630-322-7756
www.ftportfolios.com

First Trust

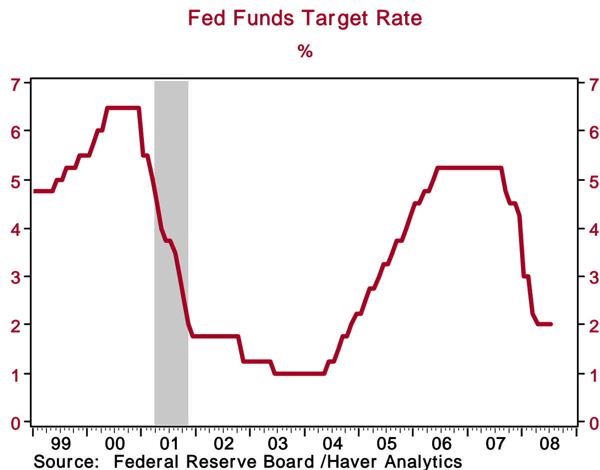
Aug 5, 2008

Economic Commentary

Fed Takes "Baby Step" Toward Tightening

Today's statement from the Federal Reserve was more hawkish than last month's statement, but only slightly. It is consistent with the Fed raising rates later this year, but only if real economic growth shows that elevated energy prices and financial market turmoil are not throwing the US back into recession or a prolonged period of weakness.

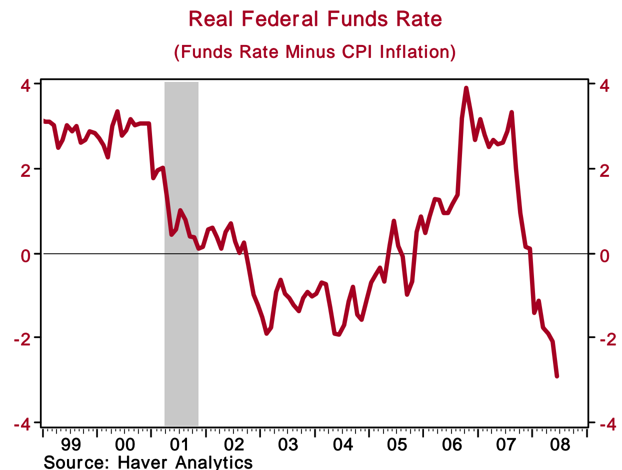
The Fed left interest rates unchanged today, with the target federal funds rate at 2.00% and the discount rate at 2.25%. It made a few changes to its statement on the economy, which suggested more of a focus on inflation.



On economic growth the Fed removed the reference that was made at the end of June to the "diminished" risk of slow economic growth. In other words, the Fed is more worried today (than six weeks ago) about slow economic growth.

However, regarding inflation, the Fed statement made two notable changes, both more aggressive. First, it came out directly and said "inflation has been high." It is unusual for the Fed to speak in such unambiguous language. Second, the Fed labeled upside inflation risk a "significant concern."

Once again, Dallas Fed President Richard Fisher – who would have preferred no rate reduction in April and a rate hike in June – dissented from today's decision, preferring an increase in the funds rate. His was the only dissent.



Text of the Federal Reserve's Statement:

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 2 percent.

Economic activity expanded in the second quarter, partly reflecting growth in consumer spending and exports. However, labor markets have softened further and financial markets remain under considerable stress. Tight credit conditions, the ongoing housing contraction, and elevated energy prices are likely to weigh on economic growth over the next few quarters. Over time, the substantial easing of monetary policy, combined with ongoing measures to foster market liquidity, should help to promote moderate economic growth.

Inflation has been high, spurred by the earlier increases in the prices of energy and some other commodities, and some indicators of inflation expectations have been elevated. The Committee expects inflation to moderate later this year and next year, but the inflation outlook remains highly uncertain.

Although downside risks to growth remain, the upside risks to inflation are also of significant concern to the Committee. The Committee will continue to monitor economic and financial developments and will act as needed to promote sustainable economic growth and price stability.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Elizabeth A. Duke; Donald L. Kohn; Randall S. Kroszner; Frederic S. Mishkin; Sandra Pianalto; Charles I. Plosser; Gary H. Stern; and Kevin M. Warsh. Voting against was Richard W. Fisher, who preferred an increase in the target for the federal funds rate at this meeting.

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

This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.