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FINANCIAL FAQs

FED EASING TO COME IN 2006?

Recently released minutes of the Federal Reserve Open Market Committee's Dec. 13 meeting revealed that Fed rate hikes may be coming to an end. The minutes said that inflation concerns had eased, and because the Fed Governors had to be mindful of the time it takes for monetary policy to filter through the economy, it might be wise to pause in order to assess the effects of rate hikes already instituted. The 13 one-quarter percent raises have raised the Prime Rate from 4 to 7.25 percent.

The news caused a minor rally in the stock and bond markets, and raised hopes that we could have another year of robust economic growth in 2006. This week's news seemed to bolster that optimism. December's unemployment rate fell to 4.9 percent, the lowest rate since 2000, and 108,000 new jobs were added to private payrolls

Both the service and industrial sectors also continued to expand in the latest Institute of Supply Management surveys, construction spending and factory orders increased, and jobless claims fell to their lowest level in weeks, indicating that job creation may remain at current levels.

UNEMPLOYMENT—Two million private payroll jobs were created in 2005, slightly less than the 2.2 million jobs created in 2004. The 4.9 percent jobless rate was the best since July 2001, but 250,000 more workers stopped looking for work. This could be the after effects of the hurricanes, since 600,000 storm-related jobs were lost, according to the Labor Dept. The results were disappointing, as just 400,000 jobs per year have been created since Bush took office in 2001. Job growth over the past 10 years has averaged 1.8 million per year.

INDUSTRIAL ACTIVITY—The Dec. ISM survey fell slightly to 54.2 percent, indicating a slower growth rate for industrial activity. The indicators used in the survey declined across the board, including prices, with only customer's inventories increasing at a faster rate. Ten of the seventeen sectors surveyed reported growth. One respondent said that "business remains strong into our traditional slow time. This is a big surprise." We should not therefore see this as a sign of weakness, but merely a seasonal pause.

SERVICE SECTOR ACTIVITY—The companion ISM non-industrial survey rose to 59.8 percent, indicating that a majority of purchasing managers saw their firms continuing to expand for the 33rd consecutive month. Only prices paid declined, a sign that energy prices had stabilized after the hurricanes. Eleven of the seventeen industries reported growth, with only agriculture, real estate and construction shrinking.

The FOMC minutes gave some reasons for the Governors' optimism on inflation. Energy prices generally had fallen back since earlier in the fall, and "much of the increases in inflation expectations posted in the aftermath of the hurricanes had reversed." Participants also noted that robust competition—including that from foreign producers—and further substantial gains in productivity were helping to contain cost and prices pressures.

We cannot help but believe that White House chief economic advisor Ben Bernanke's hand can already be seen as the incoming Fed Chairman--although he doesn't take the reins until March. A leading scholar of our Great Depression, he has seen deflation as the greater danger to our economy with ever cheaper goods and services being produced overseas. Bernanke was also a main advocate of the Fed's easy credit policy as the Fed's Vice-Chairman 2001-03 that brought interest rates to historic lows..