How Fast, How High, How Long

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The Federal Reserve plans to keep raising rates at future meetings, but at a slower pace than it has for the last four meetings. Today the Fed once again voted unanimously to raise rates by three-quarters of a percentage point – 75 basis points (bps) – bringing the target for the federal funds rate to 3.75 – 4.00%, but far more attention is being paid to the path forward from this point. While today's statement was not accompanied by updated rate forecasts from the Fed (our next look at the dot plots comes in December), it's clear a shift is on the horizon.

The Fed statement released today included much of the same text seen following their September meeting, with a few key additions. First, the Fed noted it anticipates ongoing hikes will be appropriate until they have reached "a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time." What level will prove sufficiently restrictive? Nobody – including the Fed – knows. Coming into 2022, the Fed thought that cumulative hikes of 75 basis points (bps) would be enough to quell inflation this year. Then in March it became 175 bps, in June it was 325, and as of September it was 425. During the press conference, Powell said the restrictive level now looks even higher.

The second key addition to today's statement was a sentence that the Fed will take into account the "lags with which monetary policy affects economic activity and inflation." In other words, the Fed is moving towards a more measured pace of rate hikes while they wait to see how this year's actions to-date flow through the system.

These changes set up Powell to clarify during the press conference how they are now thinking about where they need to move on rates, which rests on three questions: how fast, how high, and how long? The Fed has moved quickly to raise rates, after clearly starting late. Now the focus is shifting to the other two questions. How high will rates ultimately have to go and how long will the Fed keep rates elevated to bring inflation into check. While the pace of hikes may begin to slow, they are likely to end higher – and remain there for longer – than was previously anticipated. The fight against inflation is far from done. Today's actions represent a pivot in how they are approaching the fight.

Our biggest concern is that the Fed continues to ignore the M2 measure of the money supply and not one reporter asked a question on the topic. While Powell was questioned on the topic at a recent conference by the Cato Institute, he brushed the idea off and continued to push the same tired model of inflation that has left the Fed well behind the curve and constantly revising forecasts higher.

The bottom line is that it's good the Fed has prioritized the fight against inflation, but it remains overly optimistic in the effectiveness of its policies to get inflation under control. Follow the growth of M2 – which has thankfully slowed and must remain low for the foreseeable future – for guidance on the path forward from here.