Economists: Fed cuts should offset risks of recession

WASHINGTON, May 9 — Aggressive interest-rate cuts by the Federal Reserve should offset increased risks of recession seen by a panel of economic forecasters, a report issued Wednesday showed.

The National Association for Business Economics, which polled 27 of its members, placed the risk of a recession at 35%, up from 33% in February. But given the hopes for continued interest-rate cuts through the end of the year, the panel didn’t alter its previous forecast that the economy will grow 2% in 2001.

“While the business outlook remains cloudy and profits are under severe pressure, NABE panelists have remained steadfast in their belief that a recession is unlikely,” said Richard Berner, the association’s president. “Panelists believe that an aggressive Fed will sustain modest economic growth for the balance of the year and into 2002.”

The Fed has cut its key federal-funds rate by two percentage points this year, trimming it to a seven-year low of 4.5%. But consumer and business confidence has remained weak and in April employers reduced their payrolls by the largest amount since the 1991 recession. The Fed, as a result, is widely expected to cut the rate by an additional half point when policy makers meet May 15.

NABE forecasters predicted the three-month Treasury-bill rate, closely tied to the funds rate, would drop to 3.8% in the fourth quarter, implying a fed-funds rate between 3.75% and 4%, consistent with futures contracts.

The forecasters, however, were gloomy about the near-term outlook for corporate profits. They revised their forecast of three months ago, which called for a 0.3% increase in profits this year, and predicted that profits will decline 3.5% instead. Still the forecasters were mildly optimistic about the outlook for the stock market: 85% of them said U.S. stocks are now “correctly valued” and “should experience moderate gains going forward.”

Consumer-price inflation will accelerate to a 3% rate by the end of 2001 before settling to a 2.5% rate next year, the report said. Just three months ago, the forecasters predicted consumer-price inflation of no more than 2.6% in 2001.

In a paper entitled “Recent Changes in the U.S. Business Cycle,” Simon Potter, a domestic research analyst with the bank, and University of California, Riverside, economics professor Marcelle Chauvet argue that since 1984, the U.S. economy’s growth level has become significantly less volatile, and that recessions are now occurring with reduced frequency.

The paper compares two periods — 1959 through 1983 and 1984 through 2000 — and found that volatility in all major measures of economic activity declined, in some cases dramatically.

In the 1959-1983 period, gross domestic product grew at an average of 3.41%, with a standard deviation of 4.33. During the next period, GDP growth changed little, at an average of 3.39%, but the standard deviation sank to 2.13.

Manufacturing activity grew during the first period at an average of 3.59%, with a standard deviation of 9.45. From 1984 through to 2000, manufacturing output growth stood at 3.84%, but the volatility contained within the standard deviation plummeted to 3.67, the paper said. One
of the few areas of the economy that remained volatile was the retail-sales sector.

Mr. Chauvet said the paper’s findings “reinforce the view that there have been significant changes in the U.S. business cycle. Expansions should last longer and recessions should be less frequent.”

The report represents the opinions of the researchers and not necessarily those of the Fed itself.

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