According to the U.S. Federal Reserve:

- The target rate for federal funds rises to 4.25%. Votes: For = 10; Against = 0.
- Some further measured policy firming is likely to be needed to maintain the balance between price stability and economic expansion.
- Despite elevated energy prices and hurricane-related disruptions, American economic growth appears solid.
- Core inflation and long-term inflation expectations remain moderate and contained. Nevertheless, a possible increase in resource utilization and high energy prices have the potential to increase inflation pressure.

Commentary:

With this additional rate hike, it is now fairly clear that the U.S. Federal Reserve (Fed) believes its monetary policy is approaching neutral, that is, a level at which the policy is neither accommodative nor restrictive. It is now no longer stating that the policy is accommodative. Then, in being reticent about the approach to be followed at their next meetings, the Fed’s leaders appear to be much less firm about the extent of future monetary tightening.

There should be no surprise about the Fed’s change of message. A reading of the minutes for the previous meeting had paved the way for some questioning, even moderation, of the monetary policy applied to date.

Signalling that “some further measured policy firming is likely to be needed” in fact gives the Fed’s leaders a lot of leeway.

In the short run, it appears fairly certain that rates will reach 4.50% at the final meeting to be chaired by Alan Greenspan at the end of January. After that, the flexibility in today’s statement is, for the first time since June 2004, leaving the door open to a potential interruption in monetary tightening. If inflation risks continue to be very small and there is no surprise surge in economic expansion, it is very likely that a halt to monetary tightening will be ordered in March, at the first meeting run by the incoming chair (not yet officially approved by the Senate), Mr. Ben S. Bernanke. However, the latter’s arrival could shuffle the deck and a reading of the latest press release does not entirely rule out the possibility of rates moving to 4.75% in the spring. A key rate at this level would be higher than the other rates on the yield curve, which would not be a typical action for the Fed’s leaders and its new chair.
Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid. Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained. Nevertheless, possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures.

The Committee judges that some further measured policy firming is likely to 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 these objectives.

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