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Bernanke's First FOMC Meeting Illuminates but Does Not Surprise

No surprise is a clear theme of the FOMC meeting today, Bernanke's first as Chairman. The Committee raised the FF rates by the expected 25 basis points, but left its options open as to its behavior in the future. Another period of watchful waiting was signaled by the repeat of paragraph three.

> "**The Committee judges that some further policy firming may be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster its objectives**."

The FOMC reached the same conclusion, but provided slightly more explicit landmarks to indicate how it currently appraises the economy. The fourth quarter setback was seen as temporary and economic growth rebounded strongly. However, the Committee gave itself latitude before committing to a well defined course of further increases, by suggesting that growth "appears likely to moderate to a more sustainable pace," as it contemplates the threat of inflation.

Three "factors" seem to be highlighted in explaining current and likely forward inflation conditions; the "**run-up in the prices of energy and other commodities**" (having only a modest effect on core inflation); continued productivity gains keeping unit labor costs "in check;" and, inflation expectations that "remain contained." The "out" is contained in the statement, "**Still, possible increases in resource utilization, in combination with the elevated prices of energy and other commodities, have the potential to add to inflation pressures.**"

Resource utilization is sufficiently general to encompass labor costs and service prices, both of which might be expected to rise as the expansion uses up any remaining "slack." "Other commodities" is now on the possible suspect list, joining energy prices, and implicitly, inflationary expectations can still develop. Some observers will point to the somewhat more extensive explanation of what the Fed sees as possible outcomes for the economy as Bernanke's attempt to provide more transparency. Perhaps the inherent ambiguity of the FOMC thinking is transparent, but that lack of sureness allows quite distinctly different outcomes. One wonders if increased transparency with more ambiguity will help the market decipher possible outcomes or increase the inherent penumbra of uncertainty that surrounds economic forecasting?

The structure of today's statement also contains the thread of the dilemma the FOMC will confront going forward: it needs to see a real fire, and not just possibilities of future inflationary smoke. If core inflation does not rise, and expectations of inflation do not rise, the Committee is going to have to find some "model" that tells the market why it is continuing to raise or it will be forced to pause. So far, it has not provided one and in that sense, we don't judge this first Bernanke statement as being sufficiently transparent. He is still feeling his way along the leadership circuit.

Market soothsayers seem to be divided about what the "market" expects. The FF futures suggests that another raise is more likely than not, but it will need to be shown some hard evidence than the mere supposition that "potential to add to inflation pressures" still flourishes. Those economists who predicted a change in language can claim they were seers, but other than spelling out more clearly the "feelings" of the FOMC on the economy now and in future, the step toward transparent communication is a small one. It is hard to interpret the specific language used except perhaps as a "what if" conditional. Perhaps, Bernanke is just taking more "sightings" to use a term consistent with the Navigator reference of his last speech. We still don't know what he saw that would determine his course.

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This was the first meeting of the newest Governor, Randall Kroszner. There was also a curious circumstance that in that the Kansas City Fed, did not join its brethren in voting for a 25 basis point increase in the discount rate to 5 ¾ percent. Kansas City is often known to be more hawkish on the inflation possibilities. What does it see that its colleagues do not?

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