



Why the Fed Will Continue Raising Rates and What it Means

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Despite the softness in the U.S. economy, and in the face of a seeming slowing of inflation, the Federal Reserve is staying the course and will continue to raise interest rates.

Last week in his congressional testimony Chairman Greenspan made it clear that the Fed will continue to raise rates. Greenspan believes that price pressures will pick up unless the Fed takes action now. In particular, he cited rising labor costs. Over the last six months productivity growth has slowed down from its super-strong gains. This, combined with rising costs for health care and higher wage trends, has translated into labor costs increasing at a 2.6 percent pace. This reverses a two-year trend and is worrisome to the Fed.

Interestingly, the latest inflation reports are encouraging. On Friday the producer price index unexpectedly fell 1/10th of 1 percent in August due to falling prices for cars, computers, and even gasoline. However, this is a bit deceptive. It appears that producers are resisting raising prices for finished goods, but there are inflationary pressures building up in the pipeline. For example, the prices for crude and intermediate goods are rising sharply, presaging future inflation. Excluding food and energy prices, the core rate of inflation for crude and intermediate goods both rose by more than 1 percent in August, and the core rate for intermediate goods is up 7.3 percent over the last twelve months, with crude prices jumping 22 percent since last year.

With these types of pressures the Fed is correct to continue raising rates, even though the economy appears a little weak right now. Greenspan has steered a consistent course, ignoring the pleas of inflation hawks for bigger hikes and the worries of doves who fear slower growth in GDP. As the Fed raises rates in a slow but steady manner, the bond markets will continue to react favorably. Long

term rates on the ten-year treasury have remained below 4.5 percent, and this has allowed mortgage rates to stay low as well.

This is vitally important for Florida. Low mortgage rates promote home sales. This allows people to continue moving to Florida and boosts home sales here. Rising short term rates will also benefit Florida's retirees, many of whom rely on interest earnings. Sure, the higher short-term rates will affect those with floating rate debt and will push the financing costs for cars and other durables higher, but this is a small price to pay for price stability and for maintaining low long-term interest rates. Finally, all of this is good for growth in GDP in the long run. And this, above all other factors, is the driving force for Florida in general and for our economy here in Central Florida in particular.

This is Hank Fishkind for 90.7 FM, WMFE News.

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