CONTRASTING MONETARY POLICY STANCES

The Fed Not Likely To Ease Monetary Policy in the Near Future

The University of Michigan' s index of consumer confidence jumped to 93.7 in March, after having slipped to 88.5 in February from 89.3 in January and 91.0 in December. The index is currently not far below its recent high of 97.6 in January 1995. Since the average of the index is about 87.0 during economic expansions, the current level is indicative of continued economic growth. The latest employment figures have also added weight to the view that the five-year-old U.S. economic recovery, which had experienced a temporary slowdown, still has plenty of vigor. One of the most important statistics released recently was the stronger than expected 140,000 gain in non-farm payroll employment in March, following February' s revised 624,000 gain, the largest since September 1983, and January' s revised 146,000 plunge due to the blizzard.

Although another quarter-point cut in the 5.25% federal funds rate at the FOMC' s March 26 meeting was expected, it did not happen because the data suggested that the economy is rebounding from its year-long slowdown. Based only on these positive economic signs, it is possible to assume that no further rate cuts are necessary. Furthermore, a few analysts are even saying that the Fed will have to start raising rates later this year. However, the strike at the General Motors Corp. will rob about one-fourth of a percentage point from the quarter' s annual rate of growth and the recent surge in long-term interest rates will dampen activity in housing and durable goods.

With mixed signs regarding economic conditions, it is difficult for us to talk about the future stance of the Fed' s monetary policy. However, it does not seem likely that the Fed will reduce the federal funds rate further at the FOMC' s next meeting on May 21. This prediction is supported by the fact that consumer spending, which constitutes about two-thirds of the gross domestic product (GDP), is showing a surprisingly good pace, and the main object of the Fed' s monetary policy has been to stabilize prices in the past.

German Interest Rates Likely To Be Cut in the End

The German economy looks like it is in a plain old recession, having recorded back-to-back quarterly declines in real GDP. Even with unemployment at a record high and inflation near a record low, the Bundesbank did not cut the key interest rates at its council meeting on March 28. Big growth in the M3 money supply, which the Bundesbank views as a guide for monetary policy, is the reason for the delay in cutting interest rates. February M3 figures indicate growth of 12.6%, well above the Bundesbank' s own target range of 4% to 7%. Given the Bundesbank' s well-known heavy reliance on M3 as a key gauge of future inflation, it is unlikely to relax its monetary stance shortly after M3 growth has accelerated. However, the Bundesbank' s M3 worries will be overcome by continued subdued inflation and the soft German economy. Eventually, monetary easing will be seen as appropriate, indeed, even necessary since the government is currently determined to pursue fiscal restraint. VIP

(Jae-Chil Kim)

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