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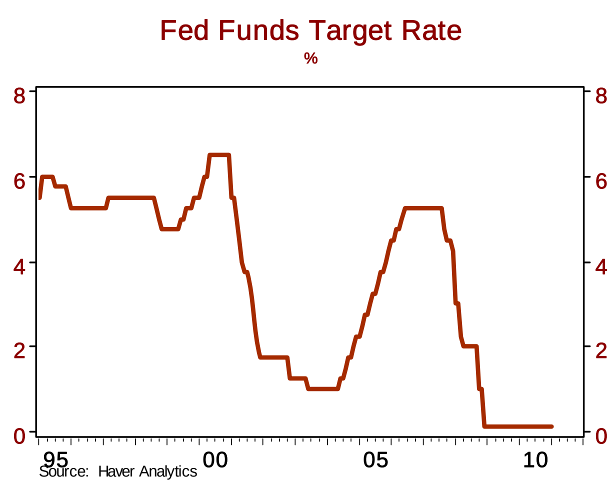
Jan 26, 2011 Economic Commentary

Bring Back Hoenig

Get out your carbon paper. No matter how much evidence there is that both real economic growth and inflation are accelerating, the Federal Reserve is determined to issue policy statements that read like the pessimistic ones from prior meetings.

As everyone expected, the Fed made no direct changes to the stance of monetary policy today, leaving the target range for the federal funds rate at 0% to 0.25%. In addition, the Fed maintained its pledge to keep the funds rate at this level for an "extended period." The Fed also reiterated its commitment – initially made in early November – to purchase $600 billion in long-term Treasury securities by mid-2011. These purchases are on top of reinvesting (into long-term Treasury securities) principal payments on its pre-existing portfolio of mortgage securities.



The Fed only made minor changes to its statement. First, by saying economic growth was "insufficient to bring about a significant improvement in labor market conditions," the Fed implied that there was *some* improvement in the employment situation (just not "significant" improvement). Second, the Fed acknowledged that consumer spending "picked up late last year." Third, the Fed deleted language from the December statement that the growth of business investment had slowed down. Last, the Fed noted higher commodity prices, but did so in a sentence that signaled it will put greater weight on long-term inflation expectations and measures of "core" inflation (which exclude food and energy).

The biggest disappointment in today's statement was the complete absence of any dissent by any member of the Federal Open Market Committee. Kansas City Fed Bank President Thomas Hoenig both rotated off the FOMC and retired at the end of 2010, leaving a gaping chasm for monetary probity and restraint. Over the prior year, Hoenig had consistently dissented in public against high levels of monetary accommodation, including the Fed's latest round of quantitative easing. We miss him already.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Senior Economist*

Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in December confirms that the economic recovery is continuing, though at a rate that has been insufficient to bring about a significant improvement in labor market conditions. Growth in household spending picked up late last year, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising, while investment in nonresidential structures is still weak. Employers remain reluctant to add to payrolls. The housing sector continues to be depressed. Although commodity prices have risen, longer-term inflation expectations have remained stable, and measures of underlying inflation have been trending downward.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Currently, the unemployment rate is elevated, and measures of underlying inflation are somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate. Although the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, progress toward its objectives has been disappointingly slow.

To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today to continue expanding its holdings of securities as announced in November. In particular, the Committee is maintaining its existing policy of reinvesting principal payments from its securities holdings and intends to purchase $600 billion of longer-term Treasury securities by the end of the second quarter of 2011. The

Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of incoming information and will adjust the program as needed to best foster maximum employment and price stability.

The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period.

The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman; Elizabeth A. Duke; Charles L. Evans; Richard W. Fisher; Narayana Kocherlakota; Charles I. Plosser; Sarah Bloom Raskin; Daniel K. Tarullo; Kevin M. Warsh; and Janet L. Yellen.