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MAS050404

The End of Patience

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 1 percent.

The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity. The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid rate ***and hiring appears to have picked up. Although incoming inflation data have moved somewhat higher, long-term inflation expectations appear to have remained well contained*.**

The Committee perceives the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. ***Similarly, the risks to the goal of price stability have moved into balance. At this juncture, with inflation low and resource use slack, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured.***

The Changes:

1)The FOMC deleted the following sentence from the March 16th meeting. "Although job losses have slowed, new hiring has lagged. Increases in core consumer prices are muted and expected to remain low." The evidence since then has revealed better hiring—in so far as we can rely on the very few datapoints and the "intentions" that get revealed in the various Surveys---and the inflation picture has clearly changed, albeit not alarmingly so. Any Central Bank that failed to pay attention to changes in price levels and the rate at which prices are changing, would fail at its central mission. Deflation fears notwithstanding, the Fed is telling the market what it is watching: employment and price acceleration.

2) The FOMC deleted the following sentence from the third paragraph of the March 16 meeting. "The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation." We think the Fed is telling the market its view of deflation has changed significantly. It is no longer on the table as an ingredient to decisions going forward. (Downside) risks are now being converted to the risk between 'stability' and 'upward instability.' Still, the new sentence tells the market that current measures of inflation are "low" and there is still resource "slack." As we have said before, "slack" is not a precise concept and if prices and perhaps nominal wages start to accelerate upward, the Fed can move and likely will move.

Measured Moves: Herein lies the Fed's attempt to 'communicate' a new policy tilt. The Market has been debating the probability of a one-step-two-step.,..stepladder approach to forthcoming interest rate rises. Since the Fed cannot be sure how fast "slack" disappears or how quickly inflation 'accelerates,' it needed to disabuse the market of the assumption that once it starts, it will continue to move based on the evidence. And it has left itself some Greenspanian ambiguity in the adverb that describes its future pace, "measured." Step laddering is not ruled out nor in. The Yellow Light is on---but it is not a Red Light. There is no commitment that a June increase is foreordained. Nor is there a commitment that a single rate move will force the Fed to keep raising to some well-defined goal. All that is promised is that the pattern of change will be "measured." We think that an inference of this stance is that the Fed does indeed care about abrupt asset value changes. It is signaling the Market not to rush to a pronounced downward path for asset values before it is abundantly clear to the Fed that the dual mandate—employment and prices---can be met. To paraphrase an old advert: 'The Fed will sell no rate change before its time!' Nor will it sit patiently if inflation breaks out! It will measure and pour.

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