Federal Open Market Committee meeting, US Fed. 20-21/09/2022

FOMC goes for third consecutive 0.75% increase in the Fed Funds Rate.

The Fed Funds Rate has now been raised from zero to 3% - 3.25% since the start of the year and it may not be the last increase of 2022. “We have got to get inflation behind us. I wish there were a painless way to do that. There isn’t” said Fed Chairman Jerome Powell after last week’s meeting of the Federal Open Market Committee, which included an unanimous vote to hike the cost of borrowing by a further 0.75%. No new statement was forthcoming about the “run off” assets purchased during 2020. As from this month, the money from $60b. worth of maturing Treasuries and $35b. of mortgage-backed securities will not be reinvested. This could cause a decline in broad money growth of as much as $50b. each month. According to the Shadow Government Statistics agency (which has published M3 figures since the Fed stopped doing so in 2006), broad money growth has slowed significantly since March. In the three months to August, broad money grew at an annualised rate of only 1.5%. The higher borrowing costs have so far failed to deter either businesses or households from taking out new loans and the US property market remains very strong. However, such a contractionary monetary policy by the Fed is likely to result in a significant slowdown, even if the worst effects of it will not be felt until 2023 or 2024.

From a political point of view, the desire to curb inflation as quickly as possible is easy to understand. If inflation expectations remain high for any length of time, they lead to demands for higher pay rises, creating a vicious circle of higher wage-price inflation. However, it takes time for changes in broad money growth to be reflected in consumer prices. Whatever the scale of the Fed’s rate hikes, therefore, any resultant fall in inflation is not going to manifest itself for several months. A decline in oil prices saw US consumer price inflation fall from 8.5% in the year to July to 8.3% a month later. Underlying inflationary pressures are nonetheless still strong, as the “monetary overhang” from the combined fiscal and monetary stimuli of 2020 – 2021 has not fully dissipated yet. Sooner or later, however, the steep decline in US M3 will be felt by the wider economy and the inflationary episode will come to an end, only to be replaced by a recession.

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