M&B News Update

April 18, 2012

At the April FOMC meeting, the Federal Reserve will meet for two days but continues to be unlikely to change the course of monetary policy. In the past month, the economic data have continued to improve. The Fed will begin internally debating how soon its expansionary policies should end. Most importantly, the Fed has continued to state that it expects to keep interest rates near zero until late 2014, but some FOMC participants have said they now think the Fed will need to raise interest rates earlier than that.

One piece of good news that the Fed will consider at its next meeting is initial claims for unemployment benefits. Fewer and fewer people are being laid off from work and filing claims for unemployment compensation, and the level of initial claims is about at the level it was in 2003. Ideally, it would drop to 300,000 or below, but it is certainly heading in the right direction and illustrates continued improvement in the labor market. The level of claims exceeded 600,000 per week in the recession (shown by the gray bars) and has now declined by almost 300,000 since its peak in 2009.

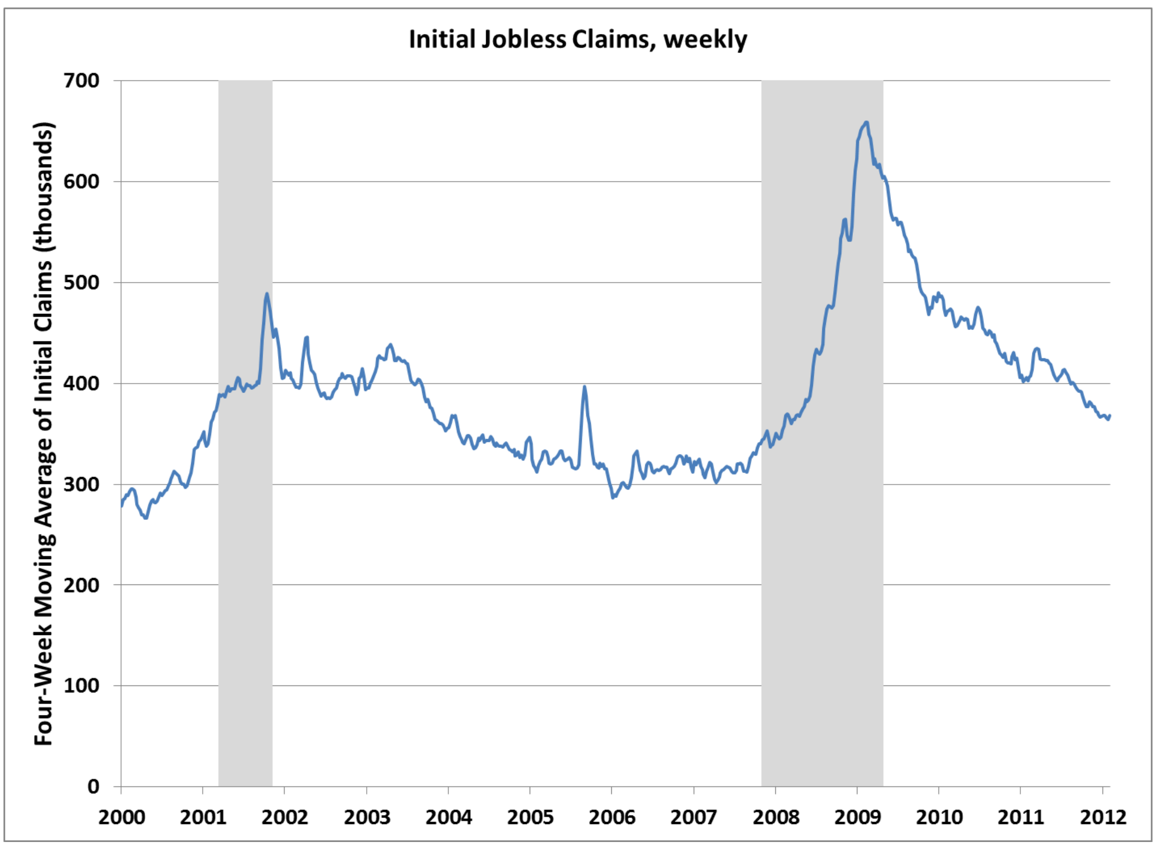

Chart 1: Initial Jobless Claims, weekly. Source: Federal Reserve Bank of St. Louis FRED database, original data from U.S. Department of Labor

The other piece of economic news that may influence the Fed's discussion at the FOMC meeting is the inflation rate. The Fed looks at a number of alternative measures of inflation, but the most important one is the personal consumption expenditures price index excluding food and energy prices, known as the core PCE price index, which is shown in Chart 2. (For more on that index, see M&B Chapter 17, page 366.) As the chart shows, the inflation rate in the core PCE price index has been rising for the past year from about 1% to about 2%. The danger the Fed may face would be if the inflation rate continues to rise even higher. Then it might have to raise interest rates quickly to keep inflation from rising significantly above its long-range target of 2%.

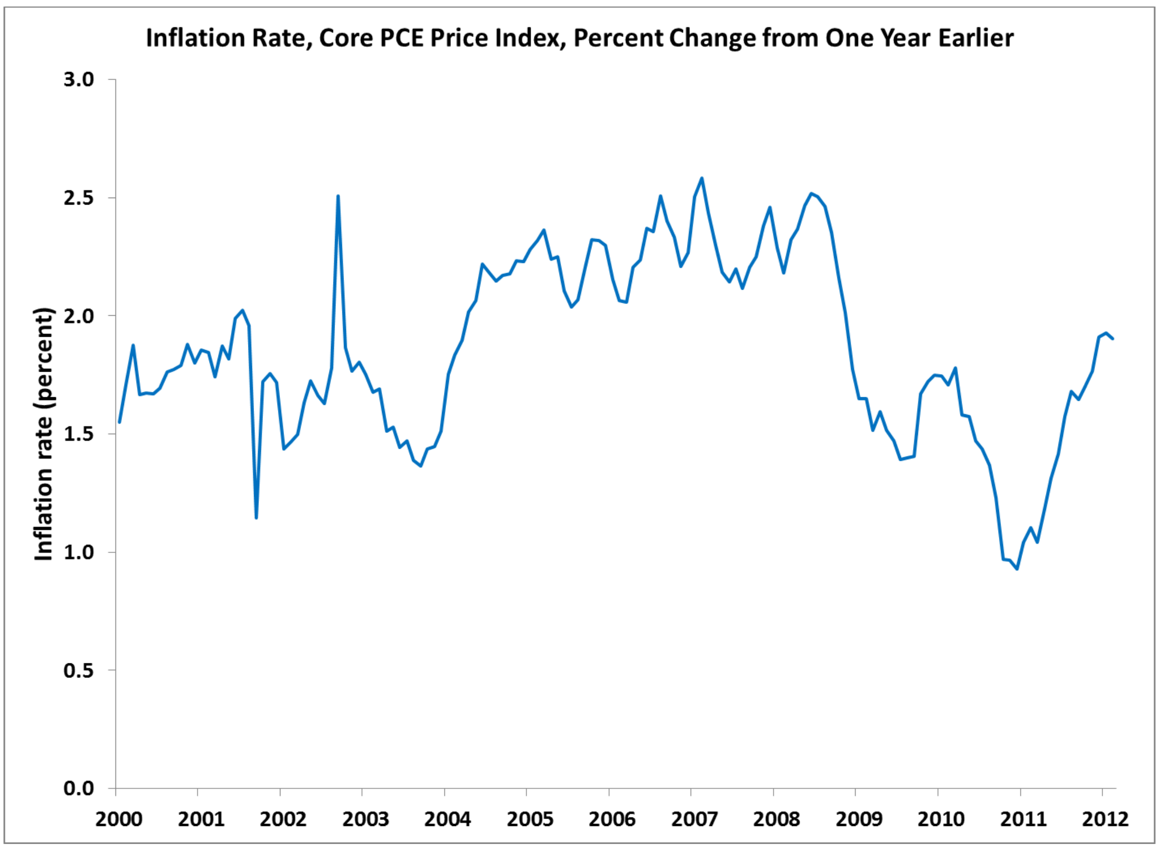

Chart 2: Inflation rate based on core PCE price index, monthly, percentage change from one year earlier. Source: Source: Federal Reserve Bank of St. Louis FRED database, original data from U.S. Bureau of Economic Analysis.