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NEWS ANALYSIS
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The Worry Beneath Greenspan's Words

In wrapping its big cut in soothing talk, the Fed hitched psychology to the wagon of economic policy -- and that hints at deeper fears

Who do Federal Reserve policymakers think they're kidding? In a statement accompanying their surprise half-point cut in interest rates, Alan Greenspan & Co. declared that the risks to the economy going forward were now evenly balanced between higher inflation and too-slow growth. Yet, with inflation running at a meager 2% and economic growth in the fourth quarter widely expected to be under 1%, it's hard to take that too seriously.

So what's going on? The central bank is out to convince edgy consumers and companies that they have nothing to fear. Yes, the economy is, in the Fed's words, going through a "soft spot." But that's mainly due to jitters about a potential war with Iraq. Once that threat is lifted -- one way or the other -- the economy is primed for a strong rebound, according to the Fed.

Greenspan's message has another subtext: Don't expect any more rate cuts. Fed watcher and consultant Richard Meldley calls the Nov. 6 move a "punctuation" cut designed to show that the Fed has put a floor under the economy and will be reluctant too further ease credit. "They've set the hurdle pretty high for another rate cut," agrees Louis Crandall, chief economist at consultants Wrightson Associates.

"IN TROUBLE." High, but not insurmountable. Another slice at the Fed's next meeting on Dec. 10, just five weeks away, does indeed look unlikely, unless the economy really swoons. But it's too soon to say for sure that the Fed is finished cutting rates. After all, with growth so slow, the economy is particularly vulnerable to any shocks that could tip it into recession -- from another terrorist strike to a spike in oil prices triggered by an invasion of Iraq.

Indeed, the double-barreled Nov. 6 cut suggests that Fed policymakers may be more worried about the outlook than they're letting on. And they have good reasons to feel that way. Free-spending consumers, until now the economy's stalwarts, are looking winded. And tight-fisted companies show scant sign of stepping up investment or taking on more workers. "The economy is in trouble," says Allen Sinai, chief global economist for consultants

Decision Economics. "It's very, very dicey."

Particularly significant is the Fed's choice to cut rates so decisively in the face of what's likely to be a big fiscal boost to the economy next year. Emboldened by the Republicans' sweep of Congress, the Bush Administration is expected to press ahead with a major package of tax cuts in January to goose growth. With that in the offing, why such a bold move -- by a unanimous vote -- on the part of Greenspan & Co.? Again, it suggests a worried mood.

ATTENTION, CEO. Privately, Fed officials fret that monetary policy may be losing some of its economic punch. It's hard to see the superstrong housing market doing much better, even with the Fed's latest move. And the car-buying binge of the last year means that market is looking satiated, too. What's really ailing the economy is stagnant capital spending -- and all the research suggests that interest rates have little influence on that. Instead, the key for business investment is the outlook for demand and profits.

Chalk this rate cut up to a psychological ploy to coax corporate chieftains into spending more by saying the risks to the economy are now balanced. And if things don't go according to plan, despite yesterday's implicit message to the contrary, the Fed retains the option of cutting rates again. Here's hoping the thinking inside the central bank is right, and the U.S. is just getting past a soft spot.

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