The Fed stays the course and leaves key rates unchanged
The tone of the statement stays the same: inflation is still a concern

According to the U.S. Federal Reserve:

- The Fed keeps its target for the federal funds rate at 5.25%.
  Votes: for = 10; against = 1 (Jeffrey M. Lacker, President of Richmond Fed).
- Once again, the Fed leaders stress that the timing and extent of any monetary tightening will depend on the evolution of the outlook for both inflation and economic growth.
- Core inflation remains high. High levels of resource utilization could maintain inflationary pressures.
- Economic growth has slowed during the year, reflecting a cooling real estate market. The pace of economic growth should be moderate over the next few quarters.

Commentary:

For the third consecutive meeting, the Federal Open Market Committee (FOMC) left key rates unchanged at 5.25%. Except for the President of the Federal Reserve of Richmond, the other members of the FOMC believe rates are where they should be at this time. This decision is in line with recent speeches by FOMC members. It was fully expected by the futures market with a 96.3% implicit probability that the status quo would be maintained. The 106 forecaster polled by Bloomberg all expected this outcome. Besides the target for the federal funds rate remaining the same, the statement accompanying this decision was almost identical to the one following the September 20 meeting. Here again, FOMC members are not excluding the possibility of a monetary tightening in the future. In fact, inflation remains a number one concern for Mr. Bernanke and his colleagues. FOMC members reflected this concern in recent speeches with a viewing to quelling the rising expectations of the financial markets for upcoming rate decreases.

Once again, the FOMC is keeping its future decisions contingent on the economic outlook and the evolution of statistics. The statement signals a decrease in inflationary pressures from the energy sector and sharply rising core inflation. It bears mentioning that the annual change in the Consumer Price Index, which excludes food and energy, was 2.9% in September, its sharpest increase since winter 1996. But the Fed is still talking about the risks associated with the real estate market. In this regard, recent statistics concerning the resale market show that existing home sales and prices have fallen 14.2% and 2.5% respectively since last year.

The balance between inflationary and economic growth risks still seems too precarious for the Fed to change its key rates in the short term. In our view, the next movement in the key rates will be downward, perhaps in March 2007. But the U.S. economy and core inflation will have to show more signs of weakness before the Fed opens the door to monetary easing.
Excerpt from the U.S. Federal Reserve Press Release:

[...] Economic growth has slowed over the course of the year, partly reflecting a cooling of the housing market. Going forward, the economy seems likely to expand at a moderate pace.

Readings on core inflation have been elevated, and the high level of resource utilization has the potential to sustain inflation pressures. However, inflation pressures seem likely to moderate over time, reflecting reduced impetus from energy prices, contained inflation expectations, and the cumulative effects of monetary policy actions and other factors restraining aggregate demand.

Nonetheless, 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.

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