INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Federal Open Market Committee meeting, US Fed. 11th – 12th June 2024

Fed holds back on reducing the Fed Funds Rate as inflation remains "too high".

The Federal Open Market Committee (FOMC) did not follow he European Central bank in reducing the cost of borrowing when it met on 11th – 12th June. Instead, it once again voted unanimously to maintain the Fed Funds Rate at 5.25% to 5.5%. After the meeting, Fed Chairman Jerome Powell stated that inflation was still too high and that although "considerable progress" had been made to bring it down, the most recent figures had "not given us confidence" to cut rates yet. In June 2023, inflation dropped to 3%, having stood at 9% a year earlier. Since then, in spite of a decline from 3.5% in the year to March to 3.3% two months later, it has stubbornly persisted at over 3%. US broad money peaked in April 2022 and then declined quite sharply in the following year as the Fed combined a series of rate hikes with a run-off of assets (Largely US Treasuries and mortgage-backed securities) purchased from 2020 onwards in response to the coronavirus pandemic. The slowdown in broad money growth came to an end in May 2023 and the annualised M3 growth rate rose as high as 3.7% in July. The improvement in broad money growth was triggered not by any increase in new bank credit but rather because of large-scale monetization of the US Government's enormous budget deficit. Initially, the main purchasers of this debt were Money Market Mutual funds, but since 2024, US commercial banks have become the principal buyers. Growth in new bank credit has picked up, albeit modestly, since the start of 2024 but broad money growth has become rather sluggish in the last two months. The annualised quarterly growth rate fell to a modest 1.3% in April, the lowest reading in 11 months.

The US labour market nonetheless remains resilient. Over 229,000 new jobs were created in May and wages are rising faster than inflation. Unemployment did tick up to 4%, but this is still relatively low by recent historical standards. These employment figures are followed closely by the FOMC and may well have been an additional factor in its decision not to reduce the cost of borrowing, The FOMC did, however reaffirm that it would slow down its run-off of assets. $35 billion in Agency Mortgage-Backed Securities will continue to be run-off each month but the amount of Treasuries has been reduced from $60 billion to $25 billion from 1st June. The stickiness of inflation may be due in part to residual excess cash holdings by US companies and households from prior stimulus measures and the pick-up in broad money growth over the last year may impede any further decline in inflation. Therefore, although many commentators and analysts are still predicting a cut in the cost of borrowing later this year, the persistence of inflation above 3% may result in such hopes being dashed.

Furthermore, above-target inflation combined with slowing broad money growth add weight to the concerns that the US economy may be about to enter a period of "stagflation". Although US GDP expanded at a respectable annual rate of 1.6% in the first quarter of 2024, the future trajectory for the economy is not particularly positive, especially as there are significant concerns about the ballooning US budget deficit as well as the monetary data.

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