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Rates Fail to Control Inflation

Economy Shows Signs of Slowing in Latest Report

By Scott Blake
FLORIDA TODAY

A federal report Wednesday showed the cost of living is rising faster than it has in the recent past, setting the stage for another interest rate increase by the Federal Reserve to ease inflation.

Some economists wonder whether the Fed will go too far, after repeated rate increases in the past two years.

"It's dangerous," said David Scott, director of the Dr. Phillips Institute for the Study of American Business Activity at the University of Central Florida. "It could be like throwing the economy up against a brick wall."

Scott said the Fed could be reaching the point, after a series of 16 consecutive targeted rate increases, where it could make borrowing too expensive and slow the economy too much. The Fed is scheduled meet June 28 and 29.

On the other hand, he noted, the U.S. Department of Labor reported Wednesday that its Consumer Price Index rose by 0.5 percent in May -- the third consecutive month of considerable increases.

For the 12-month period ended in May, the cost-of-living index rose at an annual rate of 4.2 percent. This spring, the increases have been even greater. From March through May, the index rose at an annual rate of 5.7 percent.

"That number is huge," Scott said. Overall, "the numbers reveal what a lot of analysts have been saying for the last three or four months -- that there's a great deal of inflation embedded in the economy of the United States."

The recent increases in the Consumer Price Index reflect rising energy costs, among other things, he said.

At the same time, a Federal Reserve survey of the business climate released Wednesday found the economy is showing some signs of slowing down.

Although overall economic activity expanded from mid-April to early-June, "there were some signs of deceleration," the Fed noted.

Scott agreed, saying some sectors of the economy are sluggish, such as the housing market. That's what makes raising interest rates again so tricky, he said.

Scott expects the Fed this month to raise the federal funds rate -- the rate that banks charge each other for overnight loans, setting the tone for other borrowing rates -- from 5 percent to 5.25 percent. Since June 2004, when the federal funds rate was 1 percent, the Fed has raised the rate 16 consecutive times. The Fed has raised the federal funds rate 16 consecutive times since June 2004, when the rate was 1 percent.

Scott opposes another rate increase at this point.

"Banks' profitability will go up" by raising the rate, "but it will slow business and consumer activity," he said. "To me, the risks of slowing economic activity outweigh the risks of speeding it up."

Some sectors of the local economy already are feeling the effects of higher interest rates.

Auto sales have been relatively slow at some dealerships.

"It's a little light," Luis Peraza, sales manager at Nissan of Melbourne, said about the local business climate.

According to Peraza, financing rates for autos are about 6.5 percent for those with good credit, up from about 4.5 percent to 4.9 percent a year ago.

"People don't want the payments," he said.

The Consumer Price Index showed transportation costs for the three months ended in May rose by an annual rate of 20.9 percent, which includes gasoline.

Bobby Robinson, a retired engineer and technician from Indialantic, said he is paying more for gas, electricity and auto insurance, and expects his homeowners' insurance premium to be raised later this year. Still, he doesn't think inflation is as bad as it's made out to be.

"I've been out of the work force for a while, but what I'm hearing from relatives is that (costs) are changing, but nobody is in dire straits," he said.