Economic Commentary

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The Fed to Cut Key Policy Rate on Wednesday by 1/4 point

It now looks almost certain that the Fed will cut rates on Wednesday, November 6th by one quarter of a percent (some expect a half point cut!). Job losses for two months in a row, a drop in manufacturing output and a drop in consumer confidence last week to late 1993 levels -lower than September 11 as well!) and, with a falling leading economic indicator have increased dramatically over the past 10 days the risk of a double dip recession in the USA.

Moreover, it also looks highly likely that the European Central Bank (ECB) and the Bank of England will match the fed move with rate cuts of their own later this week or later this month, in order to provide a global coordinated response to the crisis that seems to be spreading all over the industrial world.

The attached article from the Globe & Mail sums it up nicely.

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Rate cut all but certain

Economic recovery appears in peril

By GLENN SOMERVILLE
Reuters News Agency
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WASHINGTON -- A run of bad economic news last week has U.S. economists all but certain Alan Greenspan and the U.S. Federal Reserve Board will lower borrowing costs Wednesday to rescue a recovery in peril of grinding to a halt.

"The economy's stalled," said economist Mark Zandi of Economy.com in West Chester, Pa. "The risks are high and rising that the recovery may unravel back into a recession. If the economy's growing at all now, it's barely, and it needs help."

Reports on Friday showing a drop in the number of jobs for the second straight month in October and reduced activity on factory floors cemented a virtual consensus the Fed will announce after its Wednesday meeting it is cutting rates for the first time this year to try to stimulate activity.

The U.S. central bank's policy-making Federal Open Market Committee, which has kept the federal funds rate steady at a four-decade low of 1.75 per cent so far this year, is widely expected to agree on a reduction.

In a Reuters poll taken after the employment report, fully 21 of 22 primary Wall Street dealers -- firms that deal directly with the Fed -- foresaw a rate reduction, with 15 anticipating a one-quarter percentage point trim and six looking for a larger half-point cut.

The result is a dramatic shift from the last Reuters survey on Oct. 7, when the economic news was less worrying and just six dealers expected a November cut.

Pressure around the Fed's boardroom table for easier monetary policy began to ratchet up at the last policy-making meeting in September, with two voting members pressing for a rate cut. The majority, however, opted to keep rates steady.

Mr. Zandi said Mr. Greenspan faces some special pressure to keep the economy from slipping back into recession. The venerated Fed chairman is a vocal advocate of the benefits of productivity growth and a renewed slump could throw into jeopardy the technology-driven acceleration in hourly worker output that has been a highlight of his Fed tenure.

The 76-year-old Fed chief may be conscious of the history-book factor as well. After 15 years at the helm of the U.S. central bank, Mr. Greenspan is likely anxious to preserve the economic gains made during the 1990s boom that are the foundation of his legacy.

"He has to worry about the danger of the country slipping into a lengthy economic malaise," Mr. Zandi said. "I think he hopes that his legacy will be that he raised all Americans' living standards, but that's something that could quickly get lost the longer that current economic problems last."

Mr. Greenspan and the Fed cut interest rates 11 times last year and, until recently, the economic recovery from last year's recession had looked on track, although slow and uneven.

The reversal of economic fortune, after a relatively strong third quarter in which the nation's gross domestic product grew at a respectable 3.1 per cent rate, came swiftly.

"There's been a real down shift in growth late in the summer and in the early fall with clear indications the manufacturing sector already has fallen back into recession," said economist Allen Sinai of Decision Economics Inc. in Boston, adding that prospects for a significant pickup seem to be retreating to as late as possibly 2004.

The private Institute for Supply Management said on Friday its factory index fell to 48.5 in October from September's 49.5. A reading below 50 shows a shrinking manufacturing sector.

"The picture right now is depressing," Mr. Sinai said. "The odds are now eight out of 10 that at best we're going to see sluggish growth for the next several quarters -- basically a sluggish, jobless economy like we had back in 1992 and 1993 and at worst a fall back into recession."

Despite the divisions on the FOMC at the Sept. 24 policy session, economists say this time there seems to be nothing to stop a rate cut.

"Here's what the Fed sees: We're in a patch of soft economic data and inflation is very low so the Fed has the flexibility to ease and is very likely to ease," said Mickey Levy, an economist with Bank of America in New York.