INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Federal Open Market Committee meeting, US Fed. 25-26/01/2022

Fed Funds Rate likely to rise, but not yet.

US consumer price inflation rose to 7% in the year to December, the highest value since June 1982. This figure was weighing heavily on the minds of the FOMC during its meeting on 25th-26th January. No new initiatives were announced. The "taper" of the asset purchase scheme will continue as planned, with the asset purchases stopping altogether in March 2022. The Fed Funds Rate will continue at its historic low of 0.25% for now, although in the ensuing press conference, Fed Chairman Jay Powell commented that the FOMC had "stated its expectation that an increase in this rate would soon be appropriate." This was not a definite commitment to raise rates at its next meeting in March, as some commentators have stated, although such a move would appear to be quite likely.

In the press conference, Powell stated that the surge in cases of the Omicron coronavirus variant which the USA is currently suffering would slow the US recovery down, albeit only for a brief period. It is unlikely to slow down the surging inflation because this is the result of almost two years of very high broad money growth. December's figures for US M3 have recently been published by the Shadow Government Statistics organisation (the Fed ceased publishing these numbers in 2006) and they indicate that in the final quarter of 2021, broad money increased at an annual rate of 10%. December itself saw M3 grow by $148b.; the smallest increase since July but still an increase of over 0.5% and higher than the average monthly increase during 2019, when broad money growth was already starting to rise above levels typical of the decade beginning in 2010.

Powell made no mention of money, reiterating instead the familiar line that high inflation has been caused by "bottlenecks and supply constraints" which "have been larger and longer lasting than anticipated." He insisted that the FOMC would be "attentive to the risks that persistent real wage growth in excess of productivity could put upward pressure on inflation", but nonetheless predicted that inflation would decline over the course of the year. In common with other central banks, the Fed has significantly underestimated the inflation risks posed by the surge in broad money growth during 2020-21. The monetary data suggests that Powell's optimism for 2022 is also likely to be misplaced. Milton Friedman observed that the time lag between a sharp increase in the money supply and the resultant inflation was often in the order of 18-24 months. Given that broad money growth actually accelerated in the final quarter of 2021, suggesting that inflation could rise higher this year. Indeed, a figure of 10% cannot be ruled out. In a developed economy, broad money should be growing at no more than 5% if a 2% inflation target is not to be overshot. US M3 is currently growing at twice that rate and although the "taper" would in itself slow broad money growth, this could well be countered by a sharp increase in new bank lending, which after only rising by 3.5% in the year to September, has suddenly accelerated sharply to increase by no less than 14.8% in the year to December.

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