THE ECONOMIC OUTLOOK GROUP

475 WALL STREET
PRINCETON, NEW JERSEY 08540 TEL: 609 - 529 - 1300
WWW.ECONOMICOUTLOOKGROUP.COM

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

March 16, 2010

A Few Brief Thoughts About Today's Fed Decision

Aside from the minor change in wording in the FOMC statement, the decision by the Federal Reserve was loud and clear: Not only will there be no change in interest rate policy, but there is absolutely nothing to justify even removing the wording of keeping rates at exceptionally low levels for "an extended period of time."

This is hardly a surprise. While the economy has now grown for nine months, it has not yet brought any meaningful pick up in employment. Even the embers of inflation remain cold. In fact, within seconds after the Fed's announcement, bond traders --- normally the most sensitive investors to inflation -- bid up the price of the 10-yr Treasury enough to bring down yields to 3.65%, from 3.70% at yesterday's close.

The Fed knows this recovery is still quite tenuous. We still haven't seen housing rebound, bank credit remains scarce, and the consumer has only modestly increased spending so far. Any change in monetary policy, or a substantial alteration in wording that warns of a rise in rates in the near future, would have undermined this recovery and destabilized the financial markets.

Then there's the Federal Reserve's dual mandate itself. The two goals are NOT to achieve strong economic growth and price stability. It's to maximize employment within the confines of price stability. With inflation quiescent, the Fed can continue to focus doing whatever is necessary to improve labor market conditions, and keeping a loose monetary policy is critical in that regard.

There's one other key point to make here. The Federal Reserve has also become politically savvy. It is an institution under enormous political pressure not to act rashly. At a time when Congress is debating how to curb the central bank's power, the last thing Bernanke and the governors want to do is provoke legislators into taking such action. Though no Fed official will publicly admit it, Congress has, for now, become a shadow member of the FOMC, ready to pounce on the central bank with an axe should it act prematurely to tighten monetary policy.

So when will the Fed finally delete the "extended period of time" phrase from its statement? We expect them to eliminate it once payrolls consistently stay above 100,000 new jobs a month for at least a quarter or two. That process could begin this month, which will likely show payrolls increase a net 150,000 to 300,000. If that trend continues --- and we expect it will -- the Fed will rid itself of that controversial phrase by the August 10th FOMC meeting and then follow it up with the first rate increase in the final quarter of this year.

====================================