Rodney's Take

March 25, 2024

Still Awash in Money

In March 2022, with inflation reaching 9%, the Federal Reserve put its foot down. The central bankers decreed that overnight rates would soar, eventually moving from about 0.20% to 5.50%, and the Fed would squeeze the inflation out of the economy by mopping up the excess cash lying around. To prove it, the bankers announced they would reduce their balance sheet by $95 billion every month but did not define the end date.

Some of it worked, some of it didn't, and some of it never will.

Higher overnight rates eventually roused depositors. They finally figured out they could earn more than 4%, and then more than 5%, by leaving their commercial bank, which had been paying a measly 0.5%. Banks still had cash on hand, although less than before. They were lending but were a bit choosier about borrowers.

As for the Fed's big vacuum to suck liquidity out of the system, how such a thing might go depends where you start. If you have $4.2 trillion on your balance sheet, which the Fed did in January 2020, then selling $95 billion would be a chunk. If you had $7.4 trillion on your balance sheet, like the Fed did in August 2020, not so much. And if you had almost $9 trillion, like the Fed did in August 2022, then $95 billion is barely more than 1% per month. To top it off, the Fed reversed course in March with the bank mini-crisis.

This year, the Fed has reduced its balance sheet by a mere $55 billion per month and yet still has $7.5 trillion on its books. After the last Fed meeting, Chair Powell said that now is the time for the bankers to consider cutting rates… and end reducing the Fed balance sheet. If these were the actions meant to choke the life out of inflation, they were woefully weak.

The Chicago Fed has tracked national financial conditions since 1970, rating them loose (negative), neutral (zero), and tight (positive).

Chicago Federal Reserve National Financial Conditions Index
1970 through March 15, 2024

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The conditions over the last few years tightened up but remained under zero. Now, they are headed down again, which means financial asset—and possibly real asset—inflation.

Goodbye, quantitative tightening, we barely knew you.

Rodney

Got a question or comment? You can contact us at info@hsdent.com