

The Week That Was

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LaSalle Bank
ABN AMRO

Baseball is ripe with terms that have entered more common usage. Trying something is “stepping up to the plate,” succeeding is “hitting a home run,” and failure is “striking out.” Regular readers of our commentary know that it usually comes out of left field, and that we are batting far from 1.000. (For you serious baseball aficionados, our accuracy average is well below the Mendoza line.)

Richard Fisher, President of the Dallas Federal Reserve Bank, used a baseball metaphor a couple of months ago when he said that the Fed was “in the eighth inning” of its tightening campaign. Our central bank will take another swing at monetary policy next Tuesday; here is our assessment of how far they might be into their game of hiking interest rates.

Sixth Inning	Ninth Inning
The economy seems to have a lot of momentum. Early readings on July suggest that sales gains will be very strong for a second consecutive month. With inventories under control, these sales should translate directly into orders; strong readings from the Chicago and National Purchasing Manager's indices confirm this. GDP could easily grow at better than a 4% annual pace in the current quarter.	The dark cloud behind the June consumption reading was the news that the American savings rate fell to zero. Households will have to taper their consumption at some point. With a barrel of oil trading at more than \$60, many also anticipate that energy prices will reduce the expansion's momentum. And if the housing market ever learns to respect gravity, we'll lose a major source of momentum.
The Fed's favorite inflation indicator is taken from the report on personal consumption expenditures. The so-called core PCE deflator has increased by nearly 2% over the past year, nearly the double the pace of late 2003 and close to the top of the Fed's comfort zone. Energy is more expensive, housing is more expensive, and some see tightness in the labor market.	Inflation, by most measures, is still modest. The year over year change in the CPI has been trending downward as the increase in energy prices slows. Productivity is still high, competition is still fierce, and consumers are still choosy. Long-term inflation expectations are under control. No need for corrective action yet.
Recent remarks from Alan Greenspan suggest that the Fed is concerned that the yield curve is hindering efforts to get back to a neutral policy stance. Low long term rates are also hindering the Fed's efforts to cool off the housing market. In rejecting the notion that a flatter yield curve is forecasting recession, Greenspan clearly sent a message that rates are heading higher.	Many sense that the expansion is still very vulnerable. The renewed pace of terrorist attacks won't help confidence, and America's auto companies are still facing significant challenges, in spite of recent sales gains. These uncertainties might suggest a pause from the Fed, to await better clarity on the health of the business cycle.

The Fed will undoubtedly strike again with a **25-basis point hike** next Tuesday. Given recent data and commentary, we are now expecting overnight rates to reach 4% (or even 4.25%) by the end of the year.

As a youth, my baseball experience was filled with errors and foul balls. I was often sent back to the dugout for a pinch hitter. So it is in adulthood; after this erroneous and foul commentary, Adolfo will be pinch-hitting for me next Friday.

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