The US Federal Reserve Remains Cautious
The Target for the Overnight Rate Stays Unchanged

- The target for the overnight rate remains at 1.00%.
- The risk of disinflation over the next few months is almost equal to the probability of a rise in inflation.

Votes: for = 12; against = 0.

1) Various signs are showing that output is revving up vigorously and that the labour market is improving, despite the weak job creation observed over the past few months.
2) The upside and downside risks to the goal of sustainable economic growth are equal. However, the risk that the inflation rate reaches too low a level is practically equal to the probability of a rise in prices.
3) However, given the low inflation rate and production overcapacity, the Fed can be patient before it reduces the current level of accommodation of its monetary policy.

The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation. With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation. […]

Conclusion: The press release published today gives us the picture of a Federal Reserve that is remaining cautious in the face of the most recent developments in the US economy. Like us, it is seeing that, in spite of several quarters of vigorous growth, the employment situation remains unsatisfactory and inflationary pressures are still very weak, if not non-existent. All the same, we believe that the strength of the economy will shortly succeed in bringing the job market out of its lethargy and that inflation will soon be back to visit our neighbours.

So the Fed has to prepare itself to lessen the accommodative nature of its monetary policy, especially if we take into account that the federal government’s tax policy will remain very expansionist. In addition, it will also take into consideration that the greenback has lost nearly 15% of its value in two years, which has softened monetary conditions even more. That said, the Federal Reserve officers today took a first step in that direction by removing the oft-quoted phrase for “a considerable period” in favour of a “patient” position, allowing them to wait for a real upswing in employment. However, given the constraints related to the election calendar, it would be surprising that key rates come back up before the end of next fall. It must be remembered that Federal Reserve President Alan Greenspan might make use of his appearance before the US Congress on February 11 and 12 to clarify the officers’ thinking on American monetary policy.

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