Munk Advisory Services

ECOMENTARY™

MAS063004

After You Telegraph, Can There Be a Surprise?

Only in the language at arrival.

The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 1-1/4 percent.

The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace and labor market conditions have improved. Although incoming inflation data are somewhat elevated, a portion of the increase in recent months appears to have been due to transitory factors.

The Committee perceives the upside and downside risks to the attainment of both sustainable growth and price stability for the next few quarters are roughly equal. With underlying inflation still expected to be relatively low, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

The decision was unanimous (no surprise) and all 12 Districts wanted a raise in the discount rate (to 2 ¼%).

How we read this statement.

1) **The Fed recognizes the need for 'disaccommodation,' but thinks the price data, while "somewhat elevated," have transitory components that are perhaps distorting the true amount of inflation**

2) **The Labor Market is demonstrably better (but no claims are being made for the future).**

3) **The "upside and downside risks to… both sustainable growth and price stability for the next few quarters are roughly equal." Translation: The time interval over which they have some confidence in their own internal forecast ('the next few quarters') dictates removing "policy accommodation" at a "measured" pace. There is no rush to judgment here, but implicitly, if one thinks about the lags in monetary policy's effects, there is a fair degree of confidence that the Goldilocks Scenario we have outlined before is the Fed's "central forecast."**

4) **The Central Bank Catechism is replayed again. "Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability." If pushed by the data, the Fed will not get "behind the curve."**

And for the future? The Fed is basing much of its current posture and language on a Goldilocks Scenario that says that the recent uptick in core inflation will in fact subside and that growth will not peter out. That leaves the path to 'disaccommodation' a measured glide path. But, as we said in our earlier piece (MAS062904: Getting Behind the Curve), other scenarios are allowed, with perhaps smaller probabilities. As the data come in, those probabilities will change. No guarantees here either on the data or on the response, but at this moment, Goldilocks has the best odds. For the Bond Market Bulls who love the Carry Trade, Carry-on! Temporarily at least, bond and equity traders want to be a bit longer. They love it until they hate it. Right?

ECOMENTARY? is published for clients of **Munk Advisory Services, LLC**
955 Mt. Moro Road, Villanova, PA 19085. tel (610) 527 5368 fax (610) 527 5068

Website www.ecomentary.com. Contact: munkb@ecomentary.com

Munk Advisory Services

ECOMENTARY™