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Fed remains skeptical about the recovery

1.9% inflation, 4% GDP growth, 5.7% unemployment, and 0.4% decline in labor force participation

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The 5.7% unemployment rate published by the Bureau of Labor Statistics (BLS) earlier this month was a sigh of relief for many labor market observers, but it was not an absolute sign of recovery for the Fed.

As inflation remains stable and very low, the Federal Open Market Committee decided to keep its target for the federal funds rate unchanged at 1 percent. The annual inflation rate was only 1.9 percent, with the health care sector having the highest inflation rate of 3.7 percent.

The Fed "continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity," said the Fed's Jan. 28 press release.

"The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation," said the Fed. "With inflation quite low and resource use slack," the Fed believes that it can continue its accommodative monetary policy.

The BLS statistics indicate a decline in the civilian labor force by 309,000 in December to 146.9 million as the labor force participation rate decreased over the month to 66 percent.

"Over the year, the participation rate declined by 0.4 percentage point," the BLS reports.

In December, about 1.5 million persons were marginally attached to the labor force. Among those, half a million people were classified as "discouraged workers", meaning they did not believe there were jobs available for them in the last 4 weeks. The rest of the discouraged workers had not searched for work for other reasons such as school or family responsibilities.

Advance estimates released by the Bureau of Economic Analysis (BEA) showed an annual increase of 4.0 percent in the fourth quarter of 2003 real gross domestic product (GDP), compared to the 8.2 percent of the third quarter that got many economists excited about the recovery of the U.S. economy.

U.S. economic outlook remains uncertain despite the improvement in the official unemployment rate and the stable GDP growth. The Fed's fear of inflation is certainly unjustified at this point, but monetary policy makers still have the inflation target as their primary objective and unemployment as a secondary one.