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Monetary Tea Leaves: or "rules versus discretion" once again!

The FOMC met today and left the "considerable period" doctrine in tact…or did it? There were several notable shifts in the semantics of today's statement, arguably allowing market participants to put their own spin on the state of monetary policy. Critics of ambiguity will have a rich diet to digest, while Greenspan idolaters, who wish to give the "man who" plenty of leeway in determining the timing of a shift of monetary policy will be pleased. On balance, for those of us more inclined to "rules" over "discretion," it was a step backward.

The operative text for December 9th was as follows:

"The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity. The evidence accumulated over the intermeeting period confirms that <u>output is expanding briskly</u>, and the labor market appears to be <u>improving modestly</u>. (Business pricing power and) Increases in core consumer prices are muted <u>and expected to remain low.</u>

The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. <u>The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation. However, with inflation quite low and resource use slack,</u> the Committee believes that policy accommodation can be maintained for a considerable period."

We have underlined or placed parenthesis where a significant change in phrasing has occurred.

1) Focus on output expansion not 'spending is firming.'

2) Labor market appears to be improving modestly rather than "stabilizing."

3) "Business pricing power" was left off the "muted" statement and a phrase indicating the FOMC's expectation that consumer prices are not only "muted," but "expected to remain low."

4) While the "bias" remains balanced in respect to sustainable growth, " the probability of an unwelcome fall in inflation has diminished …and appears almost equal to that of a rise in inflation."

5) FOMC removed the threat of inflation becoming "undesirably low" was removed while a newer statement for maintaining the "policy accommodation" for a "considerable period" has now been written. Low inflation and slack resource use are now justifications for policy maintenance.

To see the important changes, compare the same two paragraphs for the October 28th statement.

The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity. The evidence accumulated over the intermeeting period confirms that spending is firming, and the labor market appears to be stabilizing. Business pricing power and increases in core consumer prices remain muted.

The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. In contrast, the probability, though minor, of an unwelcome fall in inflation exceeds that of a rise in inflation from its already low level. The Committee judges that, on balance, the risk of

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inflation becoming undesirably low remains the predominant concern for the foreseeable future. In these circumstances, the Committee believes that policy accommodation can be maintained for a considerable period.

Did the FOMC Change its Focus? Is the "considerable period" doctrine now a relic from the prior stages of recovery? It would be hard to see it any other way, even if the "considerable period" qualification to monetary accommodation has still been left. The absence of business pricing power has now receded; the labor market is now "improving," not merely stabilizing; the risks of inflation versus deflation are now "almost equal;" yet the considerable period doctrine remains. Who can believe that the other shoe is not about ready to fall?

What remains? The FOMC wants to leave the current amount of ease and it is almost implicit in the way the statement has been re-tooled that the criteria for real change are the labor market and the degree of slack in resource use. Normally, these two criteria would be subsumed under a price stability doctrine---but prices are stable and are likely to remain so for some---"considerable period."

So, did they change the policy metric? Yes and No---it depends upon whether you have a clock that forecasts the future behavior of prices in your hand---or a resource-use intensity meter. You don't? Neither does the FOMC, but they have warned us which dials to watch while they leave the current level of the Fed Funds rate far below its longer run equilibrium level. It might have been easier just to admit that a "considerable period" has now been adumbrated---even if the Chairman wishes to leave it in the closet for another six-week period.

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