The Daily Dish

The Fed Speaks

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With the arrival of the pandemic, the Federal Reserve cut its policy rate to zero (technically 0 to ¼ percent) and began to purchase a combination of Treasury securities and mortgage-backed securities, the effect of which was to generate a $4-trillion monetary infusion into financial markets. It was an extreme version of monetary stimulus. That was appropriate in April 2020 and maybe even January 2021. The economy expanded strongly, however, and year-over-year consumer price inflation rose from 1.4 percent in January to 7.0 percent in December 2021. The Fed was increasingly out of step with the needs of the economy.

Yesterday, the Federal Open Market Committee (the policymaking body of the Fed) concluded a two-day meeting. There was great anticipation surrounding the Fed's announcement of its policy decisions. What did we learn?

The key paragraph reads: "The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent. With inflation well above 2 percent and a strong labor market, the Committee expects it will soon be appropriate to raise the target range for the federal funds rate. The Committee decided to continue to reduce the monthly pace of its net asset purchases, bringing them to an end in early March. Beginning in February, the Committee will increase its holdings of Treasury securities by at least $20 billion per month and of agency mortgage?backed securities by at least $10 billion per month."

The good news is that the Fed acknowledged it has an inflation problem and a strong economy: "With inflation well above 2 percent and a strong labor market …." The bad news is that it did nothing: "… the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent," adding that, "Beginning in February, the Committee will increase its holdings of Treasury securities by at least $20 billion per month and of agency mortgage?backed securities by at least $10 billion per month." No increase in interest rates and continued asset purchases. It is a conscious decision to remain behind the curve.

The Fed did lay the groundwork for future rate hikes ("it will soon be appropriate to raise the target range for the federal funds rate")—and Chairman Jerome Powell made very clear in his remarks that it is in the interest of both reduced inflation and sustained growth to do so. Further, the Fed indicated that rate increases will be the primary tool for active policymaking and that the reversals of the monetary infusions would take place by a steady, consistent reduction in the size of its balance sheet.