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"One, Two, Buckle My Shoe…"

The FOMC stood pat today…or did they?

> The Federal Open Market Committee decided today to keep its target for the federal funds rate at 2 percent.
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> Strains in financial markets have increased significantly and labor markets have weakened further. Economic growth appears to have slowed recently, partly reflecting a softening of household spending. Tight credit conditions, the ongoing housing contraction, and some slowing in export growth are likely to weigh on economic growth over the next few quarters. Over time, the substantial easing of monetary policy, combined with ongoing measures to foster market liquidity, should help to promote moderate economic growth.
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> Inflation has been high, spurred by the earlier increases in the prices of energy and some other commodities. The Committee expects inflation to moderate later this year and next year, but the inflation outlook remains highly uncertain.
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> The downside risks to growth and the upside risks to inflation are both of significant concern to the Committee. The Committee will monitor economic and financial developments carefully and will act as needed to promote sustainable economic growth and price stability.
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> Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Christine M. Cumming; Elizabeth A. Duke; Richard W. Fisher; Donald L. Kohn; Randall S. Kroszner; Sandra Pianalto; Charles I. Plosser; Gary H. Stern; and Kevin M. Warsh. Ms. Cumming voted as the alternate for Timothy F. Geithner.

In our view, one can discern several distinct themes, the most important of which is that there seems to be some unity among the FOMC members. Their view is that this is a liquidity crisis not so much a yield curve problem. Such a view may not seem important in the context of the formidable credit panic that has overtaken many financial stocks, but it yet may turn out to be significant. If in fact some sort of coordinated Fed/Treasury/Private sector involvement is being built to treat the incipient AIG disaster. Perhaps, the price of offering the discount window to this insurance giant is unanimity at the FOMC concerning the proper focus of the Fed. Namely, that the Fed's balance sheet is to be used to treat the liquidity crisis, but that the level of the Federal Funds rate is more germane for discouraging any left over inflation. That is the so-called "separation" theme noted by other Fed Watchers. Somehow, one senses that there was a tradeoff involved with the FOMC members and at the end of the day, a unanimous view by the Fed would be important in restoring confidence.

What is clearly needed is for markets to understand just how far the monetary authorities are willing to go and just how far the fiscal authority (the Treasury in particular) is willing to extend its hand. The Treasury's real posture going forward is ambiguous at best, given the somewhat definitive stand by the Treasury with regard to Lehman Brothers. At some point, steepening the yield may well be necessary to accelerate the rebuilding of financial intermediary balance sheets. A unified FOMC allows for that possibility. The macro data will do the talking.

Does this preclude Fed Fund cuts going forward? Not, in our opinion. If the general macroeconomic indicators continue to deteriorate, the relative weights of inflation and unemployment in the FOMC's forecast can and will change. One of the peculiarities of this macro disturbance has been the unusual behavior of GDP growth as well the relatively strong behavior of consumers---in the face of all the negative wealth effects emanating from the housing bust!

At the end of this day, how the financial sector gets around its deleveraging process without a real financial collapse is still unanswered. One can only hope the tag line of our nursery rhyme is not an accurate forecast. .

One, two, buckle my shoe
Three, four, shut the door
Five, six, pick up sticks
Seven, eight, lay them straight
Nine, ten, a big fat hen
Eleven, twelve, dig and delve
Thirteen, fourteen, maids a'courting
Fifteen, sixteen, maids in the kitchen
Seventeen, eighteen, maids a'waiting
Nineteen, twenty, my platter's empty ...