

Economic Commentary

May 05, 2003

FED MEETS TOMORROW: EXPECTED TO STAND PAT FOR NOW

The Federal Reserve Open Market Committee is holding its regular policy meeting tomorrow to decide on what to do with short term interest rates in the USA, now at a 41-year low of 1.25%.

The consensus from economists and street analysts is that despite the weak US economy the Fed will keep its rates unchanged for now and wait until the next meeting on June 25th to decide whether to cut them or not. The reason is that even though all data confirm a weak economy the better than expected outcome with the Iraq war is generating optimism that a recovery may soon be on the way. Lower oil prices since the end of the war, improved consumer confidence and rising stock prices, should propel the economy upwards, and therefore a further cut at this point might not be necessary. Future markets suggest a 20% chance of a rate cut at this meeting and a 70% chance of a rate cut on June 25th.

My feeling is that it is too early for the Fed to assess the risks so shortly following the conclusion of the war. As a matter of fact, there is much debate amongst analysts as to whether the Fed will state its bias as to the future risks as we move forward. Some analysts expect that the Fed will shift its risk bias toward an easing of rates tomorrow, others say that they will go back to a neutral posture while others suggest that the Fed might avoid making a pronouncement right away in anticipation of more conclusive evidence. Last Friday's unemployment report showed that the US economy shed 48,000 jobs for a third month in a row, a sign that the economy may be heading back into recession, but the job losses were much smaller than the previous two months suggesting that the worse is over all the while the lessening of the uncertainty following the end of the war might give a boost to the economy as we move forward. Fed Chairman Alan Greenspan stated last week in Congressional testimony that there is room to lower rates further and that the Fed will not hesitate to cut them if it sees a need to do so.

Thus, expect no change tomorrow, but look to see what the Fed does with its bias statement.

Kenneth Matziorinis, Ph.D.

Canbek Economic Consultants Inc.

