US Federal Funds Rate Increases by 25 Basis Points

- The target for the overnight rate increases to 1.25%
- The risks to price stability and economic growth are balanced
- Monetary easing can be reduced at a pace that remains to be determined

Votes: For = 12; Against = 0

1) Production and employment continue to grow vigorously.
2) Although recent data indicate an acceleration in inflation, part of this advance is due to transitory factors.
3) The Federal Reserve is nonetheless determined to react to changes in economic prospects in order to maintain price stability.

Conclusion: A considerable change has taken place in the state of inflation in the US since the beginning of the year. The change is not only a consequence of the sharp increase in energy prices. The core consumer price index, which excludes food and energy, experienced only an annual advance of 1.1% last January, which was the lowest growth since 1963. After that, the annual variation of the core index accelerated to 1.8% and total inflation recently reached the 3% mark. It is now clear that the deflationary environment that prevailed until recently is a thing of the past. The new situation, combined with the strong growth of the American GDP and a marked improvement in the labour market, prompted the Fed to tighten its monetary policy starting today. It appears, however, by keeping a rather neutral tone, that the Federal Reserve did not wish to go against the financial markets and thereby limit expectations of a rapid increase in US key interest rates. But now, where will it stop? The current economic and inflationary environment and our forecasts show that the Federal Reserve will probably bring its target back toward a neutral rate (i.e. neither expansionist nor restrictive) within two years. So, a gradual tightening of monetary policy seems probable to us between now and the end of 2005.