

Fed worried about housing slump

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WASHINGTON — Heightened concern about the harsher-than-expected housing slump was a key factor in the Federal Reserve's decision to hold interest rates steady last month.

Minutes of the Fed's deliberations show that policy makers revealed increased concern over the real estate bust — even as they were reiterating that their No. 1 aim was to make sure that inflation, which has been calming down, continued to recede.

The Fed held interest rates steady at the December session. But it also left the door open to a possible rate increase, if needed, to thwart inflation. However, one Fed member — who was not identified in the minutes of the meeting — thought the central bank should have held out the possibility of a rate cut as well.

That member thought the Fed's statement issued last month “should emphasize that policy could be adjusted in either direction, depending on the evolution of the outlook for inflation and economic growth.”

In its Dec. 12 policy statement, however, the Fed didn't speculate about a rate cut. Rather, the policy makers hewed closely to previous language about the possibility of a rate increase, something most economists think is not likely to happen.

At their last meeting of 2006, Fed chairman Ben Bernanke and all but one of his central bank colleagues agreed to leave an important interest rate unchanged at 5.25 per cent, their fourth straight meeting without changing the rate.

Many economists believe the Fed will hold rates steady at its next meeting, Jan. 30-31, and further into the new year. The Fed's next rate move, many analysts and investors predict, will probably be a rate cut later in 2007.

At their December meeting, Fed policy makers said economic growth had slowed over the course of 2006, partly reflecting a “substantial cooling” of the housing market. That description went beyond the Fed's previous assessment in late October and suggested a sharper slump in housing could be taking place.

The policy makers suggested that the economy was in for sluggish growth owing to the housing slump, but they didn't indicate that the expansion was in danger of fizzling. Nonetheless, they said people needed to stay alert for any signs that weakness in the housing sector could seriously infect the rest of the economy.

“Several members judged that the subdued tone of some incoming indicators meant that the downside risks to economic growth in the near term had increased a little and become a bit more broadly based than previously thought,” the Fed minutes said.

The minutes noted that growth in business investment had slowed and manufacturing had cooled, in part reflecting the struggling automotive industry.

Consumer spending — the lifeblood of the economy — seemed to be holding up fairly well, yet there were risks that could change. “Considerable uncertainty regarding the ultimate extent of the housing market correction meant that spillovers to consumption could become more evident, especially if house prices were to decline significantly,” the minutes said.

Investment in building was likely to fall in coming quarters as builders sought to reduce their backlogs of unsold homes, the minutes said.

Meanwhile, Fed policy makers also made clear that they wanted to see “core” inflation — which excludes food and energy prices — move lower. They stuck to their forecast that this was likely to occur in the months ahead.

That said, “all members agreed that the risk that inflation would fail to moderate as desired remained the predominant concern,” according to the minutes.

At the December meeting Jeffrey Lacker, president of the Federal Reserve Bank of Richmond, Va., was the lone dissenter in the vote to leave rates unchanged. He believed an increase was needed so that “core inflation declines to an acceptable rate in coming quarters,” the minutes said.

Since August, the Fed has held rates steady. Before that, though, it had steadily boosted rates — 17 times — since June 2004 to fend off inflation.