The US Federal Reserve Raises Its Rates Once Again
Even though it's maintaining its objective of raising rates gradually, the Fed seems more concerned by inflation

According to the Fed
- The federal funds target rate increases to 2.75% Votes: For = 12; Against = 0.
- With an appropriate monetary policy, the risks should be kept roughly equal with regard to price stability and economic growth.
- In spite of today's increase, monetary conditions remain accommodative.
- Despite the increase in energy prices, the economy continues to grow at a solid pace and the labour market is improving gradually.
- Although long term inflationary expectations remain contained, inflationary pressure has picked up in recent months.

Commentary
After several meetings where changes to the press releases were practically non-existent, the statement accompanying today's decision by the US Federal Reserve (Fed) contains several alterations. First, in stating that economic activity continues to grow at a solid pace (rather than moderate) the Fed seems to be satisfied with the current strength of the US economy. However, the directors of the Federal Reserve System appear to be showing some concern with regard to the current state of inflation in the United States.

On the one hand, it is quite clear that the upsurge in energy prices of the last several months is not welcomed by the US monetary authorities. Remember that gas prices are up 20% relative to the beginning of the year. Fortunately, as the Fed's press release indicates, the rise in prices related to energy does not appear to have fed through core inflation.

On the other hand, similarly to what appeared in the Beige Book that prepared today’s meeting, businesses can more easily pass on increases in their costs to their customers. This phenomenon, which did not exist a few quarters ago, is probably the main source of the Fed's concern.

In spite of its concerns about inflation, the Fed states once again that the balance of current risks remains about equal between price stability and economic growth. However, it is now making the balance conditional on an “appropriate monetary policy”. So, this new piece of information, combined with renewed character of the measured pace of upcoming rate hikes, suggests to us that the current policy of 0.25% increases in federal funds rates per meeting will continue. But, 1) the neutral zone of interest rates is coming closer; 2) core inflation should stay moderate; 3) a degree of underutilization of production capacities is to remain: for these reasons, we believe that a pause is still highly plausible in 2005.
Excerpts from the Fed Press Release:

[...]The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. Output evidently continues to grow at a solid pace despite the rise in energy prices, and labor market conditions continue to improve gradually. Though longer-term inflation expectations remain well contained, pressures on inflation have picked up in recent months and pricing power is more evident. The rise in energy prices, however, has not notably fed through to core consumer prices.

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability. [...]