Slowdown in US economy to continue, says Greenspan

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Just as in politics, it seems that a week can be a long time in economics. When he gave his testimony to the US Senate on February 13, Federal Reserve Board chairman Alan Greenspan indicated that in his view the downturn in the US economy would not develop into a recession. Provided forces contributing to long-term productivity growth remained intact, he said, “the degree of retrenchment will presumably be limited.”

But in a revised version of that report, delivered to the House Financial Services Committee on Wednesday, Greenspan did not seem so sure. All the changes to his address were made on the down side.

Greenspan concluded his report by noting that although the sources of long-term economic strength remained in place “excesses built up in 1999 and early 2000 have engendered a retrenchment that has yet to run its full course.”

Earlier he had pointed out that even after the two cuts in interest rates of 0.5 percentage points each in January, “the risks continue skewed toward the economy's remaining on a path inconsistent with satisfactory economic performance.”

Two weeks ago Greenspan told the Senate Banking Committee that even with the declines noted at that time, consumer confidence remained consistent with economic growth. That line was omitted from his report to the House.

The revisions in Greenspan's testimony come in the wake of a series of reports on the US economy which show that the growth rate has slowed considerably, pointing to the possible development of a recession.

The Commerce Department has revised down its estimate of annual growth in the fourth quarter of last year from 1.4 percent to 1.1 percent—the lowest quarterly rate of expansion for six years. And all the indications are that the downward trend has continued this year.

The Conference Board, a private organisation which publishes a closely-watched index of consumer confidence, reported that the February index fell sharply to 106.8 from 115.7 in January—the fifth consecutive monthly decline and representing a four-year low. The index, which is compiled from a written questionnaire sent to 5,000 households every month, has declined by 25 percent over the past six months—a decline normally seen only in a recession.

Board official Lynn Franco said that the index's sharp descent from 30-year highs could indicate that “a severe economic downturn” may lie ahead. For the present, however, consumers' appraisals suggested “moderate growth and not a recession.” But with layoffs sweeping through American corporations, coupled with falls in the stock market, “we see much more of a fear factor for consumers.”

A report from the Commerce Department showed a fall of 10.9 percent in new homes in January after record sales in December. The decline, which was reflected in regions across the country, was the largest since a 23.8 percent monthly fall in January 1994. Earlier the National Association of Realtors reported that existing home sales also fell for the second consecutive month in January, dropping by 6.6 percent.

There has also been bad news from the manufacturing industry. The Commerce Department has reported that durable goods orders fell 6 percent in January and were now at their lowest level for 19 months. While the decline was exaggerated by the large decline in the transportation sector, where orders fell by 22 percent, the drop in electronics and electrical equipment, including semiconductors, was 6.2 percent.

In the face of the decline in these economic indicators, financial markets were hoping that the Fed may announce a further cut in interest rates before the next meeting of its policy-making open market committee scheduled for March 20. But Greenspan appeared to rule that out, again indicating the Fed's aversion to interest rate changes between meetings, except in extreme circumstances.

One reason for not announcing an immediate rate cut could be the view that such a decision may spark fears about the direction of the economy, and lead to a further decline in consumer and business confidence, even if promoting a rise in the stock markets. As one market observer commented to the *Financial Times*, cutting interest rates now—a cumulative reduction of 1.5 percentage points in just eight weeks—would make the US look like “an underdeveloped country.”

More generally, there are concerns as to the efficacy of interest rate cuts. The surprise cut in early January did provide a short-term boost to financial markets. But these gains have been more than wiped out by the fall in markets throughout February.

While the public consensus among economists and forecasters is that the US will avoid a recession, there are indications that behind the scenes concerns are growing. The National Association for Business Economists this week downgraded its forecast for 2001 saying the risk of recession had risen to 33 percent from the 20 percent in November.

And, according to London-based magazine, *The Economist*, a “disturbing number of leading economists in America have privately admitted ... that they are more worried about a recession (defined as at least two quarters of falling GDP) than their official forecast might suggest.”