



FED WATCH: Monetary Policy Change Still A Ways Off

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NEW YORK (Dow Jones)--If economists are right, the Federal Reserve is settling in for one of its longest stretches of steady monetary policy in a decade.

Central bankers gathered on Wednesday in a meeting that left the central bank's key overnight target rate unchanged at 5.25%, the same spot where it's been resting since last June. The forces that have been keeping rate policy unchanged remained: officials think inflation is too high, while they acknowledge growth has clearly slowed.

Responding to this environment appears to argue for conflicting outcomes. Too high inflation calls for rate hikes to quash the price pressure beast, while logy growth levels suggest easier monetary policy would offer welcome support for output. Central bankers' dilemma is that what remedies one ailment complicates fixing the other woe.

For some time now, policy makers have been resting their hopes on their forecast, which predicts inflation will finally back away from its current troublesome levels, just as growth recovers from its recent lethargy. Until there's some clarity, it's a matter of sticking to the sidelines.

Economists say this situation means monetary policy should stay exactly where it has been until well into the summer, if not the remainder of the year. They note that in the last two Federal Open Market Committee gatherings, Chairman Ben Bernanke and his colleagues have aimed to make the rate outlook conditional on incoming data, and ready to respond to changing economic circumstances.

"The Fed is pretty clear that they see and can appreciate the weaker economic growth" that's prevailed through much of this year, said John Norris, chief economist with Morgan Asset Management. But with inflation still above the level policy makers would like and growth showing little risk of slipping into a recession, it's very likely "the Fed will remain at 5.25% through the remainder of the year," he said.

That could herald some unexciting times for markets: "The summer doldrums might be starting early," with so little action likely from the central bank, Norris said.

Norris' expectation is shared in some form by many on Wall Street, and for the most part, it's a familiar story. For most of this year Wall Street's monetary policy expectations have undergone very little in the way of substantive changes. Most economists have reckoned policy makers would be able to maintain the current overnight rate until sometime in the summer.

Currently, most major banks reckon the Fed won't be doing anything with monetary policy until late in the year. A survey done by Dow Jones Newswires Friday, in the wake of the soft April jobs report, found dealers had pared back rate cut expectations. The median expectation is now for a single quarter percentage point easing to 5% by year's end.

To be sure, there is a wide range of expectations as to where the Fed will end the year. Indeed, some still believe that because inflation continues to remain above the Fed's understood range of tolerance, a rate hike is likely the central bank's next move.

Still, if the consensus view on rate policy proves true, it would mark an unusual circumstance for the Fed. Already, the length of time the funds rate has been unchanged rivals two periods in the mid-1990s.

Matthew Slaughter, a professor at the Tuck School of Business at Dartmouth University and a recent member of President George W. Bush's Council of Economic Advisers, said the next few months will be a challenging time for policy makers. In part, that's because much of the growth information they are watching comes from data series that are frequently revised, which makes it difficult to get a handle on what's actually happening with output. Complicating the job are questions about the economy's potential growth rate, and the uncertain outlook on productivity.

Slaughter warned it will take some time for the true nature of the economy to reveal itself. "At times like this many central banks find there's big value in waiting," he said, which argues for no near term change in monetary policy.

Still, it's worth keeping in mind that for all the uncertainties over U.S. growth, the Fed has for months now made it clear inflation is its chief bugaboo, and it's that type of data that is most likely to force the Fed into action. Speaking late last month, Federal Reserve Bank of San Francisco President Janet Yellen said "inflation risks are skewed to the upside," although she added "I think the current stance of policy is likely to foster sustainable growth with a gradual ebbing of inflation over time."

But if that doesn't happen, and happen relatively soon, Wall Street's monetary policy outlook could undergo a sharp evolution.