



Moderating to Slow: Fed Sits Tight and Still Worries About Inflation

The FOMC declined to move the Federal Funds rate today even though it continues to have concerns about inflation. (the bias is toward inflation). It acknowledged, however, that economic growth has **slowed**, as compared to its characterization at the previous meeting when it spoke of the **moderation of economic growth**. The committee did not 'translate' this lower growth into comfort about core inflation as it once again indicated that "core levels of inflation have been elevated.

This time, however, the causes of inflationary pressure were attributed to "high levels of resource utilization," but interestingly enough, energy prices and other commodity prices dropped out of the Fed's roundup of usual suspects. No doubt this reflects the very sharp reduction in crude oil and petroleum product prices, but despite the recent bearish cast to the oil market, a stiff winter and some disruptions of ordinary crude oil flows as OPEC tries to limit production, energy prices could still begin to rise in the last two months of the year. Thus despite some better inflation data since the last meeting, watchful waiting is till the by-word.

Concerns for what can still go wrong on the inflation front and the impact to the Fed's credibility must be at the base of Jeffrey Larker's fear. Larker, President of the Richmond Fed, once again cast the sole dissenting vote, indicating that he wished the Funds rate to be taken up further. At the end of the day, Larker will either prove clairvoyant or stubborn in the face of data stream to which the Fed has mortgaged its policy settings. For now, however, the "watch and wait" crowd have the upper hand at the Fed

At the same time, the Fed did not confirm recent market views that it will be lowering rates soon in 2007. Neither bond market bulls nor bears can find substance in the Fed's laconic remarks. The market must watch and wait the unfolding datastream and then make its bet on how it thinks the Fed will read the data. A watch and wait on a 'watch and wait!'



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