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## **Fed Likely to Keep Rates Unchanged at 41-Year Low (Update1)**

*by Craig Torres*

Washington, Sept. 23 (Bloomberg) -- Federal Reserve policy makers will probably leave interest rates unchanged tomorrow because there is scant evidence the U.S. recovery is in trouble or that inflation poses a threat.

The economy ``doesn't seem to be getting much better and it doesn't seem to be getting much worse," said Carl Tannenbaum, chief U.S. economist at LaSalle Bank in Chicago. ``The data we have gotten hasn't been bad enough to give the Fed a sense of urgency about cutting rates."

The latest Blue Chip Economic Indicators consensus forecast is for the economy to expand 2.3 percent this year and 3.2 percent in 2003. At the same time, the potential for a war with Iraq and this year's 50 percent rise in oil prices to above \$30 a barrel may hamper business and investor confidence, economists said. Spending, already weakened by corporate accounting scandals and lower stock prices, may slow.

As a result, the Federal Open Market Committee, the central bank's policy group that decides on the level of interest rates, will probably hold its target interest rate on overnight loans between banks at 1.75 percent, a 41-year low. And the Fed isn't likely to change its view that the risks to the economy are weighted more toward weakness rather than strength, a stance central bankers adopted on Aug. 13.

The 4 3/8 percent note maturing in August 2012 rose 6/32, or \$1.88 per \$1,000-face amount, to 105 at 8:15 a.m. London time. The yield dropped 2 basis points to 3.76 percent, adding to the 15 basis-point decline in the past week.

### **Fed's Focus**

The Fed ``has to be focusing on the weakness of the economy and not on inflation," said John Silvia, chief economist at Wachovia Bank in Charlotte. Fed officials probably don't ``think there is enough forward momentum" in the economy.

None of the 22 banks and securities firms that trade directly with the Fed expect a rate change this week, according to a Bloomberg News survey of the firms. A majority of the so-called primary dealers expect the Fed to hold rates steady for the remainder of the year.

Consumers continue to shoulder much of the economy's recovery from a recession that began in March 2001 and probably ended at the beginning of this year. Retail sales rose for a third straight month in August and sales of new and existing homes will probably rise to a record 6.5 million this year, according to Fannie Mae, the largest buyer of U.S. mortgages.

### **Mortgage Rates**

Mortgage rates haven't been lower in more than three decades, carmakers are offering zero-interest loans and inflation is tame, giving support to a rise in purchases. Consumer prices, minus volatile food and energy costs, were rising at a 2.2 percent annual rate through the first eight months of the year compared

with a 2.8 percent gain through August 2001.

Increased consumer spending is one reason why businesses are rebuilding inventories for the first time since before the recession started. Stockpiles of unsold goods rose 0.4 percent gain in July, the largest increase since November 2000. Economists say there is contradiction between indicators that measure demand and those that measure production.

Industrial production declined unexpectedly by 0.3 percent in August, following a 0.4 percent gain in July. Service industries, which account for more than two-thirds of the economy, grew in August at the slowest pace since January, according to the Institute for Supply Management's index for retail, financial services, construction, and other non-manufacturing companies. Also, job growth is sluggish.

## **Demand**

“Demand is not bad,” said Tim O’Neill, chief economist at Bank of Montreal in Toronto. “You look at the jobs picture, and you say, ‘Who is making this stuff.’”

The economy has added 162,000 jobs over the past four months after eliminating 210,000 during the first four months of the year. Economists say the U.S. must create at least 100,000 jobs a month to absorb the growing labor force and sustain a decline in the unemployment rate.

The rise in gross domestic product this quarter, estimated at a 2.7 percent annual rate in the latest Blue Chip consensus, “isn't coming from adding people,” O’Neill said. “We are getting it out of productivity,” or from workers producing more in the same amount of hours. Productivity grew at a 1.5 percent annual pace in the second quarter, the Labor Department said.

In recent speeches, Fed officials emphasized that consumer spending must carry the expansion until a pickup in business investment takes hold. Purchases of equipment and software increased in the second quarter for the first time in almost two years. And for now, economic and political concerns are weighing on business spending plans.

## **Stable Prices**

Profits can't easily be obtained by raising prices because competition is stiff. Kroger Co., the Cincinnati-based grocery chain, said Sept. 17 that annual earnings will be lower than expected because the company must reduce prices to compete with discounters such as Wal-Mart Stores Inc.

Few companies are sure that the sales they see today represent a forecast for the future because of potential threats ranging from war with Iraq to terrorist attacks.

**“It has been very hard for corporate America to feel good about making an investment in the future because there have been so many risks,” says Nancy Roman, managing director at the G7 Group Inc., a Washington-based consulting firm. The Fed would “like to see business demand pick up. That hasn't happened and that continues to be the thing we are all waiting for.”**