TrendMacrolytics

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TRENDMACRO LIVE!

On the June FOMC Meeting

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For a **Fed** that went to such lengths to manage expectations surrounding its first rate hike in four years, and from 46-year lows at that, it's no great surprise that the central bank would want to remain as innocuous as possible in framing its rationalization for the move. On Monday, we downplayed speculation that another less-than-quiescent inflation reading could prompt a marginally more hawkish pose from the **FOMC** today (see "FOMC Preview" June 28, 2004). Still, we find it striking the degree to which the post-meeting statement can be just as easily interpreted as a justification for doing nothing as it is a convincing explanation for the start of what is expected to be a long-running series of increases in its overnight rate target. If policy makers are actually approaching this tightening cycle as placidly as their announcement suggests, the risk is that they will continue to slip further behind the inflation curve even while ostensibly moving to adopt a less accommodative posture.

The statement takes cognizance of "somewhat elevated" recent inflation data, but then as much as it dismisses it by asserting that "a portion of the increase in recent months appears to have been due to transitory factors." Say what? It's widely known that the Fed focuses almost entirely on measures of core inflation, so it's unlikely that the "transitory factors" referenced here are petroleum product prices, which have started to decline in any case. If the Fed believes the recent uptick in core inflation -- with core CPI rising at a 3.3% rate over the past three months -- is "transitory," why not provide some brief explanation why? Most likely, the Fed has no such convincing explanations, and the line was plugged in largely as a throwaway -- the committee does not appear to be entirely ignoring the inflation uptick, even while offhandedly writing it off. Perhaps even more curious was the so-called "balance of risk" assessment, in which the panel said it perceives as "roughly equal" the "upside and downside risks to attainment of both sustainable growth and price stability for the next few quarters." Downside inflation risks, then, are no longer greater than upside risks, as the Fed declared they were up until March, but are still "roughly equal." If that's the case, why does the Fed perceive the need to start lifting rates? If the 1% funds rate target presents no significant risks, why change it? The statement offers no clarification.

Of course, all this was mere groundwork to justify the announcement's featured attraction, the magical catch phrase that "policy accommodation can be removed at a pace that is likely to be measured." We suppose it's some solace that the next line provided the qualifier that the Fed "will respond to changes in economic prospects as needed to fulfill its obligations to maintain price stability," although it does nothing more than state the obvious. Still, as the Fed embarks on what could be one of the longest-running and most extensive policy actions in its history, our bet is that over time policy makers will be doing more to "respond… as needed" to developments they do not now foresee, than remaining content to remove the accommodation at a "measured" pace. TM

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