No one knows the inflation answer. What's clear is that the Fed is not prepared.

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Monetary policy is inherently plagued with the twin problems of forecast uncertainty and long and variable lags between the implementation of policy and the point at which it would have an effect on economic activity. Worse, risks can emerge on either side of desired policy targets requiring either a tightening or a loosening of policy in response to incoming data. To work through this problem, the Federal Open Market Committee has traditionally endeavored not to position itself too far off "center court," following a monetary policy that neither runs too much in the restrictive direction or too far in the accommodative direction, and thus can be adjusted quickly as times change.

This is not the case today. The FOMC has a near-zero short-term interest rate in place coupled with a massive position of almost $4 trillion in longer-dated securities. This portfolio was accumulated with the express purpose of pushing the effective stance of monetary policy below the "zero bound," in effect running a policy with a negative interest rate. One could make the case for such a policy in the dark days following the financial crisis. But no one should imagine that current policy is anywhere close to "center court."

Amazingly, this emergency policy which even its supporters describe as "highly accommodative" is in place as the economy reaches an unemployment rate which is at or close to what has traditionally been considered full employment. When quantitative easing was begun, Fed Chairman Ben Bernanke predicted that it would be wrapped up by the time the unemployment rate came down to 7 percent. In fact, tapering wasn't even begun until that point. Lift-off was to happen within a period that Fed Chair Janet Yellen originally described as six months after tapering was completed. That was March. Moreover, repeated Fed statements noted that the removal of accommodation would happen sooner if progress toward full employment was faster than what the Fed expected. It happened much faster, yet the removal of accommodation did not follow.

Keep the idea of "long and variable lags" in mind when evaluating this policy by considering the following thought experiment. Monetary policy lags are roughly a year and policy will not go into restrictive mode until the Fed funds rate becomes positive in real terms. Until then, monetary policy is a tail wind, not a head wind. Even if the FOMC should raise rates at the June meeting by 25 basis points and then raise them by 25 basis points every other meeting thereafter, a positive real Fed funds rate will not occur until December 2016, and that will not become an economic headwind until December 2017. If the unemployment rate continues to fall at the same rate as in the last two years, it would (mathematically, but not realistically) be 2.2 percent by the time a positive real Fed funds would begin to slow the economy!

The sheer absurdity of this situation points to just how far off center court the FOMC currently is. Is inflation just around the corner? We don't know. But is the FOMC prepared to combat inflation should it appear in a way that would allow a non-disruptive change in the stance of monetary policy? Absolutely not.