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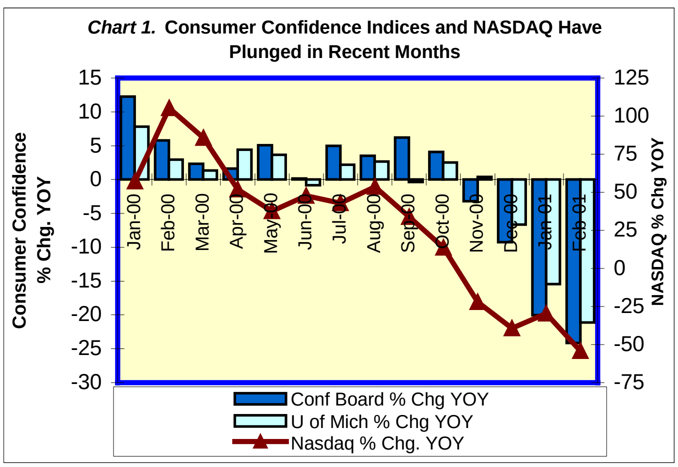
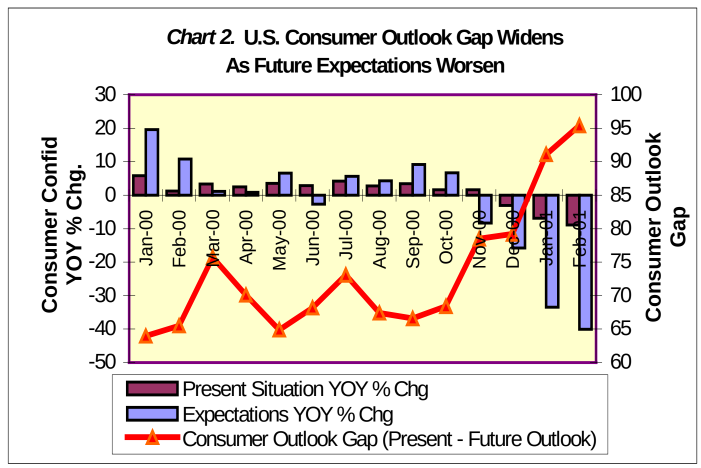
Economic and Central Bank Monitor

North America

- **Greenspan Outlook Suggests Intra-meeting Cut Unlikely although Confidence Worrisome:** In testimony on Wednesday before the House Committee on Financial Services, Fed Chairman Alan Greenspan said that although the slowdown is expected to last longer than anticipated as the inventory adjustment process is just underway, the "exceptional degree of slowing so evident at the end of last year seemed less evident in January and February." Although "the retrenchment has yet to run its full course," Greenspan suggested that the economy should rebound this year, dashing market hopes of an intra-meeting cut, which sent the NASDAQ to 2141 on Wednesday, a new one-year low. Greenspan responded to the most recently released economic data. He indicated that although new homes sales fell off in January (to 921k from 1034k in December), this did not reflect general economic weakness as sales are back to levels of early last year while housing starts and permits increased in December. Consumer confidence, on the other hand, is much more worrisome. The Fed is hoping for a consumer-led recovery and as a consequence will be closely scrutinizing consumer confidence in the days ahead, especially after the steep falloff of recent months. Consumer confidence as measured by the Conference Board continued its slide in February, along with the stock market (*see Chart 1 below*). The Conference Board's Consumer Confidence Index fell sharply in February for the fifth consecutive month. Consumers are less confident about both the current and short-term economic outlook. The Expectations Index fell from 79.3 to 68.7, evidence that the erosion in consumer confidence continues to be fueled by weakening expectations regarding business and employment conditions. While the short-term outlook continues to signal a severe economic downturn, consumers' appraisal of current economic conditions suggests we are still undergoing moderate growth and not a recession. A principal concern amongst Fed policymakers is that low confidence may translate into weaker spending and push the economy into recession. The president of the Dallas Fed Robert McTeer expressed doubt this week that a drop in one factor (such as consumer confidence) would be sufficient to justify a rate cut between meetings. **As a result of continued economic weakness, we expect the FOMC to cut interests by at least 50 bp at the next meeting on March 20.**
- **Consumers Sending Mixed Signals – Will Pickup in Spending Be Sustained?** Demand for homes and consumer durables has not matched the weakness seen in the consumer confidence indices, Greenspan testified this week. Despite precipitous declines in consumer sentiment over the last few months, personal spending has held up well. This is a "puzzling feature" of current economic conditions according to Fed Vice Chair Roger Ferguson in a speech this week, who reiterated that usually consumer sentiment closely mirrors current economic conditions and generally moves with the growth in household spending. Recently, the drop in consumer confidence has been more reflective of the weak stock market than consumption. No sooner did Fed officials point out the anomaly, the University of Michigan Confidence index jumped Friday to 90.6 in February from 87.8 in January. The Fed watches consumer sentiment because it can provide "an early reading on the direction of household spending," but that there is a range of indicators for the household sector, Ferguson said. Personal consumption rose 0.7 percent in January (after a 0.4 percent rise in December), led by durable goods spending on automobiles. Retail sales also rose for a second month, climbing 0.7 percent in January following December's 0.10 percent rise and November's 0.60 percent decline. Nonetheless, the central economic question is whether the rise in spending, which accounts for two-thirds of U.S. GDP, can be sustained to help avert a U.S. recession. Ferguson called the predictive ability of sentiment for *future* household spending limited, thus raising the challenge to Fed policymakers how to resolve the consumer puzzle. On energy and price pressures, Ferguson pointed out that the expected declines in oil, natural gas and power prices should help contain inflation directly through lower commodity prices and indirectly through lower prices for non-energy items such as transportation and production inputs.

- **Stocks Continue to Slide on Wave of Profitability Warnings:** The Fed Chairman hinted on Wednesday that although more rate cuts are needed to get the economy back on track, the markets will have wait another three weeks before further action. Stocks recovered somewhat from Wednesday's disappointment after the first positive news of the week from NAPM that U.S. manufacturing rose in January for the first time in a year, suggesting the downturn in the manufacturing sector may have bottomed out. However, another major technology company warned today that its fiscal third-quarter profit missed forecasts. Oracle, the database software maker, reported for the first time since late 1997 that earnings per share would fall short of expectations. The company cited evidence that customers are cutting computer-related spending. Also dragging down stocks were JDS Uniphase, a fibre-optic equipment maker, who announced layoffs and Nike, who issued a profits warning. The steady stream of layoff announcements has sharply dampened consumer's outlook for the future (*see Chart 2 below*).
- **Canada's GDP Slips in 4Q00, Makes Another Rate Cut Likely This Week:** Canada's output grew by less than expected in the fourth quarter following lower business investment and cooling consumer spending. Growth slipped to 2.6 percent after a 4.5 percent pace in the previous quarter. **This makes it likely the Bank of Canada will trim interest rates again when it meets this coming week, and follows the BOC decision to trim 25 bp off the overnight rate to 5.50 percent at the end of January**. Plant and equipment spending fell 2.4 percent in the fourth quarter as firms cut back their spending plans. Demand for motor vehicles fell 8.6 percent in the quarter, pulling down overall consumer spending growth to 0.6 percent.





Europe

- **ECB Holds Rates Steady Again Due to Inflation Concerns, Stands Alone:** As we expected, the ECB held rates constant at 4.75 percent at their monetary policy meeting on Thursday, citing concerns over inflation. ECB's Duisenberg stated that the impact of past oil price increases are still coming through, and that volatility in oil prices and the exchange rate might prevent consumer prices from falling below 2 percent (the ECB official target) for a few more months. Duisenberg insisted that the ECB's monetary policy stance had not changed from a few weeks ago. Despite a reduction in the overall rates of inflation across the euro-zone in January, Germany and Italy both experienced higher prices in February. Amongst the world's major central banks, the ECB stands alone in being more concerned about inflation than slowing growth. Following the Fed's aggressive rate cuts in January, central banks in the U.K., Canada, Australia and Japan have all cut key interest rates in the last few weeks to encourage investment and spending.

- **While Inflationary Pressures Fade in Europe, ECB Gets Policy Maneuverability:** Euro-wide HICP (harmonized) inflation came in on the low side this week. HICP fell to 2.4 percent in January, which is lower than 2.6 percent in December 2000 and 0.50 lower than November's peak of 2.9 percent. With the Fed expected to lower rates again at the end of this month, the interest rate and growth differentials will continue to favor the euro. Duisenberg stated that the ECB is "not considering changing the stated objective that defines price stability as a rate of increase in the HICP of less than 2 percent in the medium term. It may take another couple of months before we reach that goal, after the disturbances of higher oil prices and the depreciating tendency of the euro last year."
- **U.K. Budget Could Limit Interest Rate Cuts and Strengthen Pound, IMF argues:** In its annual assessment of the U.K. economy, the IMF cautioned that Chancellor Brown's budget package of tax cuts and substantial spending increases could limit the room for further interest rate cuts. At a time when world interest rates are falling, this fiscal stimulus could put upward pressure on interest rates causing an already overvalued currency to appreciate further. Brown insists that the level of borrowing required to pay for these expansionary policies will remain well under the ceiling of 3 percent of GDP outlined in the EU's stability and growth pact.
- **Norway Likely to Open its Gas Market to Competition:** The EU is hinting that Norway will agree sooner than expected to implement the European gas directive, which requires countries to open 20 percent of their national gas markets to competition. The EU is keen to develop Europe's gas markets and increase its bargaining power with its biggest gas suppliers, Norway, Russia and Algeria. Norway's gas sales committee, which approves all export sales of the fuel comprises representatives of Statoil and Norsk Hydro, Norway's two big energy groups.

Asia/Pacific

- **Bank of Japan (BOJ) Cuts Key Interest Rate on Slow Pace of Economic Recovery:** The BOJ cut its official target rate for overnight loans by 10 bp from 0.25 percent to 0.15 percent on Wednesday, a move that appears to be a first step toward returning to the zero interest rate policy that was abandoned last August. The rate cut follows on the heals of dismal industrial production results, which declined 3.9 percent in January (a historic month-on-month low) on lower export volumes, as well as falling housing starts and construction orders. Interest rates are the only policy tool at the disposal of authorities to jump-start the economy. However, high interest rates are not Japan's principal worry. Japan's economic woes are centered more on bad bank loans that make banks reluctant to lend to the cash-starved economy, its huge national debt, and the fact that many industries are closed off from international competition. According to the BOJ's monetary policy statement, "with a view to restoring Japan's economy on an autonomous growth path led by private demand, the Bank will continue to conduct monetary policy in a timely and flexible manner." This statement suggests a further rate cut is likely amid a slowdown in global demand for Japanese exports, steep declines in domestic stock prices, downward pressure on consumer prices stemming from weak demand, political instability, and an official forecast of a 1.7 percent contraction in GDP in 1Q01. The yen closed the week at a 6-month low of Y119.02. The Nikkei plunged over 3 percent on Friday, closing near the 12,000 mark at 12,261. At this level, the resurrection of price keeping operations becomes more likely.
- **Chinese Government Expects Robust Growth This Year:** The Chinese government predicted that its economy would grow by between 7 and 8 percent this year. Although official Chinese government's growth outlook should be viewed with some healthy skepticism, the government appears ready to unleash a $18 billion fiscal stimulus package on infrastructure and technology upgrades that would be enough to guarantee an official growth rate of at least 7 percent.

Country Update: Turkey

- **Wait and See Attitude with High Expectations For Post-Holiday Rescue Plan:** Turkey begins an Islamic holiday this week during which all financial markets will be closed. This respite will give the Turkish government, the central bank, private lenders, and international financial institutions such as the IMF and World Bank time to formulate an economic plan to stabilize and strengthen the Turkish economy through reform of Turkey's largely insolvent banking sector. But, before any credible rescue plan can be crafted and implemented, Turkey needs to assemble an economic team following last weekend's resignation of central bank Governor Garzi Ercel and Treasury undersecretary Selcuk Demiralp. On Friday, Kemal Dervis, Turkey's highest-ranking official at the World Bank, accepted the Turkish economy ministers job and will have broad responsibility for economic policy. He will oversee the Treasury, the central bank, and the Privatization Administration, among others, and will reportedly have broad authority over supervision of the banking system as well. This move strongly suggests that cleaning up the banking sector could be central to any economic stabilization program.
- **Inflation Pressures Will Mount in Turkey in Wake of Lira Devaluation:** Both administrated and private sector prices are already on the rise since last week's currency devaluation. Petroleum products, electricity and natural gas prices were increased by 10% across the board, and further increases may be necessary this month. It is likely that as soon as the lira's value against hard currencies is seen to stabilize, such administered prices will probably be re-adjusted. Although some retail stores are waiting for the lira to settle before finalizing their pricing decisions, some local shops selling everything from cell-phones to spirits have raised prices by as much as 15 percent. A spike in March and April's price levels could be quite sharp due to the pass-through effect of the devaluation.

Commodity Markets

- **OPEC Nears Production Cut on March 16:** According to one Middle Eastern report, OPEC is very likely to cut production when its oil ministers meet in Vienna on March 16. Apparently, the principle of cutting output is supported by all member states, and the central question is not will they cut, but by how much. OPEC is apparently focused on 3 key issues: supply/demand projections for the remainder of 2001, the current level of global stocks, and how much the price at the time of the meeting is attributable to supply/demand fundamentals and how much to speculation about the meetings outcome. OPEC is begun to take measures to counter the effects of speculation and manipulation in the markets. With the weak U.S. manufacturing sector, consensus estimates of U.S. economic growth in 2001 falling sharply, indicators that point toward a contraction in Japanese industrial output and slowing economic activity in Western Europe, world demand for oil has fallen, putting downward pressure on crude prices. The OPEC crude basket closed at $23.64/B Friday. Venezuelan energy minister said an OPEC oil price below $25 a barrel was "not desirable."
- **Ford Upbeat in its Sales Forecast for 2001:** Ford reported this week that it believed the industry-wide annual sales rate for new light trucks and cars in the U.S. was "in the mid-17m range" in February and expects the sector could be on track for its third-best sales year, in spite of the current U.S. economic slowdown. Ford also upgraded it first-quarter North American production plan by 10,000 units to 1.06m cars and trucks, although this leaves production down about 16 percent from the first quarter of 2000.

G-7+ Central Bank Monitor

Country	Official Interest Rate	Current (%)	Change from prev. bias	Last Change	Next MPC Mtg.
The Americas					
United States	Federal funds rate	5.50	19 Dec 00 (-100 bps)	31 Jan 01 (-50bps)	20 Mar 2001
Canada	Overnight rate	5.50	23 Jan 01 (-25 bps)	23 Jan 01 (-25bps)	6 Mar 2001
Europe					
ECB	ECB rate	4.75	4 Nov 99 (+225 bps)	5 Oct 00 (+25 bps)	15 Mar 2001
U.K.	Base rate	5.75	11 Jan 01 (-25 bps)	8 Feb 01 (-25 bps)	7 – 8 Mar 2001
Asia/Pacific					
Australia	RBA Cash rate	5.75	6 Feb 01 (-50 bps)	6 Feb 01 (-50 bps)	6 Mar 2001
New Zealand	Cash rate	6.50	16 Nov 99 (+200 bps)	17 May 00 (+50 bps)	14 Mar 2001
Japan	Overnight call rate	0.15	28 Feb 01 (-10 bps)	28 Feb 01 (-10 bps)	19 Mar 2001

Economic Calendar – March 5 to March 9, 2001					**(all times are CST)**
Country	**Mon. March 5**	**Tues. March 6**	**Wed. March 7**	**Thurs. March 8**	**Fri. March 9**
The Americas					
U.S.	NAPM Non-manufacturing (Feb)	Redbook Productivity (Q4) Unit Labor Costs Factory Orders (Jan) Treasury Strips (Feb) Fed Gov. Gramlich to address the New York University Money Marketeers	Mortgage Applications (March 2) Consumer Credit (Jan) Fed Beige Book	Jobless Claims (March 3) Chain Store Sales (Feb) Chicago Fed President Moskow to address the Prairie State College Foundation	Labor Market (Feb) • Payrolls • Unemployment • Hourly Earnings Wholesale Trade (Jan)
Canada			Help Wanted Index (Feb) Building Permits (Jan)	Housing Starts (Feb) IVEY PMI (Feb)	Employment (Feb) Unemployment Rate (Feb) Capacity utilization (Q4)
Europe					
ECB	**Euroland:** Services PMI (Feb) Business Climate Indicator (Feb) **Germany:** Services PMI (Feb) **Italy:** Services PMI (Feb) New Car Registrations (Feb)	**Euroland:** Retail Sales (Dec) **Germany:** Employment (Dec) Unemployment (Feb) **France:** Monthly Budget (Jan) INSEE Household Survey (Feb)	**Euroland:** PPI (Jan) **Germany:** Manufacturing Orders (Jan)	**Euroland:** GDP (Q4) **Germany:** Industrial Production (Jan) ECB Monthly Bulletin	**Euroland:** Current Account (Q4)
U.K.	Money Supply (Feb) Services PMI (Feb) Notes and Coin (Feb) Changes in Official Reserves (Feb)	Halifax House Prices (Feb) Report on Jobs (Feb)	Monetary Policy Committee (MPC) Meeting	Construction New Orders (Jan) Housing Starts and Completions (Jan) Monetary Policy Committee (MPC) Meeting	Industrial Production (Jan) Manufacturing Production (Jan) Industrial Output (Jan)
Asia/Pacific					
Japan		Foreign Currency Reserves (Feb) Diffusion Index (Jan)	Leading Indicators (Jan)	Money Supply (Feb) Bank Lending (Feb) Wholesale Prices (Feb) Household Survey (Jan) Machinery Orders	

				(Jan)	
Australia	Retail Sales (Jan)		GDP (Q4)		
NZ					
Singapore				Foreign Reserves Total (Feb)	