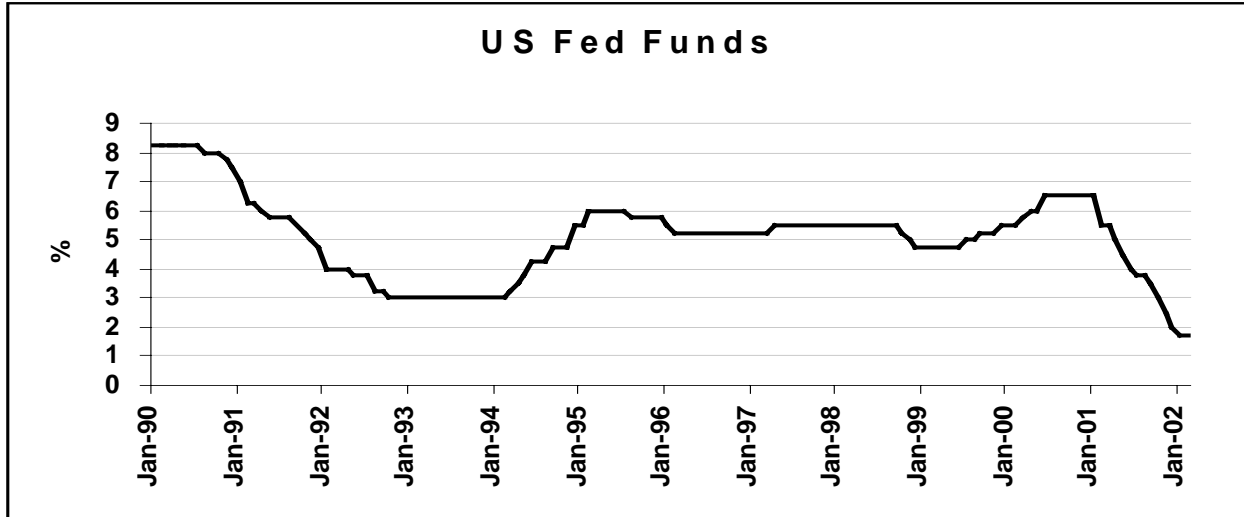


Fed in No Hurry to Hike Rates



Fed Chairman Alan Greenspan's cautiously optimistic economic and monetary policy testimony to Congress last Wednesday reinforces our view that the Fed will be content to leave US interest rates at their current low level for sometime to come and will also retain its easing bias. Fundamentally, Greenspan believes that there will be a recovery but that it will be a modest one. *"In the past several months, increasing signs have emerged that some of the forces constraining the economy...are starting to diminish.... An array of influences unique to this business cycle, however, seems likely to moderate the speed of the anticipated recovery."*

History shows that the first monetary tightening after a recession does not take place until after the unemployment rate has peaked. With economic growth still not strong enough to generate significant job opportunities we are unlikely to have seen this peak yet. During 2002, the central tendency of FOMC's forecasts for real GDP growth are 2.5%-3.0%. Such a pace for the growth is below the rates of growth typically seen early in previous expansions. Certain factors, such as the lack of pent-up demand in the consumer sector, significant levels of excess capacity in a number of industries, weakness and financial fragility in some key international trading partners, and persistent caution in financial markets at home, seem likely to restrain the near-term performance of the economy.

Greenspan believes that a weak labour market could still have negative implications for consumer demand. Even if the economy is on the road to recovery, the unemployment rate, in typical cyclical fashion, may resume its increase for a time, and a soft labor market could put something of a damper on consumer spending. Furthermore, the central bank seems to be optimistic about the outlook for inflation and its central tendency for the personal consumption deflator in 2002 is only about 1.50%, down from 1.75%-2.5% in the forecasts released last July.

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