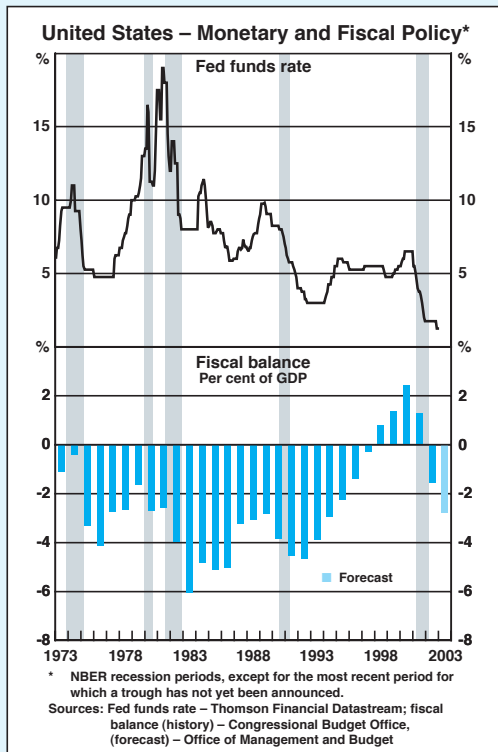


Box A: US Macroeconomic Policy Developments

There has been a substantial easing of both monetary and fiscal policy in the US over the past two years in response to the recent recession. Since the beginning of 2001, the Fed funds rate has been reduced by a total of 525 basis points (Graph A) and expansionary fiscal packages were enacted in 2001 and 2002, with a further package currently before the US Congress. In the case of fiscal policy, the easing was both earlier and larger than in previous recessions; in the case of monetary policy, the easing may not have started earlier, but the speed of the interest rate reductions was much faster than in the previous recession.

The easing in monetary policy commenced in January 2001, slightly ahead of the peak in economic activity, which the NBER dates as occurring in March 2001. This was not as early in the business cycle as it was in the early 1990s' recession, but the overall change in the stance of policy was more decisive on this occasion. Most of the easing in monetary policy in the current cycle occurred during 2001 and, by late 2001, the Fed funds rate was at its lowest level in 40 years. Following a pause of almost a year, the Fed eased by another 50 basis points late in 2002, which took the Fed funds rate to 1¼ per cent.

Graph A



The change in the fiscal balance (an approximate measure of the boost to the economy from fiscal policy) from 2000 to 2002 has totalled nearly 4 per cent of GDP, as the balance has moved from a surplus of 2.4 per cent of GDP in 2000 to a deficit of 1.5 per cent of GDP in 2002.¹ According to the Congressional Budget Office, around half of this change in the fiscal balance has resulted from the automatic response of the budget to the weaker economy. Most of this was due to lower revenues as individual and corporate income taxes and capital gains tax receipts were all significantly lower in the past two years. The other half has resulted from discretionary measures taken by the Bush administration, primarily reflecting the 2001 tax cuts, the worker-assistance package in 2002 and the emergency assistance provided following the September 2001 terrorist attacks. In contrast to earlier downturns, the timing of the discretionary measures was not subject to significant lags; for example, tax rebates commenced relatively soon after the peak in the economy in March 2001.

1. The US fiscal year operates October through September.

In response to the continued uncertainty over the prospects for recovery, the Bush administration is proposing an additional fiscal package worth US\$670 billion over the next 10 years, of which US\$100 billion (1 per cent of GDP) is planned over the next 12 months. The package includes: continuing funding for the extension of unemployment benefits (which has already

been enacted); bringing forward the reductions in income tax rates that were due to be implemented in 2004 and 2006, with these to take effect retroactively from 1 January this year; eliminating the double taxation of dividends; tripling the value of equipment investment that businesses can write off each year as expenses; and financing job retraining and support programs. √