INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Federal Open Market Committee meeting, US Fed. 14-15/05/2022

FOMC raises the Fed Funds Rate again – this time by 0.75%.

Any hopes that inflation may have already peaked when the annual increase in consumer prices fell from 8.5% in March to 8.3% in April were dashed when May's data were published. The 8.6% inflation rate was the highest since December 1981. It is unsurprising that the Federal Open Market Committee voted for a further increase in the Fed Funds Rate at its meeting on 14th – 15th June. The size of the increase, 0.75%, takes the cost of borrowing to 1.5% - 1.75%. Inflation has become a political "hot potato", perhaps because it is such a long time since US households experienced such a rapid increase in prices. President Biden summoned Fed Chairman Jay Powell and Treasury Secretary Janet Yellen to a special meeting on 31st May to discuss inflation, stating that fighting it was his top priority. Even without this additional pressure from the White House, several Fed officials have indicated their support for a sharp increase in borrowing costs in the hope that it will bring inflation down. For example, James Bullard, President of the St Louis Fed, indicated his desire to see the Fed Funds Rate increased to 3.5% by the end of the year. The FOMC also reaffirmed its commitment to shrink its balance sheet. For three months beginning 1st June, $30b. worth of Treasuries and $17.5b. of mortgage-backed securities will be "run off" - in other words, the Fed will not reinvest the money when they mature - and from 1st September, these quantities will be doubled. Powell warned that a further 0.5% - 0.75% rate rise could be expected at the next meeting, which is scheduled for July 26th – 27th.

Powell also stated that "we have both the tools we need and the resolve it will take to restore price stability." However, as usual, no mention was made of the quantity of money. In April, according to the Shadow Government Statistics, US M3 declined by $1b., bringing down the annualised quarterly growth rate from 6.1% in March to 2.8%, the slowest rate of increase since November 2018. It is now looking increasingly likely that in order to be seen to be "doing something" about inflation, the Fed will cause broad money growth to crash. This will very likely lead to a recession in 2023 or 2024. The cause of the current inflationary spike was the massive increase in broad money in 2020, when it accelerated at a rate unparalleled since the end of the Second World War. The Fed's actions are thus unlikely to slow the rise in consumer prices in the short term. Furthermore, higher inflation figures in the coming months may result in the FOMC raising the Fed Funds Rate even more rapidly and sharply than it currently plans. The current inflation projections expect the Fed's Personal Consumption Expenditures index (which it prefers to the Consumer Price Index) to drop back to 2.6% next year, which, based on our analysis of monetary data, looks to be excessively optimistic. Regrettably, given the thinking of the FOMC, in the next two years the USA looks destined to go from a "boom" to an equally serious "bust".

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