QE Infinity and Beyond

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The Federal Reserve has been extremely aggressive since the Coronavirus and related shutdowns hit the US economy and made it clear today that it will continue to be so until the US economy has gotten back on its feet. This includes keeping short-term interest rates near zero, continuing to expand its balance sheet with purchases of Treasury debt and mortgage-backed securities (both residential and commercial), as well as using facilities to maintain liquidity and the flow of credit to households, businesses (both large and small), and state and local governments.

Chairman Powell made it clear at his press conference that the Fed will continue to use the full range of its legal powers "forcefully, proactively, and aggressively" and wants to see an economic recovery that is "as robust as possible."

After the Great Recession, the Fed didn't raise short-term rates again until December 2015, well into the recovery, and when the unemployment rate was 5.0%. Given the Fed's commitment to make sure the economy heals from the current crisis, don't expect the Fed to raise rates for the next couple of years, perhaps not until 2024. As Chairman Powell said at his press conference, the Fed won't be in any hurry to raise rates.

Does this mean higher inflation? Not right away. If anything general price measures will keep falling in the short term due to lower commodity prices. After that, we expect a return of general price increases, but not rampant inflation. Yes, the supply of money is growing by leaps and bounds. But the demand for money by households and businesses has also grown enormously. Cash is King right now and likely to remain so over the medium term. One key issue is how long the federal government maintains very generous unemployment benefits in which a large share of workers can earn more through July by not working than by going back to work. If these benefits remain in place into 2021, we may see faster inflation as the businesses that are growing and hiring need to ramp up wages to entice people back to work. Time will tell.

Looking forward, expect more of the same in 2020: continued expansion of their balance sheet and short-term rates near zero.
