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FOMC Recap

The FOMC was not overly pessimistic in its economic assessment, and also seemed to be considerably less concerned about downside inflation risks--and, accordingly, left policy settings unaltered.

On the economy, the policy statement text noted that activity is growing "somewhat more slowly than the Committee had expected" and highlighted that "recent labor market indicators have been weaker than anticipated,"

but quickly asserted that the growth slowdown "reflects in part factors that are likely to be temporary," and, soon after, announced that "the Committee expects the pace of recovery to pick up over coming quarters and the unemployment rate to resume its gradual decline."

Central tendency forecasts released later implied that growth is likely to reaccelerate clearly as the year goes by, but also showed meaningful net reductions in expected Q4/Q4 growth both this year (now 2.7% to 2.9%, down 0.4-point from before) and next year (now 3.3% to 3.7%, down 0.35 point). The 2013 estimates were essentially unchanged (3.5% to 4.2%).

Asked to explain those adjustments, Chairman Bernanke pointed to the "reflects in part" qualification, and rephrased it as "part of the slowdown is temporary and part of it may be longer lasting." Later, in discussing his personal views, he said "I do think that given that we can't explain the entire slowdown, the best guess would be that growth, at least in the near term, might be a little bit less than we--than we anticipated." However, he also made a point of noting the fact that thinking on 2013 was unchanged.

The FOMC inflation assessment, meanwhile, was nudged in the firmer direction. The previous version was "Inflation has picked up in recent months, but longer-term inflation expectations have remained stable, and measures of underlying inflation are still subdued."

Now, the wording conspicuously omits the reference to "subdued" underlying inflation: "Inflation has picked up in recent months, mainly reflecting higher prices for some commodities and imported goods, as well as the recent supply chain disruptions. However, longer-term inflation expectations have remained stable."

The central tendency core-PCE inflation forecasts were marked up by a not-inconsiderable 0.2 point in 2011 and 0.15 point in 2012. Estimates for 2013 were unaltered--so the situation is seen as being under control.

The 2011 numbers were notable for showing even the outmost lower-end "range" estimate, among all the participants, moving up from 1.1% in April to 1.5% now, with that new figure matching the lower end of the central tendency zone (the upside "range" number is 2.3%, while the high end of the central tendency zone is 1.8%). Obviously, there is a very tight consensus that downside risk has diminished.

In the Committee's formal discussion of the "mandate" parameters, the conclusion on unemployment continues, of course, to be that the "rate remains elevated," while on inflation the new judgment is slightly more guarded than before.

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The former flat statement that "measures of underlying inflation continue to be somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate" has been removed outright. The new, replacement, phrase fudges on the underlying inflation issue: "Inflation has moved up recently, but the Committee anticipates that inflation will subside to levels at or below those consistent with the Committee's dual mandate as the effects of past energy and other commodity price increases dissipate." The news there is the addition of the word "at."

The new statement also conspicuously--but with very unclear significance--omits outright the previous assertion that "The Committee continues to anticipate a gradual return to higher levels of resource utilization in a context of price stability." There seems to be no new problem with the resource-utilization prediction, since the economic-assessment paragraph points to a resumption of the "gradual decline" in the unemployment rate. However, it does seem very premature to abandon hope in "price stability."

The policy-action paragraphs are streamlined from the earlier version; in particular, focusing the attention on interest rates and the balance sheet--as opposed to the full gamut of "tools" that has been employed in recent years--by stripping off the earlier open-ended statement that the Committee "will employ its policy tools as necessary" to further its objectives. Perhaps that omission reflects a diminished concern with extreme tail risks.

The "extended period" language is retained, and the QE2 program, as expected, will be completed. Also, "The Committee... will maintain its existing policy of reinvesting principal payments," and the time frame over which it will do so remains--deliberately--unspecified.

Chairman Bernanke was nudged into being yet more explicit on the meaning of "extended period," saying that "I think the thrust of extended period is that we believe that we're at least two or three meetings away from taking any further action. And I emphasize at least." In the previous press conference, he had said "'Extended period' suggests that there would be a couple of meetings probably before--before action," so he now seems to have extended the period.

At various points in the discussion, the question came up of attaching an "extended period" commitment to the size of the balance sheet, and Bernanke noted that Fed doctrine would regard the introduction of such a commitment as representing a new easing step in itself. He emphasized that no such commitment has been made, even implicitly--perhaps because some FOMC voters have been fairly adamant in opposing further easing steps, and they might be provoked into formal dissents.

All of this seems to point to a Committee reasonably confident in the medium-term growth outlook, and perhaps eager to signal that it has noticed the broadening out of modest firmness across the components of underlying inflation. This is probably a somewhat more "hawkish" mentality than markets had perceived going in.

Of course, confidence in the growth outlook could evaporate very quickly, should employment, or consumer-spending data, falter seriously--and the FOMC pendulum would swing more quickly back to dovishness than it swung to the hawkish side.