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FEDSHOCK: "considerable period" replaced by being "patient"

Statement Comparisons 12/9/2003—1/28/2004

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For immediate release

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 1 percent.

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 output is expanding briskly. ***Although new hiring remains subdued, other indicators suggest an improvement in the labor market.*** Increases in core consumer prices are muted and expected to remain low.

The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. 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. With inflation quite low and resource use slack, the Committee believes ***that it can be patient in removing its policy accommodation.***

Voting for the FOMC monetary policy action were: Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Ben S. Bernanke; Susan S. Bies; Roger W. Ferguson, Jr.; Edward M. Gramlich; Thomas M. Hoenig; Donald L. Kohn; Cathy E. Minehan; Mark W. Olson; Sandra Pianalto; and William Poole.

Release Date: December 9, 2003
For immediate release

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 1 percent.

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 output is expanding briskly, and the labor market appears to be improving modestly. Increases in core consumer prices are muted and expected to remain low.

The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. 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, the Committee believes that **policy accommodation can be maintained for a considerable period.**

Voting for the FOMC monetary policy action were: Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Ben S. Bernanke; Susan S. Bies; J. Alfred Broaddus, Jr.; Roger W. Ferguson, Jr.; Edward M. Gramlich; Jack Guynn; Donald L. Kohn; Michael H. Moskow; Mark W. Olson; and Robert T. Parry.

Today, the market put a value on "nuance" as the FOMC altered the now famous "considerable period" doctrine to one of patience. The key sentence is "**With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation."** The market's initial reaction was one of shock since the prior statement was the "maintained for a considerable period" doctrine. How much real difference is there between the two? We see three major elements.

1) The Fed now has given a slight signal that it is cognizant of the very rapid escalation in the GDP growth rate, in spite of two rather benign conditions: no price pressure and no pressure from tight labor markets.

2) The Fed has given itself some breathing room to take account of forward developments (such as increased job creation) without having to impose an unexpected shock when those data begin to change, as surely the Fed must think they will

3) By pointing to patience in removing its current policy accommodation, it conditions the market to adjust on the actual macro data points and not to regard the current level of interest rates as inviolable, as some have suggested well into 2005. In effect, the data will do the talking, although the Fed will be patient and apparently Solomonic in reviewing the evidence.

The immediate reaction was a very sharp decline in all the barometers of the equity market and an elevation of the bond market at the long end. Steepening today, but what of tomorrow and what about mortgage rates? More importantly, what about Asset Prices?

The Fed is in process of searching out how best to communicate to the various markets on two areas of policy:

Assessment of the economy and how it wishes to characterize its forward policy moves (the reaction function). Our "take" of the statement is that the Fed is telling us what we already know, that the Fed is getting some ambiguous and unconventional signals. Growth is high, profits are rising but prices are not and employment trends are still mixed. Job loss seems to be slowing, but the hiring side is apparently still saddled with very patient business hiring. In fact, this morning on a CNBC, former Governor, Lawrence Meyer, pointed to the likelihood that the core PCE measure of general price movement and the one most preferred by the current Fed Chairman is likely to decrease further from 0.8% to something on the order of 0.4% to 0.5%. Further, in market scuttlebutt over the last 10 days, there have been rumors of the core PCE falling close to zero. That has to be disconcerting to any Central Bank that takes price stability as a major goal.

Fed modeling of the economy still has difficulty reconciling strong output and productivity growth with declining core inflation. Even if the current Fed doesn't adhere to a Phillips-curve version of the universe, it must feel a bit uncomfortable with this new Goldilocks quality of the economy. Furthermore, employment, the second objective of the Fed's charter, has not given the signal that a rapidly growing economy traditionally has given.

In short, we interpret the FOMC's change in language as providing **breathing space** in the recurrent debate as to the meaning of **considerable period.** By taking it out of the statement, they have discarded an ambiguity. The new word for the day is "patient in removing its policy accommodation." The Fed has replaced one ambiguity with another. We can all scratch our heads how the Chairman views the concept of "patience."

On a personal note, we are chastised by today's change in orientation. The conventional wisdom was "no change." We speculated privately with a well-known Wall Streeter that this meeting provided an opportunity to the Fed and particularly the Chairman to dance a two-step or a jig if he wanted over the next two weeks when important economic gatherings take place. First off, the cycle of other Central Banks will begin to roll. Second, the G-7 meets at the end of the first week in February and in the second week, Greenspan testifies before Congress. As we pondered the data and the stakes, we thought there was some possibility that Greenspan would take the opportunity to give himself some wiggle room. He could let the data roll in, take advantage of the new insights provided by the data and re-interpret, if necessary, the new stance when he testified before the Congress. We were talked out of that vision by because it seemed so clear to experienced Wall Street economists that the Fed had no need to rush and it had not prepared the market for a major shift. Further, there were risks to introducing uncertainty into spending functions such as consumption and investment.

Still, by this stance, the Chairman could be seen as offering the ECB a chance to shift even before it has prepared its own market for a change. Maybe he is offering a carrot before the G-7 meeting so as not to have to deal with the attempt to get out of constraints that flow from the Dubai statements last year? And, maybe the Fed has had an early look at data from QIV 2003 that are explosive to the upside. The move allows Greenspan to be seen as responding to rapidly accelerating equity valuations, in spite of the constant denials about asset price targeting. By taking a little steam out of the market, the Fed creates some breathing space and conditioning the market if it has to make a change based upon new data. The risk is that the market now begins to seriously discount a tightening process in 2004, something many had ruled out quite firmly. A little bit of ambiguity is not unheard of by a Fed Chairman who does not want to be tied down completely with a clearly articulated formula. What will be really interesting is to see what the Minutes of the December 9th FOMC will say tomorrow---and perhaps even more interesting will be the Minutes of this meeting scheduled to be available on March 16---unless the Chairman surprises us once again with a change in the Minutes release interval. Maybe the bottom line is that risk spreads have fallen to such levels that a bit of uncertainty may cause bond and equity traders to be just a bit more cautious until the Fed actually starts removing the punch bowl.