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POLITICAL PULSE

Frustrated and Concerned

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John Snow said something sensible yesterday. That begs the question -- why?

It's not every day that we can say we agree with **Treasury Secretary John Snow**, but yesterday was one of them. His statement yesterday to the ***Times* of London** that "interest rates are set to rise over the next few months," and that "far from being a dampener on the economy [they] would underline the strength of the country's growth prospects" is precisely what we have been saying for months.

His explanation for this is so true as to be nearly axiomatic: "Interest rates are the price of capital. As profits increase, there is going to be a need for a capital-rationing process." He even echoed our own sense that it would be a problem if such a process *did not* occur: "I'd be frustrated and concerned if there were not some upward movement [in rates]." Bravo -- we'd be frustrated and concerned, too.

We even agree with his jobs forecast. "I would stake my reputation on employment growth happening before Christmas. I'd bet dollars to doughnuts that we're going to see a pickup in jobs in the next few months."

Markets and the media reacted sharply to Snow's comments at first, because he has been the administration's point man in its dangerous mercantilist war-of-words over dollar exchange rates. The administration rushed out a spokesman to pour oil on troubled waters, saying that Snow "was not indicating Treasury yields would rise." Such inanities hardly inspire confidence: what other meaning can "interest rates are set to rise" have? Better to have said what an editorial in today's *Wall Street Journal* did: that Snow was simply telling the truth.

Why did Snow say what he said? It could be that he was simply trying to talk up the US economy -- it wouldn't be the first time. Or perhaps it was a version of "when stuck with a lemon, make lemonade." In light of some of the more bullish statements from regional **Fed** presidents over the last week, the administration may believe that rate hikes before next year's elections are a fact of life. So perhaps Snow took this opportunity to endorse an action that would be seen by the conventional wisdom as consistent with a "strong dollar policy." Or perhaps, as the *Journal* suggested this morning, this is a rehearsal of **the President's** defense against the inevitable **Democratic** accusations that rising rates are a consequence of the administration's large budget deficits.

Another reason may have been to send an all-clear signal, relieving the **FOMC** of any fears that **the White House** is expecting any election year favors where interest rates are concerned. Many investors tell us that they believe that **Alan Greenspan** will keep rates low through November 2004 in order to make it up to **President Bush** for the fact that he raised rates in 1992, and possibly cost his father re-election. Snow brushed all that aside, saying, "It is amazing how you get this sort of mythology without any factual backing."

Why would an administration that may need all the election-year favors it can get send such a signal to the Fed? Perhaps the administration shares our concern that the consequence of a Fed that stays too easy for too long could easily trigger an outbreak of inflation. At this stage in the recovery and the election cycle, with it being a virtual certainty that Bush will be the first president since **Herbert Hoover** to have presided over net job losses during his administration, the last thing he needs is to have an inflationary outbreak push up the "misery index."

All in all -- and without wishing to exaggerate the importance of this -- we take Snow's remarks as a welcome note of coherence in what has been, recently, a symphony of economic nonsense. TM