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Greenspan May Try to Boost Confidence, Not Rate Fears (Update 2)

Washington, Feb. 27 (Bloomberg) -- Trying to build confidence without scaring investors, Federal Reserve Chairman Alan Greenspan will probably tell Congress today that the U.S. recovery isn't strong enough to need a rise in interest rates.

Home, auto and retail sales are rising, layoffs are diminishing and manufacturing is starting to grow again. Still, factory capacity is at its lowest level in almost 19 years, consumer confidence fell this month and stock prices are down for the year, suggesting a rebound may be slow to come.

"Expect him to point to recent data as comforting evidence that a recovery is under way," said Nancy Roman, a Fed analyst at the G-7 Group in Washington. "But you can also expect him to reiterate the potential threats to this nascent recovery."

The Fed chairman will appear before the House Financial Services Committee at 10 a.m. Washington time. He'll be delivering the Fed's twice-yearly monetary policy report, and so will be speaking on behalf of all 17 members of the Fed's policy-setting Open Market Committee.

The 4 7/8 percent note maturing in Feb 2012 fell 1/8 point, pushing its yield up 2 basis points to 4.94 percent, after the Commerce Department reported that factory orders for durable goods rose last month. A basis point equals 0.01 percentage point.

Jan. 24 Testimony

Economists say they don't expect the chairman's testimony to be much different from his own remarks before the Senate Budget Committee on Jan. 24.

"There have been signs recently that some of the forces that have been restraining the economy over the past year are starting to diminish and that activity is beginning to firm," Greenspan said then. At the same time, he said any rebound "will be short-lived unless sustained growth of final demand kicks in."

There is evidence demand is picking up. Existing home sales rose 16.2 percent in January to a record annual rate of 6.04 million. Excluding auto dealers, retail sales rose 1.2 percent in January, more than during any other month in almost two years.

Still, because consumers kept buying retail goods and homes during the recession, there may not be much pent-up demand to drive a strong rebound.

"Consumer spending and housing are not likely to provide the usual kick we've seen coming out of previous recessions," Jack Guynn, president of the Federal Reserve Bank of Atlanta said Tuesday.

Unemployment

Also, consumer confidence fell in February from a five-month high, according to the Conference Board's gauge of sentiment. While the decrease was the first in three months, the level stayed higher than November's 7 1/2-year low.

The recovery also may be stalled by a rise in joblessness, Fed Governor Edward Gramlich told Bloomberg Television last week. The February consensus forecast from the Blue Chip Economic Indicators survey is for unemployment -- at 5.6 percent in January -- to average 6 percent thi s year.

"It's hard to worry about spending demands being too buoyant with the unemployment rate heading up to 6 percent," Gramlich said.

That means business investment will have to lead the expansion, and there the picture is more mixed. New orders of durable goods rose 2.6 percent in January, the third increase in the last four months, the Commerce Department said. Production at factories was flat last month after five months of decline.

Capacity Utilization

General Motors Corp., the largest automaker, announced yesterday it was boosting profit and production estimates for the first quarter and full year because U.S. sales are higher than expected.

Still, the nation's factory plant-use rate fell to 72.7 percent in January, the lowest since March 1983. "There's still a great deal of excess capacity out there right now, and there may be a very long wait for profits in some of the most over-built industries," Guynn said.

Stocks have also struggled this year following the collapse of Enron Corp., as investors sold shares whenever questions have been raised about a company's accounting practices. The Standard & Poor's 500 index is down 3 percent for the year.

That suggests Fed officials are hearing pessimistic reports on business spending plans. "The accounting witch-hunt has exacerbated" central bankers' concerns about the economy, said Lou- Crandall, chief economist at Wrightson Associates in New York.

Fed Funds Futures

"Greenspan's central theme this year has been that a sustainable expansion depends on a recovery in capital spending, and that capital spending cannot pick up while corporate profitability remains weak," he said.

Fed officials who see a rebound under way will need to prepare financial markets for a change in policy, said Deutsche Bank Chief Economist Peter Hooper.

Right now, investors are betting the central bankers will leave the benchmark overnight bank lending rate at its 40-year low of 1.75 percent at least until their June 26 meeting, according to trading in fed funds futures.

"Policy makers clearly are concerned that the markets could overreact to any hint of a change in their sentiment," Hooper said.

Greenspan's twice-yearly testimony has affected financial markets in the past. The average absolute yield change on the 2-year Treasury note is about 12 basis points on the days when he's offered the Fed's monetary policy report, according to the Deutsche Bank economists.

Moving Markets

"That's a substantial move, owing to the fact that Mr. Greenspan's testimony often changes perceptions on the future course of monetary policy," Hooper said.

After a Jan. 11 speech that investors interpreted as suggesting the economic recovery might not hold, the implied yield on the March fed funds contract fell 9 basis points that day to 1.61 percent.

On Jan. 24, he suggested he'd been misinterpreted. March fed funds futures rose 3 basis points that day to 1.73 percent.

"Everyone's dying to see whether he's become more hawkish or will remain more dovish," said the G-7 Group's Roman. "We think that answer is both."

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