



## Fed Minutes Reveal A View Toward Considerable “Disaccomodation”

Despite many signs of less than robust growth, (as of August 10<sup>th</sup>), the FOMC was definitely on the “watch path” and foresaw considerable room for **removing the current level of accommodation. It also saw its role as doing that in a ‘measured’ fashion.** Our view of what the FOMC thought at the time was that raising the nominal funds rate considerably beyond its then current level (1.75) was the preferred course for monetary policy and that the path would extend well into 2005. The salient points are summed up in the following section of the minutes, quoted below.

In the Committee's discussion of policy for the intermeeting period, all the members favored an increase in the target for the federal funds rate from 1-1/4 to 1-1/2 percent. Although the pace of economic growth had moderated in the second quarter, the Committee believed that the softness would prove short-lived and that the economy was poised to resume a stronger rate of expansion going forward. Given the current quite low level of short-term rates, especially when judged against the recent level of inflation, members noted that significant cumulative policy tightening likely would be needed to foster conditions consistent with the Committee's objectives for price stability and sustainable economic growth. In this context, a relatively small tightening move at this meeting would help to limit the risk of a rise in inflation expectations and reduce the likelihood that policy might need to be adjusted more sharply in the future, thereby lowering the attendant risks to financial markets and the economy. The members thought that policy accommodation probably could be removed gradually--a view that had been reinforced by the slower pace of growth and more moderate rates of price increase that had become evident over the intermeeting period. However, members also recognized that the timing and pace of additional policy tightening would depend importantly on incoming economic data and the Committee's assessment of their implications for economic activity and inflation.

With regard to the Committee's announcement to be released after the meeting, members agreed that the description of recent economic circumstances should acknowledge the slowing in output and employment growth, as well as highlight the role of higher energy prices in those developments. They also agreed to retain the assessments adopted at the June meeting that the risks to the Committee's goals of sustainable economic growth and price stability were balanced over the next few quarters. While a more persistent slowing of household spending was possible, and more subdued inflation readings over the intermeeting period had eased concerns about a potential increase in underlying inflation, policymakers continued to judge the risks to sustainable growth and the inflation outlook as roughly balanced. The Committee chose to reiterate its belief that policy accommodation could be removed at a pace that is likely to be measured as well as its intention to respond to changes in economic prospects as needed to fulfill its obligation to achieve its goal of price stability.

As we have reiterated several times, the FOMC is clearly looking at the “mistakes” of Fed actions in prior oil shocks and has no intention in letting Stagflation become the dominant motif for the economy. Market players who believe that the Fed will ease off in the face of weaker economic data may be disappointed in viewing the Fed as a much more political body than in fact it is. That said, weakness in the economy can force markets to readjust what they view as most likely in the bond market and flatten the curve anticipating a weaker economy and a resolute Fed. Sooner or later, however, that is inevitably going to create a new tension...lower rates are not consistent over time with weaker expenditures by spending units, no matter how much the structural ‘underconsumptionists’ allege.