Bernanke begins his mandate with another rate hike
Federal funds are now close to neutral

According to the U.S. Federal Reserve:

- The target for the federal funds rate rises to 4.75%. Votes: For = 11; Against = 0.
- Further policy firming may be needed to maintain the balance between inflation risks and economic growth.
- The slowing of the growth of real GDP in the fourth quarter of 2005 was temporary. Economic growth has rebounded strongly in the current quarter, but should moderate to a more sustainable pace.
- As yet, the run-up in the prices of energy and other commodities appears to have had only a modest effect on core inflation. 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. Inflation expectations remain contained.
- Productivity gains have helped hold the growth of unit labour costs in check.

Commentary:

The 25 basis point increase in the target for the federal funds rate, now at 4.75%, came as no surprise. Most observers were expecting this move from the U.S. Federal Reserve (Fed) and its new Chair, Ben S. Bernanke. The committee in charge of monetary policy (FOMC) is thus continuing to push U.S. key rates toward a neutral monetary policy zone, that is, toward a policy that is neither accommodative nor restrictive.

The Federal Reserve commented on the economic situation that prevailed in the final quarter of last year, concluding that the factors that took the growth of real GDP down to only 1.6% were temporary. In line with our scenarios, FOMC members also stated that the U.S. economy would rebound at the start of 2006, adding that growth could “moderate to a more sustainable pace.” Our projections also indicate a slowdown in the near future. However, we are expecting GDP growth that is well below capacity.

For inflation, Fed leaders continue to show concern regarding the increase in energy and commodity prices. They also remark that, as yet, these cost increases have not been passed along to the prices of other goods and services. The Fed adds that inflation expectations remain contained and that productivity is succeeding in curbing growth in unit labour costs. As long as these factors persist in the United States, the inflation situation should remain under control.

Further rate hikes may be needed to control inflation. Mr. Bernanke and his colleagues are expected to bring the key rate up to 5.00% at their May 10 meeting. At the same time, since FOMC members say they are prepared to respond to any changes in economic prospects, we can assume that the economic slowdown expected for the second half of 2006 will mean that we will then see a status quo on the monetary policy.
[…] The slowing of the growth of real GDP in the fourth quarter of 2005 seems largely to have reflected temporary or special factors. Economic growth has rebounded strongly in the current quarter but appears likely to moderate to a more sustainable pace. As yet, the run-up in the prices of energy and other commodities appears to have had only a modest effect on core inflation, ongoing productivity gains have helped to hold the growth of unit labor costs in check, and inflation expectations remain contained. 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.

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 these objectives. […]