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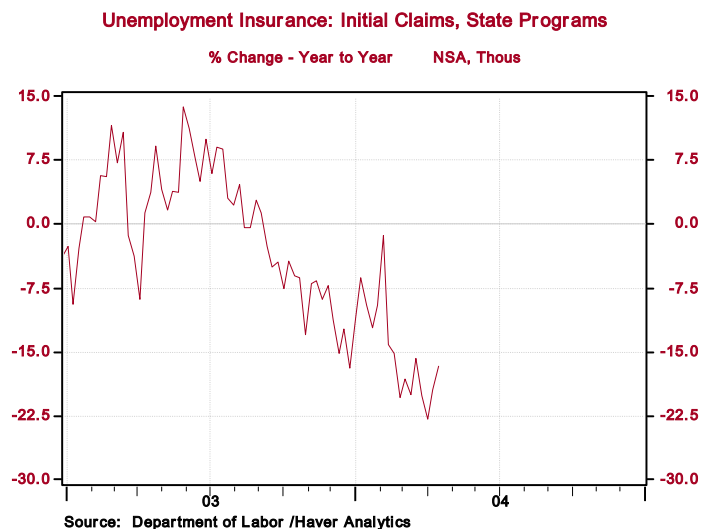
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April 28, 2004

The Labor Market Holds the Key to Near Term Monetary Policy

The near term course of monetary policy is closely tied to developments in the labor market. At the end of the first quarter, retail sales rose at an annual rate of 9.4% vs. a 4.5% gain in the fourth quarter. Factory production posted a 5.8% annualized gain, noticeable price pressures surfaced at the wholesale and retail levels, and home sales surged. However, there were mixed messages from the labor market. The unemployment rate has edged down gradually to 5.7% in March from 6.3% in June 2003, signifying improving conditions on the one hand. On the other hand, payroll employment picked up steam only in March (up 308,000) after tepid gains in prior months. The large increase in payrolls during March and upwardly revised January and February payroll readings changed the perception of the labor market. But, one cannot declare it a trouble free zone based on these numbers. The initial jobless claims data clearly show a downward trend. The continuing claims numbers should be treated with caution for they could be declining because of an increase in the number of exhaustees. Chairman Greenspan's testimony of April 21 noted that 85,000 individuals per week exhausted their unemployment insurance benefits in March vs. 35,000 per week in September 2000. The year-to-year change in initial jobless claims offers an alternate way of assessing labor market developments. On a year-to-year basis, initial jobless claims dropped 16.6% during the week ended April 17. This is a small deceleration in the pace of declines of initial jobless claims from a 22.8% drop in the first week of April and a 19.4% decline in the second week of April. We are watching these numbers and the monthly employment data closely. The FOMC will not be in a position to change the federal funds rate until there is unambiguous growth in employment.



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