According to the U.S. Federal Reserve:

- The target for the federal funds rate rises to 5.25%. Votes: For = 10; Against = 0.
- Fed leaders stress that the timing and extent of any additional firming will depend on the evolution of the outlook for both inflation and economic growth.
- Readings on core inflation have been elevated in recent months. High levels of resource utilization and of the prices of energy and other commodities have the potential to sustain inflation pressures.
- Economic growth is moderating, reflecting a cooling by the real estate market and the consequences of increases in interest rates and energy costs. Moderation in growth should help limit inflation pressures.

Commentary:

Once again, it was to no one’s surprise that the U.S. Federal Reserve (Fed) went forward with another increase in its key rates. This 17th straight increase takes the target rate for federal funds from 5.00% to 5.25%. Given the stress on fighting inflation following the release of some worrisome statistics, it had been clear that Fed leaders would proceed to this additional increase in the cost of money. The futures market had in fact fully priced in this interest rate increase. This latest decision puts the monetary policy in the upper part of the neutral zone, where it is neither accommodative nor restrictive.

As at the time of May’s decision, members of the committee in charge of monetary policy (FOMC) opted to accompany today’s decision with a statement that still does not rule out further monetary tightening or a pause at the next meeting. The Fed has thus hung onto its leeway. However, by continuing to make future decisions dependent on the economic situation and how statistics evolve, FOMC members risk sustaining the major volatility that has been characterizing the financial markets since their previous meeting. As this new statement in no way clearly expresses leaders’ intentions for upcoming meetings, the credibility problems facing Bernanke and his colleagues continue.

While expressing continued concern about inflation developments in the United States, the Fed is remarking that the U.S. economy is decelerating. In this context, and given that we see core inflation’s recent acceleration as primarily a lagged result of the pressures on the real estate market in the last few years, and this market is currently in a slowdown, we are less concerned about inflation risks. With the American economy’s expected deceleration, we believe that key interest rates should not have to go up for the rest of the year. However, as the Fed is not closing the door on another rate increase, we will have to wait for more information from the economic statistics and speeches by Fed leaders. Here, Chair Bernanke’s tabling of the U.S. Federal Reserve’s semi-annual report before Congress on July 19 and his accompanying speech will probably be very important.
Recent indicators suggest that economic growth is moderating from its quite strong pace earlier this year, partly reflecting a gradual cooling of the housing market and the lagged effects of increases in interest rates and energy prices. Readings on core inflation have been elevated in recent months. Ongoing productivity gains have held down the rise in unit labor costs, and inflation expectations remain contained. However, the high levels of resource utilization and of the prices of energy and other commodities have the potential to sustain inflation pressures.

Although the moderation in the growth of aggregate demand should help to limit inflation pressures over time, the Committee judges that some inflation risks remain. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth, 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. [...]