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Greenspan plays Offense and Defense: Fed cuts 50 bps, moves Bias to Neutral

This is a first read, and no doubt post-mortems will reveal new information. Several obvious inferences step to the front. The question to ask is whether this is an offensive or defensive strike? A little bit of both that fits the famed Greenspan ambiguity.

1) the Fed recognizes the **slowdown** is not trivial and is moving to offset it. Its aggressive policy is "protected by the disinflation of commodity and final goods prices," so it remains a prudent Central Bank operating a multiple targets policy.

2) the Fed is not signaling that it will NOT go down the curve slowly (as their Staff paper noted about Japan) and that must reflect the oft-mooted concerns of its Staff. It will act when the data tell it to act. The data spoke and they answered.

3) The Fed is taking no prisoners. By restating its belief that its stance is "accommodative," it affirms the belief that is keeping up with the "curve" and not behind it as has been suggested by the constant harp of 'deflation.' But it warns the market not to think that it is committed to take the rates down further. It says, 'let the data do the talking.' The Fed takes the present situation seriously, but shows no panic. That should eliminate the "what is it that the Fed knows that I don't know" reasoning that prevented more analysts from being predictors of the 50 bp cut.

4) Be careful in inferring too much from the shift in the Bias---it can shift back. This move leaves the Fed a free hand to look at December, take into account the effects of an outbreak of war or a sudden shift in stimulative fiscal policy without tying its hand and having the market cause sufficient discounting of a prospective rate change that were the Fed not to follow the market, it would be faced with a financial shock!

5) International implications for the ECB and Bank of Japan, in our view, are far less than popularly believed. By its forcefulness, it invites the ECB to act. Whether Wim Duisenberg is still in the 'we listen but don't hear,' mode, a phrase that rattled European markets in the summer of 2001. we will know tomorrow. The gap of 275 basis points will challenge the ECB to do something in spite of their higher inflation numbers. The ECB has an internal battle on fiscal policy with the respective Finance Ministries of the separate member States. They could once again push the States with 'excessive spending,' that violate the terms of the Stability Pact, to prove their case before yielding to a demand for lower rates. I have no fly on the wall to advise whether they have gotten the 'agreement,' but without it, they would look silly once again, as they did in 2001. The market may be vulnerable to a small shock if they do not follow the Fed since it appears this has heightened suspicions that the ECB will finally " come to the party," Such a shock should not be fundamental.

6) The BOE, which also reports tomorrow, may have some room to counter its own sag in aggregate demand by a reduction in the rate. The BOE tends to be more pragmatic than the ideologically driven ECB.

7) The BoJ is caught in the throws of its long campaign to fix the financial sector. They don't need the Fed cut to move to even easier monetary conditions. It is best to look at their politics and their economics from a national point of view, not from a Fed interactive mode.

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