Economic Commentary

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Federal Reserve Leaves Key Rate Unchanged, Indicates that it is Patient

The Federal Reserve's rate setting committee, the FOMC met yesterday and decided to leave the key fed funds rate unchanged at 1.0%. The decision was unanimously expected by markets, so it was absolutely no surprise. In the statement that accompanies the decision the Fed said: "With inflation quite low and resource use slack, the committee believes that it can be patient in removing its policy accommodation". The statement further added that "although job losses have slowed, new hiring has lagged" and "increases in consumer prices are muted and expected to remain low".

This morning the US Labor Department released the latest CPI data which showed that inflation remains subdued. Headline inflation in February fell to 0.3% from 0.5% in January while the closely watched core rate of inflation (which excludes food and energy items) rose slightly to 1.2% for the twelve month period ending February. Canada, releases its inflation figures tomorrow and are also expected to show a drop.

Although there was not much change in the wording of the announcement compared to the previews ones, the statement that the Fed is prepared to be patient suggested to most that interest rates may remain low for a longer period than was currently expected –perhaps into 2005- causing short-term and long term yields to fall on both sides of the border.

The two-year Canada bond fell to 2.25% while the ten-year one fell to 4.21%, increasing speculation that the Bank of Canada may cut rates again on this side of the border. The job losses reported last Friday by Statistics Canada and the drop in factory shipments in January are raising the odds of a further cut in rates in Canada. In the meantime, the odds of a rate cut by Europe's central bank are rising following the shock that the Madrid terrorist action has had on Euro confidence.

Kenneth Matziorinis, Ph.D.
Canbek Economic Consultants Inc.