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Fed Dilemma: who's crying now?

Markets have recognized quite clearly that the Fed is about to move its target rate ---most likely at the June meeting---but that leaves the "path" to a neutral Funds rate open. Were the world to behave like the Fed had hoped earlier in the year (ending the deflation threat with no worries about inflation), a "measured" path might allow a gradual ascent toward a "neutral" Fed Funds rate. That said, even a gradual ascent leaves open the issue of what a neutral Fed Funds rate would be and when it needs to be in place? In a non-inflationary world (say 1.5-2.0% with a broadly measured price index), a neutral nominal Fed Funds rate would most likely have to exceed 3.5%, perhaps 4%. Even "path" has more than a single dimension. It could involve a set of 25 basis point steps and it could include intervals of time in between each of the steps. But whatever the path, the Fed cannot be seen to be losing it's hold on the timing and extent of its increases. (that would be seen as "behind the curve"). That means that a 25 basis point at the June 29-30th meeting is surely fully discounted, as long as expectations of inflation do not rise between now and the next FOMC meeting. What can go wrong with this scenario? A great deal!

Today's PPI numbers are data points---but they leave much unanswered. Are they outliers above a smoother path to an acceptable rate of inflation or do they point to a more price-explosive environment that is now emerging? The market cannot be sure---but neither can the Fed. Before now and the end of June meeting, another employment report will emerge, various regional Fed surveys that ask pointed questions about current and forward price expectations will show up, more data on consumer expectations, more CPI and PPI data and more importantly, personal consumption deflators, top line and core.

Some at the Fed should be pondering how it can be that there is still considerable "slack," in an environment of broadly rising prices?

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