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No Equivocation This Time: Fed cuts 50 basis points

The Fed responded aggressively to evidence of depressed household and business spending by reducing the Federal Funds target rate 50 basis points while approving the request of a single Federal Reserve District Bank (Richmond) for a 50 basis point cut in the discount rate. The text of the announcement is given below.

Three broad points:

(1) The recession is sufficiently serious to merit extraordinary attention "for the foreseeable future." Don't look for an end to Fed response yet. The door has been kept open. (2) Uncertainty and deterioration in business conditions are global ("here and abroad"). (3) Ignore shorter term disruptions to the productivity story caused by the shift in the mix of public-private expenditures. A call to honor for the ECB! Is it listening?

> The Federal Open Market Committee decided today to lower its target for the federal funds rate by 50 basis points to 2 percent. In a related action, the Board of Governors approved a 50 basis point reduction in the discount rate to 1-1/2 percent.
>
> Heightened uncertainty and concerns about deterioration in business conditions both here and abroad are damping economic activity. For the foreseeable future, then, the Committee continues to believe that, against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the risks are weighted mainly toward conditions that may generate economic weakness.
>
> Although the necessary reallocation of resources to enhance security may restrain advances in productivity for a time, the long-term prospects for productivity growth and the economy remain favorable and should become evident once the unusual forces restraining demand abate.
>
> In taking the discount rate action, the Federal Reserve Board approved the request submitted by the Board of Directors of the Federal Reserve Bank of Richmond.

The Fed's strong emphasis on the slowdown in business and household spending as a result of "heightened uncertainty and concerns about a deterioration in business conditions both here and abroad" is by far the strongest statement during its rate-cutting spree. There is no equivocation in today's statement either on what is going on or the Fed's resolve to deal with it now and going forward. The Fed gave the 'market what it wanted' on both the size of the rate cut and its implicit willingness to do more later.

RISKS: "For the foreseeable future, then, the Committee continues to believe…the **risks are weighted mainly toward conditions that may generate economic weakness." (emphasis added).**

PRODUCTIVITY: long term productivity growth will continue, even if restrained "for a time" due to diversion of private resources into public spending. (This is a story with many more chapters yet to come)

BOTTOM LINE: The Fed is not keeping its powder dry; it sees no immediate end to the recession pressures; the downturn is global and the FED is prepared to ignore cyclical changes in productivity growth that it may observe, particularly if the mix of public versus private spending is altered for security reasons

This is an Alan Greenspan decision if ever there was one---He is not prepared to err on the side of caution. Another Bush and no 1990-91 déjàvu! One District Bank request for a Discount Rate cut is an enigma! Why make the best show in Washington totally transparent when you give the Market what it wants?

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