

Economic Commentary

February 2, 2005

The Fed on Course to Raise the US Overnight Rate to 2.5%

The FOMC, the monetary policy arm of the U.S. Federal Reserve is holding its first scheduled rate-setting meeting for the year and is widely expected to announce at 2:15 P.M. today a quarter point hike in the fed funds rate to 2.5%, the interest rate banks charge each other for overnight loans. Today's decision will mark the sixth rate hike since June, 2004, when the Fed began what it calls a "measured" return to more neutral monetary policy setting. Most economists view the neutral setting as being around 3.5% in the current economic environment.

For a full explanation as to the reasons the Fed is raising the key short-term rate, read my December 13, 2004 Commentary.

Today's action by the Fed will bring the US short-term rates to the same level they are here in Canada thus erasing the positive differential between Canadian and US rates. Because this move has been widely anticipated the exchange value of the Canadian dollar has eased in recent days and has been trading around the US \$0.81 cent range.

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