



FOMC Minutes December 10, 2002: hindsight or foresight

This is the meeting that followed the November “surprise,” at which a 50 basis point cut in the Fed Funds target was ‘paradoxically’ paired with a balanced statement of risks. At the December 10th meeting, the Fed paused to consider how effective its November decision had been and to assess the likely course of the economy. The spending data cited by members seems to imply that the Committee felt they had done the right thing at the November meeting and the behavior of financial markets seemed to ‘reward’ their judgment. Financial markets had a better tone with noted (if modest) reductions in uncertainty and risk aversion. The inflation data was benign and the risk of deflation seemed not to be a bothersome issue to members. The focus of attention was the relatively poor response to months of accommodative monetary behavior and strong fiscal support, but the implicit message was that the uncertainty in the business sector was largely a product of heightened geopolitical risks.

It is always tempting to look at the data since the meeting (which has been poor) using hindsight to evaluate the perceptions expressed in the meeting. This is particularly the case since the equity market has had an UP-DOWN in the past six weeks. At the close on December 9th, the S&P stood at 892 but reached an intra-period high of 931.66 on January 14th while the effects of the President’s tax proposals were given wide currency.

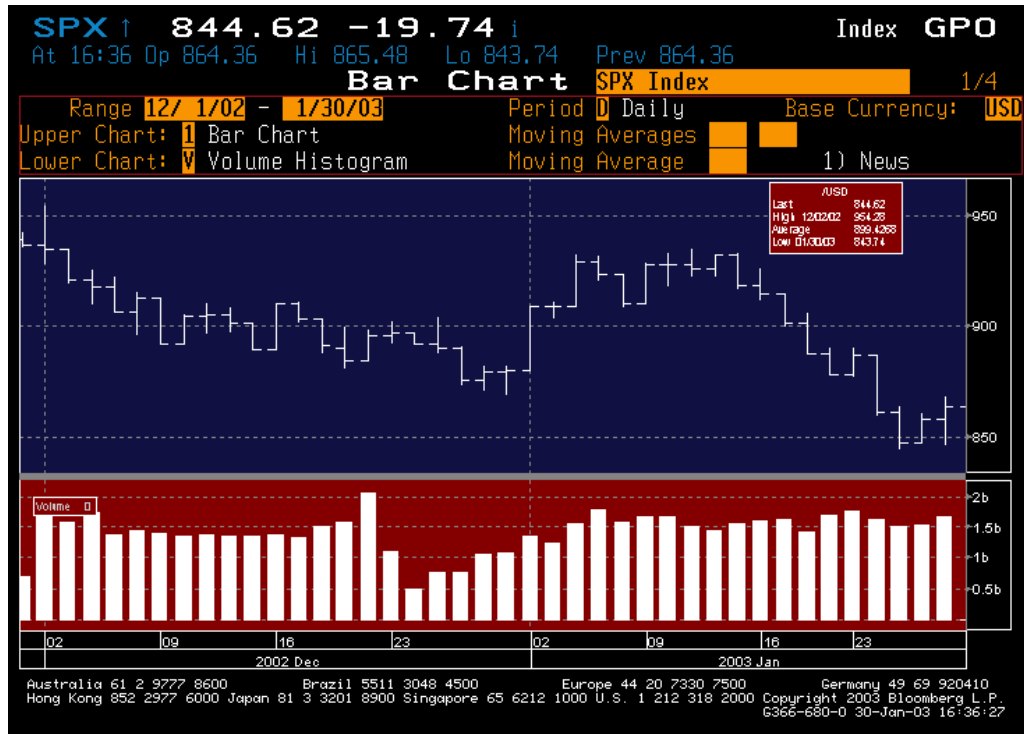
One other point worth mentioning is that while the Committee did note that fiscal policy moves would have a positive impact and would assist monetary policy in reviving the economy, there is a single sentence in this report that has now emerged as a major policy position---at least of the Chairman.

“The outcome of the recent Congressional elections had fostered expectations that fiscal policy might be more expansive than previously anticipated, although the size, timing, and composition of federal budget initiatives were subject to substantial uncertainty. Members commented that added fiscal stimulus might prove to be a useful complement to an accommodative monetary policy in the period immediately ahead when economic activity was likely to remain below the economy’s potential. In this regard, some observed that additional stimulus on the federal level would be an offset to measures that were being taken by numerous state and local governments to address severe budget deficits. **At the same time, a number of members expressed the hope that new fiscal legislation would not endanger the prospects for federal budget discipline over the longer run, given the desirability of supporting national saving and capital accumulation.**” (emphasis added).

The FOMC decision to leave rates unchanged and the balance of risk at neutral, despite the acknowledged risks to current economic activity that could arise from geopolitical events is a continuation of the December 6th meeting—despite evidence that the economy has not improved---seems to suggest that the course of fiscal policy going forward may have a lot to do with how the Fed behaves. The report that Greenspan has already gone to the Congress to express his concerns about a worsening Federal Deficit in the future underscores the importance of this issue for policy making in the near future.



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