

The FOMC will meet to consider monetary policy on April 27-28. We expect the committee to leave the target federal funds rate at the 0% to 0.25% range. There is a strong likelihood that the committee will replace the "extended period" phrase with "some time." The next step would be to change the characterization of the appropriate rate level from "exceptionally low."

The Fed has maintained since March 2009 that it will implement "exceptional low rates for an extended period." But at least one committee member has suggested replacing "extended period" with "some time" to provide greater flexibility to policy makers as the time for tightening policy approaches.

The back-to-back meeting dissents by Kansas City Fed President Hoenig and discussion in the minutes from the March 16 meeting suggest that the committee might change the wording at this meeting. In the last rate cycle, the FOMC shifted from saying rates would be low for a "considerable period" to saying they could be "patient" before lifting rates to rates increases would be "measured."

The continuing recovery in labor markets also points toward a change in the wording of the statement this spring. The Fed began raising the fed funds rate target one year after the peak in the unemployment rate following the 2001 recession. The rate appears to have peaked last October, which would be consistent with a rate increase by the September or November meeting.

To prepare markets, the Fed would need to begin changing the wording of its statements probably no later than June. An important difference this time is that the perceived risk from waiting too long to raise rates is diminished by the bust in housing. But that is more of an issue for the timing of rate increases than for adjustments to the statement designed to provide flexibility.

Another likely change will be to make the statement more conditional on developments in the economy and with inflation. While inflation is unlikely to become an issue this year, we expect that net employment growth will reach the 200,000 to 300,000 range (excluding census positions) in the next few months.

The Fed is likely to leave its target rate unchanged but alter its statement following the FOMC meeting on April 27-28, opening the door to rate increases later this year.

Our measure of the stance of monetary policy indicates that the funds rate target is now below equilibrium, meaning that policy is becoming inflationary. We expect an upturn in the interest rate cycle – which peaked in 2007 – to occur late this year or early in 2011, lifting long rates out of the trading range and flattening the curve.

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