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THE AMERICAS: Fed ‘won’t need a recession’ to cut rates again

By Peronet Despeignes in Washington

Few outsiders are as well equipped as former Fed governor Laurence Meyer to guess what the US central bank might do - or not do - next.

As policymakers at the Federal Reserve are scheduled to meet tomorrow and Wednesday, Mr. Meyer said a double-dip recession was "unlikely" but acknowledged the possibility.

Some speculators expect the Fed to consider for the first time this year cutting short-term interest rates to a new 40-year low.

Addressing emerging speculation of another rate cut, Mr. Meyer said: "The Fed won't need a recession. If growth remains sub-par [less than 3 per cent] over a sustained period then you will get another easing. All it will take is a concurrent rise in unemployment."

In an interview with the Financial Times, Mr. Meyer also questioned speculation that the Fed would raise rates by September, saying economic data, which have been "mixed and disappointing", showing little or no inflation, "have not even begun" to justify a rate increase. He added that a rate cut could happen if economic growth remained anaemic.

"There's virtually no chance of an interest-rate hike in June or August," he said. "September is a possibility, but the data has not even begun to support a move in September."

Mr. Meyer, a highly regarded economic forecaster who was nominated by President Bill Clinton in 1996 as a member of the Fed's board of governors, resigned earlier this year and is now returning to his forecasting consultancy, Macroeconomic Advisers.

Though in the past an inflation hawk, he has always voted with the majority of the Fed's policy-making open market committee and recently shared his thoughts on the monetary and economic outlook. He said the US economy probably grew no more than 2 per cent in the second quarter, after surging nearly 6 per cent in the first. He said America's ongoing hangover from the ill-fated investment binge of the late 1990s remained "the single most important" uncertainty hanging over the economic outlook.

The economy's recovery from last year's recession has been haphazard, with housing strong, consumer spending apparently slowing and business investment and hiring still depressed. The recovery has appeared increasingly troubled in recent weeks, as the stock market has sunk toward September 11 lows and reports have shown both production and sales of consumer goods - the bulk of the economy - were essentially flat last month after rising solidly through the first quarter.

"Right now, we're in a soft spot, struggling toward a sub-par recovery," Mr. Meyer said. "And legitimate concerns have been raised as to whether the economy is gaining traction."

While a renewed slide into recession was unlikely, "I wouldn't rule it out," he said. Still, the most likely scenario in his view is that the economy will pick up steam in the second half of the year, growing at an annual rate of 3.5 per cent in the second half and at 4.5 per cent next year.

Mr. Meyer said futures markets, which have reflected a relentless erosion since March in market expectations for any Fed rate increases this year, were appropriately "reacting to the economic data".

The stock market was working against a recovery, he said.

"Instead of the stock market leading and becoming a factor supporting it, the recovery is dragging it along," Mr. Meyer said.

While he does not expect the market's travails to derail the resumption of solid growth, "there aren't too many post-recession precedents for this. It's a very unusual situation," he said. "We have this enormous set of corrections taking place, and the question is whether or not there's an ongoing post-bubble hangover that could put the expansion on hold for a while."

The unambiguously good news, he said, was that inflation would probably continue falling this year, as "we've seen an unusually large cyclical rebound in productivity" that reduced the upward pressure of wages on profits and prices.

But he is worried that by next year "we'll see an inflection point and inflation begin to rise somewhat", forcing an inevitable, pre-emptive move by the Fed to tighten the noose on money and credit, after cutting short-term interest rates to 40-year lows last year.

When will the investment slump end? Mr. Meyer's favourite "real" leading indicators of investment are the government's monthly report on orders for non-defence capital goods (commercial heavy equipment), also a favourite of Alan Greenspan, Fed chairman, and a recently devised G7 investment index, as well as surveys conducted by the National Federation of Independent Business and the National Association of Purchasing Management. All suggest that, if not sinking, investment may have stabilised.

Mr. Meyer said a critical turning point from the current mix of sluggishness and uncertainty for employment and the economy in general would be when "firms turn their attention from maintaining current profitability to looking for opportunities to enhance future profitability".