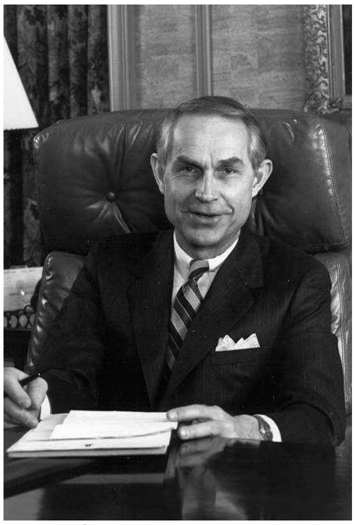
An interview with William Ford, ex President of the Federal Reserve of Atlanta

«Confessions of a former central banker»

Bond yields are going up, housing prices are bound to correct , and the Fed may raise rates more than you expect.

Talking to someone who represented the monetary authority of a country at the highest level of competence provides excellent insight into current events. And Professor William Ford does not conceal his point of view: he thinks inflationary pressures are disappointing and that this fact increases the odds that the Fed will elevate the cost of money again at some point in the future. He also bets that bond yields are on their way up, favouring a shift from stocks to bonds. And yes, there is a bubble in the housing market.



Professor William F. Ford

Professor William F. Ford is a former President of the Federal Reserve Bank of Atlanta, and currently holds the Weatherford Chair of Finance in the College of Business School at Middle Tennessee State University. He formerly served as Dean of the Business School at the University of Denver; President of First Nationwide Bank; and as Senior Vice President of Wells Fargo Bank. He also served as Executive Director and Chief Economist of the American Bankers Association.

Let's start with monetary policy: the financial community has adopted the view that the US central bank is about to stop, or at least to pause, its tightening. Do you share that view?

"Well, recent statements point in that direction, I mean, in the direction of a pausing. However, I would say that the fate of future Fed's decisions remains unresolved. We simply do not know."

You were a central banker yourself, you may have an opinion.

"Let's go back a little bit. Everybody knows in the March minutes that central bankers indicated that the end of their rate-raising program might be near. They would not have written such words if they were then seriously concerned about the threat of inflation. But since that meeting some bad news has come to light."

Are you referring to the March consumer price index (CPI)?

"Yes, I am. It was far too high even if you take into consideration the CPI data minus food and energy. The April CPI numbers will come out on Wednesday. Subsequently, they will see the May CPI numbers before their June 28 meeting, and those figures are not likely to be comforting. Therefore, If I had to bet today, I would argue that a need might emerge to tighten the grip on monetary policy later this year. That said, I want to repeat myself. The fate of future moves is unresolved at the present time. And I think that people at the Federal Reserve do not know for sure what they will do. Decisions are data-dependent."

What factors on the table?

"You know, the economy is showing a good dynamism. And if we created another 200-300 thousand jobs per month for the next 3-4 months, we would be looking at a fairly tight labour market, meaning wages might start to go up. Productivity gains are another element which may decelerate as usually happens toward the end of a business cycle and that does not help. By contrast, we have to take into consideration that in the next 6-18 months the delayed effects of the past tightening will come on stream. Thus, I think the situation is not unequivocal. As I mentioned, it is data-dependent."

In the past, the end of a tightening cycle often ushered in a recession. What about this time?

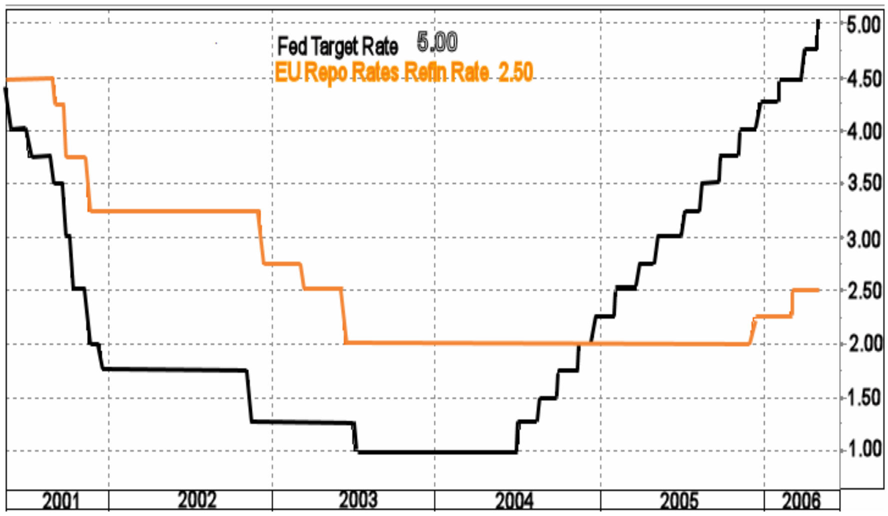
"You are right. You are right for the past. But the single most important variable is how much you tighten. Let's say for instance that they stopped on May 10. In this case, you are talking of an 8% prime rate, a 5% fed funds rate and a 6.5% mortgage rate. Those are not figures which are going to precipitate a recession. Yet they are likely to slow down the economic activity."

Do you have any figures in mind?

"Perhaps we may have a 3% real GDP growth for 2006 compared to the 3.5-4% we experienced in the last two years."

Some claim that monetary authorities in Asia and in oil-rich countries may diversify their reserves into gold, the euro, the yen, and forth. If you were a central banker now,

The cost of money in Europe and the US



would you buy any gold?

"Well, a more serious diversification which is beginning to happen, as I understand, is putting more reserves in euros in addition to dollars. Asia holds a very large share of our publicly traded debt. Exporting money is our best export industry. Thus diversification is reasonable. But as far as gold is concerned, I must say that there is not enough gold running around."

Would you buy any gold as a central banker?

"I would not buy gold as a central banker, certainly not in the US. I don't think Alan Greenspan has ever hoarded any gold in his 18 years as far as I know. But then what is the sense of having those miners in South Africa going a mile or two into the ground to get some metal out and then you store it again in a room? It's a stupid process."

Do you have the same opinion when it comes to emerging economies buying gold?

"I understand that. When you had bad experiences with inflation you may want to buy some gold."

Let's change topics. 10-year yields have broken out on the upside, reaching quickly 5 percent. Is that a temporary high or an uptrend?

"I have been forecasting a raise in Treasury bond yields for quite some time and eventually they have started to increase. And would you like to know something? I'd not be surprised if they moved higher, say to 5.5-6 percent."

What are the main implications for financial markets?

"I can envision the possibility of a shift from stocks to bonds to some extent. People like me love higher interest rates because I am a saver and I am now getting 5 or 6 or 6.5% on my life savings and I love it. And money market funds, where wealthier Americans, especially older persons, used to hold their savings are yielding 5% compared to 1-2% earlier. Going forward, fixed rates will be exerting their fascination."

Mr. Greenspan stated in mid-April that "asset prices will fall eventually." Do you agree?

"The first asset which comes to my mind is real estate. In the past, Greenspan denied there was a housing bubble. He spoke of *froth*, like when you shake your beer and a lot of little bubbles materialize. One thing I do know is that there's definitely a bubble in some of our major markets, like San Diego, New York, Boston and, I'd say, in the coastal areas. Prices have been increasing at 20% per year. It must stop and it will stop. And it is stopping right now. Sellers are having to cut their prices for the first time in a long time. Yes, we shall see some asset price deflation in certain real estate markets."

And what about stocks?

"Stocks are not crazy as they used to be in 2000-2001. There are perhaps some crazy cases like Google, but it's not the overall situation."

Mr. Greenspan also said that current imbalances in the global economy could be corrected if high-growth countries allowed their currencies to strengthen. Do you see that happening?

"I do not want to indulge in fantasies. It will be a slow process."

Many claim that the US trade deficit is a big problem for the US. But given the fact that the deficit is mirrored by surpluses all around the world, is it accurate to say that it is a US problem?

"I share the view of people like Milton Friedman who say, the deficit is not so much the consequence of the fact that our exports are uncompetitive; our deficit simply reflects the fact that all you foreigners love to invest in the US, buying our Treasury securities, companies, ports. The fact that savers want to invest bids up the price of the dollar and causes the trade deficit to go forward. This is what is keeping the dollar up, according to the other point view, the one I share."

Staff

A Buyout Fever in Gold Stocks?

Futures players call it "contango," a strange word describing a situation in which distant futures prices are well above spot prices. In the oil market, this has encouraged inventory-building so that, ironically, oil prices and inventories have been rising in tandem. In gold, some are now saying, contango may lead to a leveraged buyout spree. The idea was first advanced by ***John Tumazos*** *of Prudential about Newmont Mining, and then elaborated by* ***John Doody****, the author of the outstanding newsletter The Gold Stock Analyst. Circumstances for a leveraged buyout are favourable, according to Doody, due "to the current contango in the gold forward market, where the metal's price increases approximately $3/oz each month into the future and hedging is possible for 15 years out." A buyout could be financed by borrowing from a banking syndicate and selling forward Newmont's 6.5 mil oz/yr production for each of the next 12 years. Doody thinks that "this analysis could likely apply to other big non-hedging gold miners, namely Freeport or Gold Fields." Leveraged buyouts: another by-product of the commodity boom?*