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A "Two handed Fed": FOMC sits and wonders

President Truman, once frustrated by seemingly contradictory economic advice, announced that what he needed was a "one handed economist.' What he meant was he was tired of receiving economic advice that consisted of his economic advisors exploring policy options with the caveat "on the one hand…," followed by "…and on the other hand…" Economic reality is not simple and the data that purport to describe that reality are not always reliable, and subject to substantial revision. Today, the market got a vintage dose of two-handed monetary policy analysis from the FOMC, even if it prefers one handed advice.

The FOMC sat tight on its 5.25% Fed Funds target rate, but it wandered over the economic landscape throwing up clouds of dust as to its definitive view of the economy's direction…or for that matter the monetary policy that should be followed going forward. There were two, distinct threads, however. Slowing growth matched against the potential of an inflationary surge. Between those two possible outcomes, one can drive the biggest flattop in the U.S. Navy and virtually any monetary policy, at least in the short run!

The FOMC's lead sentence was "**Economic growth has slowed over the course of the year, partly reflecting a substantial cooling of the housing market.**" Normally, that would make one think the economy is starting to slide in a more serious manner, doesn't it? Certainly, that is a possibility. Yet, the next sentence says "**the economy seems likely to expand at a moderate pace on balance over coming quarters.**" What does the FOMC really think will happen? Slow or moderate growth? Pick 'em, as they say in Vegas!

But, what about the 'other hand?' The third paragraph turns its attention to inflation, commenting as in previous statements that "**readings on core inflation have been elevated**," before telling the reader that "**…inflation pressures seem likely to moderate over time…**" Pick 'em, once more!

A statement that contains any and all things possible is not a statement with a policy direction, and thus the FOMC ends with "nonetheless, the Committee judges that some inflation risks remain," said pressure sustained by the "high level of resource utilization." Translation: A bias toward higher core inflation. ('We'll continue to sit still, watch closely until we take a stand and do something else!). No one will accuse this Fed of being overly directional in its guidance.

There are now two elephants in the room, moderate growth that could be fading and core inflation ready to create a firestorm. The FOMC has opened the door to a raise or a cut, which must be quite reassuring to derivative theorists who like two-tailed risks, but will leave most of us with little guidance. A forerunner of this outcome was contained in recent speeches by Don Kohn, the Vice Chairman, and Bernanke himself. The former confessed that the data were very hard to read and the Fed had to be wary with making hard and fast judgments with so much data revision abounding. The Chairman's speech focused on the risk of an upsurge in core inflation, probably intending to influence the market not to expect a rate cut very soon in the future. Both elephants are there, and either one could break its tethers. That means we have both upside and downside risks, to use an older phraseology. Finally, if you think the Committee takes its position with unanimity, note that President Lacker of the Richmond Fed dissented once again. He wants the Funds rate up another 25 basis points. He may be wrong, but he is firm in his view.

Where do we think the FOMC will be in 45 or 90 days? Our own view is that Bernanke always worries about overshooting and if the data stay soft, the Funds rate will be lowered. Will the data stay soft? I don't know. but I have good company. Neither does the Fed!

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P.O. Box 749, Horsham, PA 19044

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