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INTERNATIONAL
MONETARY RESEARCH

Federal Open Market Committee meeting, US Fed. 02-03/05/2023

Fed Funds rate increased by 0.25% but may pause for now.

The Federal Open Market Committee voted unanimously to increase the Fed Funds Rate by 0.25% during its meeting at the start of May. The cost of borrowing has now been raised from zero to 5% - 5.25% since the start of 2022 and now stands at its highest level since 2007. The problems which have surfaced in several US banks since the start of the year have led to widespread speculation that the FOMC may well pause the increases to the cost of borrowing – indeed, this tenth rate hike may well be the last. Unlike the statement following March's meeting, there was no mention that "some additional policy firming may be appropriate" to bring inflation under control while in the ensuing press conference, Governor Jay Powell said the bank was "getting close or maybe even there" when it came to pausing its rate-hike campaign although he emphasized that the Fed was prepared to take further action if the situation so warranted. Inflation is coming down but still remains well above the Fed's 2% target. Prices rose by 5% in the year to March, the ninth consecutive month of decline and the slowest rate of increase since May 2021. Producer Prices (i.e. prices at the "factory gate") rose by only 2.7% in the same period, which suggests that inflation is likely to continue on a downward trend in the coming months.

Indeed, inflation may be the least of the Fed's worries by the end of the year. According to the Shadow Statistics Agency, US M3 declined by a remarkable $336b. (or approximately 1.2%) in March. This figure is much larger than that of any single month during the Great Financial Crisis of 2008-10. M3 has been contracting on an annual basis since the start of 2023, with March's figure 2.2% lower than 12 months previous. Since the start of the year, the annualised fall in M3 is no less than 5.9%. The Fed's own data state that in the four weeks to April 28th, US bank deposits declined by a further €352b., which suggests that a similar, if not larger contraction in US broad money is likely in April. There was no announcement of any change to the Fed's policy of running off the assets purchased in 2020-22, currently by $95b. per month. Furthermore, in spite of the Fed's insistence that the collapse of the Silicon Valley and several other banks do not imply that the US banking sector as a whole is in an unhealthy state, Michael Barr, the Fed's Vice Chair for supervision, has wanted to close what he calls "loopholes" in the regulation of medium sized banks. This essentially means forcing them to hold more capital and thus having less money available to new bank credit.

The US economy has remained fairly resilient so far this year. GDP increased by 1.1% in the first quarter of 2023. Unemployment remains at historically low levels - March's 3.4% being equal to January's 50 year low – and the annual rate of wage growth remains above 7%. Figures like these have prompted Jay Powell and his colleagues to express their hope that the US economy will avoid a recession. There are already hints that such optimism is misplaced. The volume of retail sales has fallen for two consecutive months and the used car market has recorded falling prices for eight consecutive months. House prices are still going up, but the annual rate of increase in the year to March was the lowest since 2014. On the week ending April 28th, demand to purchase a house was 32% lower compared with a year ago. Given the lag between changes in the money supply and their effect on nominal GDP and prices, it is inevitable that the US economy will deteriorate, although possibly not until the latter half of 2023 or even 2024.

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