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Business investment key to rebound

By Christine Dugas and Barbara Hagenbaugh, USA TODAY

The U.S. economy appears to be emerging from a sharp summer slowdown, but a rebound in business investment, the missing link in the recovery, faces numerous hurdles, Federal Reserve Chairman Alan Greenspan said Thursday. (**Related audio**: Greenspan: Economy is doing well considering

"It is too soon to judge the final outcome of the strategy that we adopted," Greenspan said.

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The Fed chief also noted that deflation was unlikely and mortgage refinancings will continue to boost the sluggish economy early next year.

"The limited evidence since the November easing has supported our view that the U.S. economy has been working its way through a soft patch," Greenspan told members of the Economic Club of New York.

He noted that stock prices have, on net, moved higher over the past few months. The decline in orders for equipment and software has ended and, in some cases, demand has risen.

Greenspan warned worries about the scope and timing of a war with Iraq, lack of pricing power because of global competition and meager profits were creating a "formidable barrier" to business investment. Business investment — one-tenth of economic activity — has dropped for nearly two years.

But with productivity zooming ahead, an increase in profits and a lifting of uncertainty about Iraq in the future should inspire CEOs to spend.

"Any significant fall in the current geopolitical and other risks should noticeably improve capital outlays, the indispensable spur to a path of increased economic growth," he said.

Other comments:

- "The United States is nowhere close to sliding into a pernicious deflation," he said. Deflation is when prices fall, the opposite of inflation. Deflation likely would cause more harm for the economy than inflation, he said, adding the Fed has plenty of tools to fight a sharp decline in prices.
- The Federal Reserve likely cannot prevent stock bubbles. The central bank's role instead is to soften the blow when a bubble bursts, Greenspan said.
- A backlog of mortgage applications and low interest rates should lead to a continuation of the refinancing boom. The combination of lower monthly payments and "cash-out" refinancings have given consumers more cash to spend.

The Fed cut interest rates once this year, bringing the central bank's target for short-term interest rates to a four-decade low of 1.25%. Most economists expect rates will remain at that level until the second half of 2003, when a gradual pickup in the economy is anticipated. The Fed next meets at the end of January.