The slow down the economy and reduce

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Thearticle titled ‘ Fed Unlikely to Alter Course’ by John M.

Berry of the WashingtonPost takes an interesting look at actions that Alan Greenspan his colleges ofthe Federal Reserve have been taking over the last 9 months to slow the economicgrowth of United States. The astonishing growth rate of 7. 3% is fueled by aneconomy that is in the midst of a “ high tech revolution”. The articlealso explores the contrasting view of other economists that say that the Fed hasincreased interest rates too much in its attempts to slow the economy. The meansby which Alan Greenspan and the Federal Reserve have chose to slow the economyis through a monetary policy, or more specifically, an increase in the nationalinterest rate. The article states that the Fed officials have come to a” broad agreement that they will keep raising the rates until growth slowsto a more sustainable pace to make sure inflation stays under control.” Because of the booming economy and the investment in the stock market theexchange of money has increased for goods and services, which in turn increasesthe price level or the quantity of money demanded. By increasing the interestrates the Fed commits itself to adjusting the supply of money in the UnitedStates to meet that rate at a point of equilibrium.

If the interest rate isincreased, less goods and services are demanded, and therefore will slow downthe economy and reduce the rate of inflation. The article points out that as” stock prices have risen over the last couple of years, so have Americanhousehold wealth and consumer spending.” This is precisely the cycle thatFed officials want to interrupt to slow growth before it fuels more inflation. At the time this article was written the stock market prices had fallen sharplyespecially in the technology sector. But the Fed

continued on the path to raiseinterest rates further noting that the index that they closely follow andcontains a broader rage of public traded US stocks, the Wilshire 5000, is up forthe year. Even though they began raising rates gradually 9 months ago, it takesalmost a year for the economy to feel the full effects. In this case the resultsof the interest rates increased could be felt as last as the second half of2000. Yet the economy has not slowed down, and the demand for goods and servicescontinues to increase as wealth does.

One of the ideas that has been presentedto Greenspan by the fed officials was to take bigger steps in raising theinterest rates. They feel that this will decrease the money demand in a quickerfashion. In turn these actions will lead to lower consumer spending, and thusdecrease the inflation rate. However, because of the erratic patterns in today'shigh tech economy Greenspan is expected to stick to his pattern of more gradualincreases to the interest rate. Eventually when monthly loan payments increaseenough, consumers will back on purchases and investments.

The article points outan example where the rate for a new 30 year fixed-rate home mortgage is up to8. 5% from 7. 75% nine months ago in June.

In the situation of a $150, 000 homeloan, this new interest rate will add almost $100 to each monthly payment. Overtime the full effect of the interest rates will be felt. One economist, JamesGlassman of Chase Securities takes a different look at the new interest rate. Hepoints out that the rates that the Fed has set are fairly high in comparison tothe rate of inflation as it is currently in the United States. The formula thatGlassman follows examines the inflation rate when food and energy items areexcluded because they are

so volatile. With these items removed the rate ofinflation in the US is less than 2%. As with other measurements, this rate canbe subtracted from the interest rates to find a ‘ real’ interest rate whichconsumers a paying.

So in terms of 30-year home mortgage rate set at 8. 5%, only6. 5% of it is what the consumers are actually paying and the rest is accountedfor by inflation. Glassman goes further to point out that “ with inflationso low, wages aren’t going up all that fast.

” To be said more specifically, the interest rates are increasing faster than consumers’ wage increases. Thiswill eventually be felt in the tightening of the American economy. However withstock market fueling the incredible momentum