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Federal Open Market Committee meeting, US Fed. 14-15/12/2021

Fed increases the taper, but is it enough?

Since the last FOMC meeting, US consumer price inflation has risen further, rising to 6.8% in the year to December, the highest value since June 1982. The Fed has insisted for much of 2021 that inflation would only be transitory and would subside once supply chain issues were resolved. However, in a speech tosession of the US Senate banking Committee on 30th November, Fed Chairman Jay Powell admitted that it was "time to retire" the word "transitory" when discussing inflation. He predicted that the country would suffer from high inflation well into 2022, but added that he would "use our tools to make sure that higher inflation does not become entrenched." Given these comments, there were few surprises at the announcement after December's FOMC meeting "taper" of the asset purchase scheme, which began in November, will be stepped up from $15b. per month to $30b per month in January, with the asset purchases stopping altogether in March 2022. The Fed Funds Rate remains unchanged.

While this is a step in the right direction, broad money growth remains too high to be compatible with an inflation target of 2%. In the three months to October, US M3 grew 10.3%. The taper might reduce broad money growth, but on the other hand its effects may be countered if lending by US banks continues on an upward path. After months of sluggish growth, US bank lending (or "loans and leases in bank credit" as the Fed calls them) increased from just over $50b. in October to over $80b. in November. Given there is often an 18-24 month time lag between a surge in broad money growth and inflation, prices are likely to rise at an even faster rate in 2022, with 10% inflation possible. The Fed has revised its inflation forecast for 2022 upwards, but still thinks that inflation will fall to 2.6% in 2022. This is likely to be very wide of the mark and there is a danger of a rapid tightening if inflation continues to overshoot, causing a sharp decline in broad money growth which in turn could result in a significant slowdown in 2023 or 2024.

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