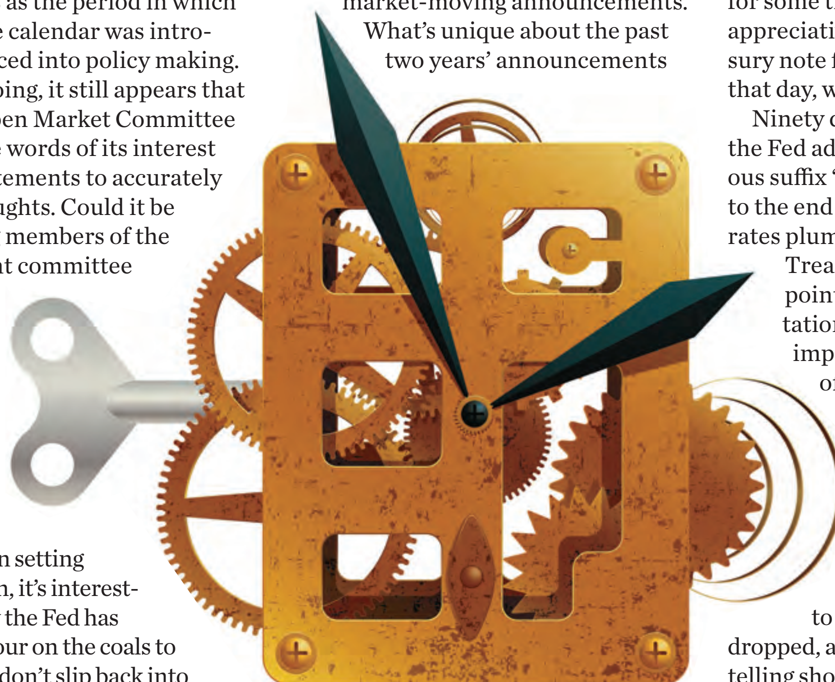
Jim Reber *(jreber@icbasecurities.com)* is president and CEO of ICBA Securities, ICBA's institutional fixed-income broker/dealer for community banks.

Wind the Clock

The Federal Reserve resets its criteria for altering monetary policy

By Jim Reber

The last two years may go down amongst Fed watchers as the period in which the calendar was introduced into policy making. As 2013 gets going, it still appears that the Federal Open Market Committee is finessing the words of its interest rate policy statements to accurately convey its thoughts. Could it be that the voting members of the most important committee of the most important central bank in the world has changed its standards for taking action?



With the Great Recession setting into the horizon, it's interesting to note how the Fed has continued to pour on the coals to ensure that we don't slip back into negative growth. It has employed a multi-pronged approach, utilizing both clear words (via its comments at the conclusions of the regular meetings) and strong actions (to wit: $2 trillion of quantitative easing, and counting).

But back to the wording: The Fed meets eight times per year, and each time it releases a statement regarding its just-reached conclusions about the economy's direction and its target fed funds interest rate. The parts that interest Fed watchers most greatly are ones that contain clues as to a shift in policy, including any timing considerations. These can in fact be market-moving announcements. What's unique about the past two years' announcements is that they contain an on-the-fly series of adjustments regarding actual dates that the Fed had in mind. Then the Dec. 12, 2012, meeting changed all that—again.

As done before

Up until 2011, any timing suggestions fell into the obtuse category. For example, the last time the Fed actually dropped its fed funds target was Dec. 16, 2008. The statement that accompanied the action included the suggestion that "conditions are likely to warrant exceptionally low levels ... for some time." Still, the market was appreciative, and the two-year Treasury note fell in yield 9 basis points that day, which is a substantial move.

Ninety days and two meetings later, the Fed added the seemingly innocuous suffix "for an extended period" to the end of its statement, and again rates plummeted, with the two-year Treasury shaving off 22 basis points. One can see that connotation and implication has a big impact on even the most liquid of markets.

In August 2011 came the first-ever, date-pegged rate change forecast. The Fed's statement that day defined "at least through mid-2013" before it anticipated any change to fed funds. Rates once again dropped, as the FOMC appeared to be telling short- and intermediate-term investors they would be free of rate risk for a couple of years.

How, many wondered, will they talk their way out of this if something goes amiss? It's clear the Fed doesn't scare easily. Either that or it has continued to miss its own growth targets. Since the "mid-2013" disclosure, it has been extended twice, to "late 2014" and "mid-2015."

This time around

In December 2012 the FOMC had yet another revision. This one removed

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any reference to dates (perhaps mercifully), and instead pegged the end of the "highly accommodative stance" to unemployment and the Fed's own forecast of inflation.

So now, until the unemployment rate drops below 6.5 percent (currently it's 7.9 percent), and the Fed's anticipated inflation level two years hence is more than 2.5 percent, we appear to have the fed funds rate anchored at a quarter point. This stance of course is subject to further tweaking. Perhaps as early as May.

In the meantime, it would appear that the 2.5 percent inflation target would be a tougher nut to crack than would the unemployment rate. Unemployment has been over 6.5 percent every month since October 2008, it's true, and the rate is also subject to the vagaries of the "those seeking employment" faction lurking in the denominator. Still, it's been tracking lower consistently since its peak of 10.0 percent in 2009.

Inflation, on the other hand, has been tracking lower also, and is now at 1.4 percent. While the Fed has made clear that any shift away from the current stance is predicated on its own forecast, it also has recently said "inflation over the medium term will likely run at or below its 2 percent objective." So it could be many months, meetings and quarters before the Fed gets what it needs to start bumping rates higher.

Be in the Know

Craig Dismuke, Vining Sparks' chief economic strategist, writes a recap of all Federal Open Market Committee meeting announcements as soon as they are released. To subscribe to this *FOMC Newsbreak*, contact your ICBA Securities sales rep or visit ***www.icbasecurities.com***.

Advice for portfolio managers: Be aware of Fed announcements, but it could be folly to make short-term trade decisions based on them. Many times in the last couple of years these rallies actually have run out of steam quickly and market fundamentals have taken back over. Better to follow a well thought out strategy than to watch the clock. IB

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