Another rate hike from the Federal Reserve

Future decisions will be even more "dependent" on data

According to the U.S. Federal Reserve:

- The target for the federal funds rate rises to 5.00%. Votes: For = 11; Against = 0.
- Further policy firming may yet be needed to deal with inflation risks.
- Fed leaders stress that the timing and extent of any firming would depend heavily on how the economic situation develops.
- Economic growth has been sustained since the year began, but the cooling real estate market and the lagged effects of increased interest rates and energy costs should cause growth 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. 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.

Commentary:

To no one's surprise, the target rate for federal funds has been taken from 4.75% to 5%, its highest level in five years. The decision by U.S. Federal Reserve (Fed) leaders puts the monetary policy in the centre of the neutral zone, where it is neither accommodative nor restrictive.

The increase in key rates, passed unanimously by the members of the committee in charge of monetary policy (FOMC), was accompanied by a statement that rules out neither further monetary firming nor a pause for the next meeting. In fact, Chair Ben S. Bernanke and his colleagues have adroitly acquired substantial manoeuvering room for upcoming meetings. They strove to make future decisions even more dependent on economic conditions and developing statistics.

The Fed's leaders are no longer describing the balance of risks between overly weak economic expansion and overly strong inflation. However, they mention that, after fairly strong economic growth to date in 2006, some deceleration should be expected. It will be caused in part by the real estate market slowdown, as well as by the lagged effect of increases in interest rates and energy costs. With respect to inflation risks, the Fed has maintained its stance, reiterating that, while they are a concern, increases in the costs of energy and raw materials have not had much impact on core inflation.

The Fed's increasingly conditional tone, the lagged causes of a potential deceleration in growth, and our own economic scenarios all suggest that rates are very close to their peaks for the remainder of the year. Stronger than forecast growth or core inflation could increase the probabilities of a further key rate hike at the end of June.
Press Release

U.S. Federal Reserve Press Release:

[...] Economic growth has been quite strong so far this year. The Committee sees growth as likely to moderate to a more sustainable pace, partly reflecting a gradual cooling of the housing market and the lagged effects of increases in interest rates and energy prices.

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 yet be needed to address inflation risks but emphasizes that the extent and timing of any such firming will depend importantly on the evolution of the economic outlook as implied by incoming information. In any event, the Committee will respond to changes in economic prospects as needed to support the attainment of its objectives. [...]