INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Federal Open Markets Committee meeting, US Fed. 15-16/6/2021.

Fed expects current inflationary surge to be transitory

In the year to May, consumer price inflation in the USA hit 5%, the highest reading since August 2008. Fuel and transportation costs recorded the biggest increase but virtually every sector of the economy saw prices rising above the Fed's 2% target. Even though these prices refer to the Consumer Price Index rather than the Fed's preferred Personal Consumption Expenditure index (PCE), it is very apparent that inflation is well above target. Factory gate prices rose by 6.6%, an increase on April's figure of 6.2%. This suggests that consumer prices could rise at an even rate in the coming months. Nevertheless, at the latest meeting of the Federal Open Markets Committee, a week after the inflation figures were published, no monetary tightening was announced. Fed Funds rates will stay at 0% to 0.25% and the Fed will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage‑backed securities by at least $40 billion per month.

The press release following the FOMC meeting acknowledged the strong recovery in the US economy, where the number of deaths from and cases of coronavirus is falling with more states, including California, now easing restrictions. However, after denying that its loose monetary policy and the monetisation of the substantial fiscal stimulus would be inflationary, the Fed has now changed its tune, yet nonetheless claiming that the current spike in inflation merely reflected "transitory factors". The very accommodative monetary policy therefore needs to be continued as unemployment must fall further and inflation ought to remain above its 2% target for a sustained period before there could be any talk of "tapering".

Current Fed projections are that median inflation levels for 2021 as measured by the PCE index will be 3.4%, before falling back to 2.1% in 2022. As the special money note from the Tim Congdon and Juan Castañeda points out, the FOMC, along with the majority of economists worldwide, take very little interest in the quantity of money when assessing the economy. However, there is ample evidence to suggest that money does matter and that inflation is likely to be considerably higher in the next 1-2 years than the Fed's current predictions. In the three months to April, the quantity of money grew at an annual rate of 10.6%, which is likely to be inflationary even without any upturn in bank lending or the imminent increase in the velocity of money as consumers spend their excess cash accumulated over the past year.

Rather surprisingly given the dovish long term inflation forecasts, a majority of FOMC members expect that two rate rises will be required in 2023 and seven out of the 18-strong committee expect rates to go up in 2022. The Institute of International Monetary Research expects inflation to remain between 5% and 10% for much of the next 18 months unless monetary policy is tightened before then. There is currently no sign whatever of this happening. Even the more hawkish members of the FOMC are seriously underestimating the likely scale of inflation in the months ahead.

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