm Nomura issued a note saying they expected a 100-basis point rise.

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[afgazad@gmail.com](mailto:afgazad@gmail.com)

“Incoming data suggests the Fed’s inflation problem has worsened, and we expect policy makers to react by scaling up the pace of hikes to reinforce their credibility,” they said.

Speaking after the inflation numbers came out, Atlanta Fed president Ralph Bostic said, “everything is in play,” repeating the phrase when asked whether that included a full percentage point rise.

Across the 49th parallel, the decision by the Bank of Canada yesterday to lift its key interest rate by 100 basis points, contrary to market expectations of a 75 basis-point increase, indicated the direction in which central bank policy is heading everywhere. In its monetary policy statement, the central bank made clear the target of its policy is to suppress wage demands to prevent a wage-price spiral.

This was also the theme of a blog post issued by the managing director of the International Monetary Fund (IMF), Kristalina Georgieva on the eve of the meeting of G20 finance ministers being held in Bali, Indonesia.

She noted there was already a synchronized tightening of monetary policy by central banks, but more was required, and they would “need to continue to tighten monetary policy decisively.”

“This is especially urgent where inflation expectations are starting to de-anchor. Without action, these countries could face a destructive wage-price spiral that would require more forceful monetary tightening, with even more harm to growth and employment.”

As the IMF and all central bankers well know, the price surge has not been caused by elevated wage rises—data from every country, including the US, reveal that real pay levels are being cut by price hikes. And they also know that lifting rates will not bring down price rises. Monetary policy tightening is a pre-emptive strike against workers striving to lift their wages in the face of the highest inflation in four decades.

After their refusal to deal with the pandemic, leading to a supply chain crisis, and the flooding of financial markets with trillions of dollars over the past decade and a half set off the inflation spiral, governments and the institutions of financial capital are dictating that the working class the world over must be made to pay by having their wages cut still further, if necessary, by means of a recession.

Georgieva said it was “going to be a tough 2022—and possibly an even tougher 2023, with the increased risk of recession.” The IMF was preparing to shortly revise down its projections for global growth both for this year and next. Since the G20 last met in April, the economic outlook had “darkened significantly” and “multiple crises facing the world have intensified.”

Less developed countries are already being heavily impacted as the deepening crisis in Sri Lanka indicates.

As economic analyst Mohamed El-Erian noted in a comment published in the *Financial Times*: “They now face a further tightening of global financial conditions, as well as increased dollar appreciation [because of the interest rate hikes in the US] that aggravates their imported inflation and risks destabilising their debt sustainability and the domestic financial markets.”

El-Erian essentially dismissed suggestions that if inflation numbers started to come down the crisis would somehow pass, pointing to “the damage already unleashed and that which is to come.”

While less developed countries are the first in the firing line, the crisis is reaching into the heart of the major economies. The US bond market, the basis of the global financial system, is already in turmoil with the yields or interest rates on two-year Treasury bonds now consistently above those on the 10-year.

This so-called yield curve inversion, which is contrary to the situation in “normal” conditions, is widely regarded as a sure indicator of a developing recession.

The rise in the US dollar is causing major shifts in currency markets, leading to a fall in the value of the euro to just above parity with the US dollar. This development is throwing the monetary policy of the European Central Bank awry.

The fall in the euro, which lifts the price of imports, is further fuelling inflation on top of the price hikes caused by the escalation of energy prices which has lifted the euro zone inflation rate to 8.1 percent—far above the ECB’s target of 2 percent.

The ECB, like other central banks, is moving to lift rates to counter wage demands but it is operating in a situation where a rapid hike could lead to so-called “fragmentation” in which the gap between the yield of the bonds issued by more indebted countries, such as Italy, sharply diverge from those issued by the stronger economies, principally Germany.

When this divergence emerged in the euro zone banking crisis of 2012 it threatened the existence of the single currency.

Following the Fed’s interest rate hike of 75 basis points in June, the ECB convened an emergency meeting to try to devise a mechanism to prevent a recurrence. No details have been released with a report to be present to the meeting of the ECB’s governing body at the end of the month.

Noting the sharp drop in the value of the euro against the US dollar – a depreciation of some 12 percent since the start of the year and that the dollar-euro exchange rate is “the most important in the world,” an editorial in the *Wall Street Journal* warned that “sharp movements in exchange rates create uncertainty and can lead to economic and financial instability.”

Several factors had contributed the plunge in the euro but the most important was the divergence between monetary policy in the US and Europe. This lack of coordination, it said, meant that Italy’s lack of funds “could become the least of everyone’s problems” as the risks embodied in exchange rate shifts weigh on “financial stability, and on the Main Street economy.”

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