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MAS080606

## Current Data and Past Minutes Suggest the Fed Will Pause on August 8

This FOMC meeting appears ready to mark a turning point in its policy course. After 17 straight increases in the Federal Funds target rate, we believe the FOMC will pause this time. Markets already seem ready to accept this change because the implied probability of a further rise in rates has fallen from about 50% two weeks ago to less than 15% at the end of last week. While the FOMC is not necessarily in the business of ratifying the Market's call, it would put even more pressure on an FOMC searching for a sense of operating consistency under the current chairman were it to "shock" the Market at this point. Here's why we have come to conclusion that a pause is the most likely outcome.

In the minutes to the June meeting, released on July 20th, the staff forecast for GDP growth sees growth occurring at less than the trend rate of growth going forward into 2007 and certainly below the rates exhibited over the past six quarters. The conclusion is reinforced by the FOMC view that housing is continuing to slow; that the pass through of energy costs is continuing, weakening the real spending capabilities of households, and that there are still more depressive effects to be realized from past monetary policy tightening. While business expansion seems robust, there is some belief that consumer spending is slowing. Ultimately, there is an implied belief that if consumer spending slows, ultimately, so must business spending.

What makes a pause more plausible is the continuing belief by the majority of FOMC members that inflationary expectations are still contained, notwithstanding, a higher rate of core inflation than the Committee would prefer. It is not that the FOMC doesn't believer that there are risks to the inflationary outcome. It is that current events have been in the direction of lower spending growth while the effects of prior tightening may not have yet been fully realized.

The FOMC is likely to focus on the growing pressures that may restrain spending rather than the likely increases in inflationary expectations. Had inflation expectations shown evidence of becoming "uncontained," the FOMC would have clearly acted by raising rates at this meeting. Having no such evidence has given the committee a breather and we believe the Committee will take the respite offered.

In addition, taking a breather leaves the Committee a bit freer from past doctrinally motivated moves to fight inflation until the last data point is beaten. For many reasons, the FOMC needs to expand the range of possible policy outcomes and the data bits that have shown up since the last FOMC meeting are consistent with the staff-predicted slowing.

This does not mean that the FOMC is through for this policy cycle. Events could clearly conspire to give more impetus to further rate increases However, pausing now is a bit like reloading its gun. They don't have to fire again, unless a clear data signal triggers such a response. By pausing now, the Committee gains an extra degree of freedom so to speak. This can be applied to exploring alternative policy outcomes and alternative data bits. But while the tilt on inflation is still there, more concerns about slowing growth and consequences of becoming too restrictive with a sharp fall in spending dominate concerns about inflationary expectations becoming less anchored.

The final straw was Friday's Employment report that showed that recent slowing of job growth has continued. This slowing of job growth is not consistent with an acceleration in household spending in the current environment and it signals the FOMC to be cautious about overreacting to the inflation already built into the pipeline.

**ECOMENTARY**™ is published for clients of **Munk Advisory Services**, **LLC**
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