M&B News Update

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At the March FOMC meeting, the Federal Reserve is unlikely to make any policy changes. Earlier in 2012, the Fed had been prepared to take additional monetary policy actions to stimulate the economy. But after good economic data has been released this year, the Fed is unlikely to increase the money supply any more. In fact, if the economy continues to grow as it has in the past few months, the Fed's next move will be to begin to tighten monetary policy, raising interest rates far earlier than they expected a few months ago.

The good economic news was especially noticeable in the employment report, which you can read at http://www.bls.gov/news.release/pdf/empsit.pdf. As M&B discusses in Chapter 10, the unemployment rate is one of the key macroeconomic variables that determine to state of the economy. The unemployment rate (defined on page 203 in Chapter 10) has declined from 9.1% to 8.3% over the past six months. Economists also pay a lot of attention to the monthly increase in nonfarm payroll employment, which increased an average of 245,000 workers (that's net new workers in the economy) per month from December 2011 to February 2012. That pace is much faster than most forecasters, including those at the Fed, had expected.

With faster growth of the economy than was expected before, monetary policy may need to tighten earlier than before, as M&B discusses on page 387 in Chapter 18. But just a few months ago, the Fed said it planned to keep interest rates at a very low level until the end of 2014. The Fed was trying to commit to low interest rates in an attempt to keep long-term interest rates low, based on the term structure of interest rates in Chapter 5. Now, however, it may have to raise short-term interest rates much earlier than it had planned, perhaps even in 2012.