The Fed Continues to Tighten Its Monetary Policy
But a Pause Could Be Announced Later in 2004

- The target for the overnight rate increases to 1.75%.
- The upside and downside risks to price stability and economic growth are about equal.
- The relaxed monetary policy can be removed at a pace that remains to be determined.
VOTES: For = 12; Against = 0.

1) In spite of today’s increase, monetary conditions remain accommodative.
2) After some moderation earlier in the year following a substantial hike in energy prices, economic growth seems to have regained some traction and the labour market has improved modestly.
3) Inflationary expectations have eased recently despite the rise in energy prices.

Press Release

The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. After moderating earlier this year partly in response to the substantial rise in energy prices, output growth appears to have regained some traction, and labor market conditions have improved modestly. Despite the rise in energy prices, inflation and inflation expectations have eased in recent months.

The Committee perceives the upside and downside risks to the attainment of both sustainable growth and price stability for the next few quarters to be roughly equal. With underlying inflation expected to be relatively low, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability. […]

Conclusion: Today’s decision by the Federal Reserve (Fed) is no surprise: nearly 98% of the analysts questioned recently by Bloomberg expected an increase of 25 basis points in the US federal funds rates, which is the third increase since last June. The current area of question depends much more on how events unfold. Will the Fed continue to tighten its monetary policy systematically at each of its upcoming meetings or could a short break be announced between now and winter? According to the Fed, economic growth seems to be regaining its drive, which opens the door to a new federal funds rate increase in November.

On the other hand, even if the US economy actually continues to advance over the next few quarters, our opinion is that the pace of growth could be less sustained between now and the end of 2005. Since inflationary pressure remains limited in spite of the sharp upswing in the price of crude oil, the US Federal Reserve could, under the circumstances, opt for some moderation in tightening its monetary policy. So, even if the trend in federal funds interest rates remains to the upside for the next few quarters, the probability of a pause of a few months beginning in December is not negligible.