How aggressive will the Federal Reserve (Fed) tighten monetary policy? **May 10, 2022**

At its May meeting, the Federal Open Market Committee (FOMC) voted to raise the Federal funds target rate range by 0.50% to 0.75%-1.00% and signaled similar 50 basis point rate increases would be on the table for the next couple of meetings. Notably, Chairman Powell ruled out the possibility for a larger 75 basis point increase, which may have comforted investors fearful the committee would be overly aggressive in tightening policy. In addition, the committee also announced an end to quantitative easing, and will begin to reduce the size of its balance sheet beginning next month.

A few key takeaways from today's announcement:

1. Inflationary pressures have intensified due to the Russia/Ukraine conflict and COVID-related shutdowns in China, suggesting the committee is woefully behind the curve. Moreover, while the headline growth figure contracted in the first quarter, robust job gains and still strong consumer spending and business investment indicate demand in the economy remains strong.

2. Further half-percent increases in the Fed funds rate are likely over the next couple of meetings. The statement noted that "appropriate firming", or increases, in policy rates will be needed to cool inflation to the committee's 2% target and that "ongoing increases will be appropriate".

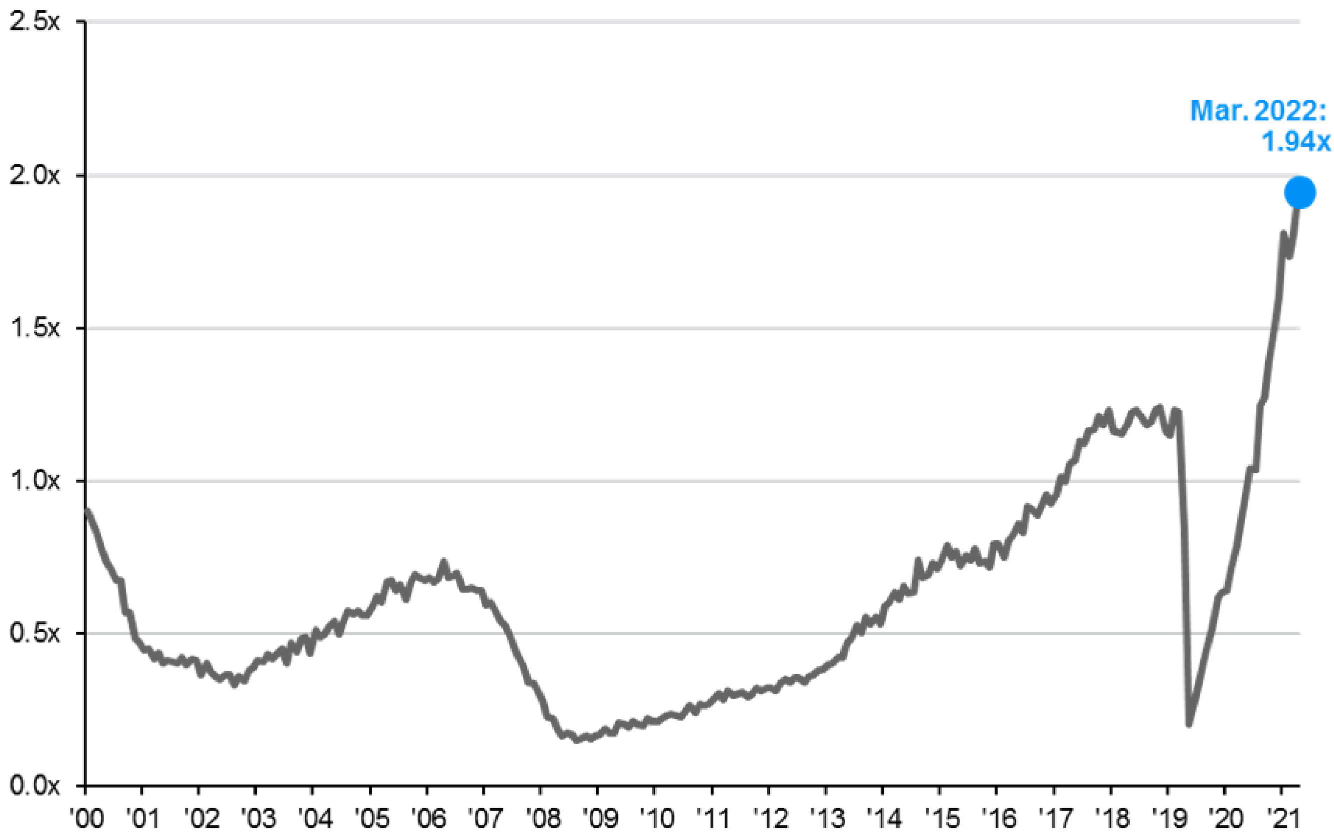
3. The committee will begin reducing the size of its ~$9 trillion balance sheet in June. The Fed will initially reduce the size of its U.S. Treasury holdings and agency mortgage-backed securities (MBS) by $30bn and $17.5bn per month, respectively. These caps will be doubled to $60bn and $35bn per month in September.

Interestingly, it's not just inflation the Fed's concerned about, but also labor demand. As highlighted, job openings climbed to 11.5 million in March, while the number of unemployed persons now stands at 5.9 million, implying that there are nearly twice (1.9x) as many vacancies as there are Americans looking for a job. The Fed feels comfortable raising rates to at least neutral rather quickly so that supply/demand in the labor market is more balanced next year.

To be clear, we expect 0.50% increases at the June and July meeting, and for further 0.25% increases thereafter, suggesting a year end Fed funds target range of 2.50-2.75%. Moreover, further increases next year are likely given it will take time for inflation to come down and labor demand to moderate. That said, while the Fed believes it can orchestrate a "soft-landing", the committee is essentially using a hammer for a procedure that requires a scalpel. Monetary policy is a fairly blunt tool with long and variable lags and the aggressive tightening outlined today, still run the risk of tipping the economy into recession in 2023.

Demand for labor far outpacing supply

Ratio of job openings to unemployed persons, seasonally adjusted



Sources: *Jordan Jackson, Global Market Strategist at J.P. Morgan, May 5, 2022*
Bureau of Labor Statistics, Haver, J.P. Morgan Asset Management, May 4, 2022