The Daily Dish

Decision Day for the Fed

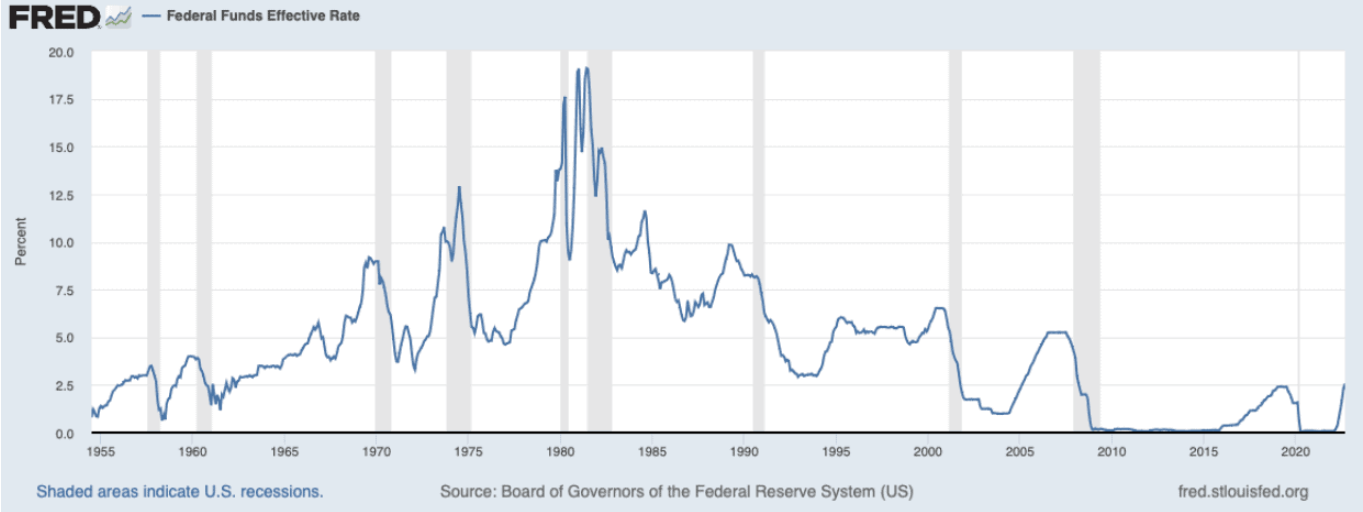
DOUGLAS HOLTZ-EAKIN | NOVEMBER 2, 2022

Raise the target range by 75 basis points to 3.75–4.00 percent. That's what the Fed will announce today as its latest decision on interest rate policy. No mystery. 75 basis points. No guesswork. 75 basis points. No dissents. 75 basis points. There is more suspense in whether a cover of "Freebird" will contain a guitar solo.

Then the fun will begin. What will be the future path for the remainder of 2022? How high will the Fed ultimately take the funds rate? (Will it beat the Volcker Fed's 19.25 percent? No.)

There has already been considerable public commentary that the Fed has done too much and that the four consecutive hikes totaling 3 percentage points is out of line with history. Nonsense.

The graph (below) shows the federal funds effective rate. Recall that the federal funds rate is a market-determined interest rate on overnight lending between large banks. The Fed influences the rate by adding, or in this case removing, cash from the market to move the rate lower, or in this case higher, to be in target range. The graph shows the outcome of this process.



Clearly, there have been previous moves of this magnitude or larger, especially in eras of high inflation. More to the point, there is no measure of inflation that is rising at below 4.0 percent, so the real (inflation-adjusted) interest rate remains negative. That's not exactly killer-tight monetary policy.

Clearly, the Fed is not done. It has promised to "keep at it" until inflation is tamed, so rates will keep going higher. The real question is just how quickly inflation will begin to fall, permitting the Fed to moderate its increases. To date, there has been precious little evidence of falling inflation. When will that evidence arrive?