INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Federal Open Market Committee meeting, US Fed. 3-4/11/2021

Fed finally announces its tapering programme

After hinting strongly at its previous meeting in September that a "tapering" of asset purchases may not be too far away, the Federal Reserve's Open Market Committee provided some further details after its meeting on 3rd - 4th November. This month, the Fed will reduce its purchases of Treasury securities by $10b. and its purchase of agency mortgage-backed securities by $5b. Further reductions by the same amounts will also take place in December, but although further similar reductions are pencilled in for the early months of 2022, the Fed stressed that it is "prepared to adjust the pace of purchases if warranted by changes in the economic outlook". At the ensuing press conference, Chairman Jerome Powell insisted that the reduction in the monthly asset purchase programme did not imply that a rise in the Fed Funds Rate was on the cards any time soon. He acknowledged that inflation remained above target but insisted that once supply chain bottlenecks had been addressed, it would fall back.

With some form of tapering announcement widely expected, the reaction of the markets was fairly muted. The yield on US Treasuries nudged up, but not to any significant degree. The Institute of International Monetary Research does not expect that high inflation will prove as transitory as Mr Powell and his colleagues at the Fed expect. We believe that yesterday's announcement is only going to have a marginal effect on consumer price inflation as broad money growth, the true cause of high consumer price inflation, will still be much too high if the Fed wishes to see prices going up by only 2% per annum. In 2018, when US inflation was moderately higher than target, average monthly broad money growth was just under $58b. By contrast, the figures or August and September 2021 were $289b. and $172b. respectively. A modest $15b. monthly reduction in asset purchases could easily be offset by an increase in lending by US banks (bank lending creates new deposits, which are money) Indeed, an uptick in bank lending may already be under way. According to data from the Fed, "Loans and leases in bank credit" rose by $60b. between September 29th and October 20th after increasing by a mere $7b. between March and July 2021.

It therefore looks as though the annual rate of US inflation, which currently stands at 5.4% as measured by the CPI, could rise even higher before the end of the year. If inflation expectations remain high, this will feed into demands for higher wages, which are already increasing by nearly 10% per annum, making it even harder for the Fed to bring inflation under control without precipitating a recession.

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