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MAS012710

FOMC OPENS THE DOOR-----a crack!

The Kansas City Fed President dissented today from the prevailing FOMC opinion to leave rates unchanged. That dissent was probably welcomed by other members of the Committee---if for no other reason then it opens the door for future FOMC changes. The central issue is when will policy change? The Committee's statement is presented below with **bold face texts of the previous meeting statement (December 16, 2009)** to permit a brief comparison of Committee views. **There were many (significant) changes in wording and placement. It is doubtful that markets can be certain from this statement how quickly the Fed intends to change its fundamental posture.** The "for an extended period" flag is still flying. Less clear is for how long?

We highlight some of the more important changes from the December 16, 2009 statement.

1. Removes the housing sector improvement statement. Perhaps, recent housing sales figures are beginning to cause some concern at the Fed?

2. Household spending has changed from "appears to be expanding" to just plain "expanding." Retail sales are slightly more robust, but not sufficient to think that a full consumer rebound is in the offing.

3. Business spending is clearly more definitive, but there are still major holdups investing in structures and a decided reluctance to expand payrolls. The FOMC deleted any mention of business inventory changes.

4. For Money Supply devotees, the FOMC noted that the contraction in bank lending was continuing, but financial conditions continued to be "supportive."

5. The characterization of economic recovery changed from the prior, "**remain weak for a time**" to"moderate," a modest improvement it appears.

6. The FOMC cut to the chase, dropping all reference to previous policy actions taken to stimulate the economy to focus on "a gradual return to higher levels of resource utilization in a context of price stability."

7. Substantial slack continues and is likely to (**dampen**) restrain cost pressures and inflation is likely to be (**will be subdued**) subdued for some time.

8. Omitted a qualifier to its security purchase intentions: "The Committee will continue to evaluate (**the timing and overall amounts of**) its purchases of securities in light of the evolving economic outlook and conditions in financial markets. Inherently an ambiguous omission since it is unclear what aspect of its purchases the Committee intends the market to focus on. It could be interpreted to give even greater scope to Fed purchases in the future and leaves open just how much more quantitative easing will be allowed.

Fed watchers focus on changes in language as signals of impending changes in policy, but the numerous changes in phrasing lack clarity as to the timing future FOMC policy changes. It does appear that the dissent filed by Kansas City Fed chief Hoenig was directed at moving the FOMC away from the "extended period of time" doctrine. This dissent opens the door to a policy change without specifically telling the market when the FOMC "should" or "will" move. It could actually give the FOMC much more wiggle room in picking the date for changing the rates, but the opportunity to wiggle also creates another transparency problem. Hopefully, the minutes of the meeting will shed more light on the prospective timing of a policy change.

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Had housing sales, industrial production and mortgage data been far more supportive since the FOMC's December meeting, the FOMC might have well given a more extensive time table for change. Recent macro-stats suggest that the economy's move to a higher and sustainable level of growth is not sufficiently well developed for the majority of members to have them walk the plank on announcing the timing of future changes. That reluctance, however, creates a less than transparent FOMC and in the long run, it is transparency of policy intentions that allows the market to do the heavy lifting arising from changes in monetary policy.

This reluctance to take back some of the monetary juice now circulating is understandable, but it is not necessarily commendable. Even if changes in monetary policy must take into account long and variable lags, the FOMC appears more comfortable with being "late" rather than "early." Thus, there is a contradiction between the consequences of an actual lag in effect and the FOMC's lag in recognition of the true state of the economy. This creates even more opportunities for a non-transparent course of action.

Generally, ambiguity is not the market's friend. The Fed should address the consequences of creating more ambiguity as to the timing of major policy changes. A good opportunity would be the semi-annual Humphrey Hawkins hearings in February. Normally, this would be an opportunity for the Fed to lay out its decision scenario more clearly for the market. Unfortunately, the focus of legislators is politics, not sound monetary economics. Judging by the pillorying of Secretary Geithner today, it is quite easy to see that Bernanke (if he is confirmed) or Kohn (if he is not) will have all each could do to shield the Fed from devastating criticism. Laying out future policy is bound to lose out to the din of Congressional desires to "play to the crowd."

FOMC STATEMENT OF JANUARY 27, 2010

(bold face for statement language of December 16, 2009)

Information received since the Federal Open Market Committee met in December suggests that economic activity has continued to strengthen (**pick up**) and that the deterioration in the labor market is abating. (**Deletes "the housing sector has shown some signs of improvement over recent months"**) Household spending is (**appears to be)** expanding at a moderate rate but remains constrained by a weak labor market, modest income growth, lower housing wealth, and tight credit. (**Businesses are still cutting back on fixed investment, though at a slower pace, and remain reluctant to add to payrolls; they continue to make progress in bringing inventory stocks into better alignment with sales.**) Business spending on equipment and software appears to be picking up, but investment in structures is still contracting and employers remain reluctant to add to payrolls. Firms have brought inventory stocks into better alignment with sales. (**Financial market conditions have become more supportive of economic growth.**)While bank lending continues to contract, financial market conditions remain supportive of economic growth. Although the pace of economic recovery is likely to (**remain weak for a time**) be moderate for a time, the Committee anticipates (**that policy actions to stabilize financial markets and institutions, fiscal and monetary policy stimulus, and market forces will contribute to a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability**) a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack continuing to(**dampen**) restrain cost pressures and with longer-term inflation expectations stable,(**the Committee expects**) inflation (**will remain subdued**) is likely to be subdued for some time.

The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve is in the process of purchasing $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt. In order to promote a smooth transition in markets, the Committee is gradually slowing the pace of these purchases, and it anticipates that these transactions will be executed by the end of the first quarter. The Committee will continue to evaluate its purchases of securities in light of the evolving economic outlook and conditions in financial markets.

In light of (**ongoing improvements**) improved functioning of financial markets, the Federal Reserve will be closing the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Term Securities Lending Facility on February 1, as previously announced. In addition, the temporary liquidity swap arrangements between the Federal Reserve and other central banks will expire on February 1. The Federal Reserve is in the process of winding down its Term Auction Facility: $50 billion in 28-day credit will be offered on February 8 and $25 billion in 28-day credit will be offered at the final auction on March 8. The anticipated expiration dates for the Term Asset-Backed Securities Loan Facility remain set at June 30 for loans backed by new-issue commercial mortgage-backed securities and March 31 for loans backed by all other types of collateral. The Federal Reserve is prepared to modify these plans if necessary to support financial stability and economic growth.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman; James Bullard; Elizabeth A. Duke; Donald L. Kohn; Sandra Pianalto; Eric S. Rosengren; Daniel K. Tarullo; and Kevin M. Warsh. Voting against the policy action was Thomas M. Hoenig, who believed that economic and financial conditions had changed sufficiently that the expectation of exceptionally low levels of the federal funds rate for an extended period was no longer warranted.