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FED SHADOW

Greenspan Still On Hold

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Greenspan may be "upbeat," but that doesn't mean rates are going up any time soon.

It doesn't happen very often, but today we can safely say: don't blame **Greenspan**. For the most part, today's credit market setback is part of an inevitable process of moving back toward sustainable prices and yields following last week's panic-driven rally. True, the **Fed** chairman's **Senate Banking Committee** testimony pulled the rug out from under what had been an emerging bet that the Fed's next move would be to cut rather than hike rates. But that was also the product of an equity market free-fall that now shows signs of leveling off. Barring a complete collapse of stock prices, chances of the Fed dropping rates again are negligible. And as we noted at the end of last week in a *TrendMacro Live!* note, the prospect of equities stabilizing left Treasuries vulnerable after a rally that drove 10-year yields nearly 30 basis points lower.

The real significance of Greenspan's testimony is that, while it was widely said to be "upbeat," the reality is that it revealed no inclination to begin the process of taking back last year's rate cuts anytime soon. Yes, he allowed again that the Fed's stance is now "accommodative," and that the current 1.75% fed funds rate target "likely will not prove compatible over time…with price stability." But he immediately added, "with inflation currently contained and with few signs that upward pressures are likely to develop any time soon, we have chosen to maintain that stance pending evidence that the forces inhibiting economic growth are dissipating..." Indeed, the Fed's subdued inflation outlook was reinforced by the forecast accompanying Greenspan's testimony, which showed the "central tendency" of the **FOMC** for the personal consumption expenditure deflator remaining at 1-1/2% to 1-3/4% both this year and next.

Clearly, Greenspan is persuaded that the "fundamentals are in place for a return to sustained healthy growth." But just as clearly, he remains acutely aware that "considerable uncertainties…still confront us." Remaining high on that list are prospects for recovery in capital investment. "Business spending has been depressed," Greenspan said, noting that real business fixed investment "plunged about 11 percent between its quarterly peak in the final months of 2000 and the first quarter of this year." And while he sees the glut in high-tech capital goods as having been largely worked off, "a recovery in this category of spending is likely to be gradual by historical standards and uneven across sectors." Capital expenditures "should strengthen with time" as firms respond to an improving outlook for sales and profits as well as the productivity gains made possible by technological advance.

But Greenspan also offered an important caveat to this notion. Due to a loss of "pricing power… …nominal corporate revenues, although no longer declining, are growing only tepidly," he said, and "managers seem to remain skeptical of an emerging upturn." The lowest inflation rates in 40 years "imply that nominal growth in sales and profits look particularly anemic." Greenspan would be the last to admit it, but we have identified the hit to nominal revenues as being rooted in the Fed's deflationary liquidity squeeze of recent years. It's also our analysis, though, that the deflation relief indicated by the dollar's decline this year relative to key commodities and foreign exchange provides the basis for restoration of nominal revenue growth. TM

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