



Fed Watch

January 6th, 2009

FOMC Minutes December 15-16, 2008

- Fed economic outlook deteriorates further, while downside risks to inflation intensify
- The Committee discussed extensively additional ways to stimulate the economy

Participants agreed that economic conditions worsened considerably in the intermeeting period as *“the adverse feedback loop between financial conditions and economic performance had intensified”*. Members agreed that *“the uncertainty surrounding the outlook was considerable and that downside risks to even this weak trajectory for economic activity were a serious concern”*.

Moreover, *“the severe ongoing financial market strains, the large reductions in household wealth, and the global nature of the economic slowdown were seen by some participants as suggesting the distinct possibility of a prolonged contraction, although that was not judged to be the most likely outcome”*. According to the staff forecast, *“Real GDP was projected to decline for 2009 as a whole”*, nonetheless, GDP is expected to *“rise at a pace slightly above the rate of potential growth in 2010”* as the financial turmoil begins to recede and the economy benefits from monetary and fiscal policy actions.

The staff also revised down its forecast for inflation due to increasing slack in labor and goods markets, lower import prices and diminishing pressures from energy and other commodity prices. Participants seemed worried from the recent sharp decline in the rate of inflation and were uncertain *“about the extent to which inflation would fall. Some saw inflation leveling out near desired levels, while others expressed concern that inflation might decline below levels consistent with price stability in the medium term”*.

Participants discussed extensively the benefits and costs of very low interest rates, advantages and disadvantages of quantitative targets, how best to use the Fed's balance sheet and communication strategies. Members stressed the need to provide more information regarding future policy; particularly that rates were likely to stay exceptionally low for some time and explicitly conditioning future policy on the economic outlook. In addition, they discussed a more explicit indication on their long-term inflation prospect aimed at preventing inflation expectations from declining significantly.

The minutes reflect that members are worried on the inflation path and that despite the use of alternative policies, *“the economic outlook would remain weak for a time and the downside risks to economic activity would be substantial”*. Not surprisingly, FOMC announced that it stands ready to keep interest rates low for a prolonged period of time and that it will continue implementing nontraditional measures to boost economic activity.

Fed Funds: 0 to 0.25%
Next Meeting: January 27-28th
Minutes Release: February 18th

FOMC Minutes, selected quotes

December 15-16th 2008

A number of participants observed that, under the approach of conducting monetary policy by acquiring a variety of assets as needed to address financial and macroeconomic strains, the quantity of excess reserves and the size of the Federal Reserve's balance sheet would be determined by the Federal Reserve's asset purchases and the usage of its lending facilities. It was likely that, during the period of financial turmoil, the size of the Federal Reserve's balance sheet would need to be maintained at a high level. Participants discussed the potential advantages and disadvantages of setting quantitative targets for bank reserves or the monetary base. Some were of the view that quantitative targets for an increasing reserve base could be effective in preventing deflationary dynamics and useful in communicating to the public the Committee's determination to take the steps needed to avoid such an outcome. Several other participants, however, noted that increases in excess reserves or the monetary base, by themselves, might not have a significant stimulative effect on the economy or prices because the normal bank intermediation mechanism appeared to be impaired, and banks may not be willing to lend their excess reserves. Conversely, a decline in excess reserves or the monetary base would not necessarily be contractionary if it occurred in the context of improving financial market conditions. A few of those who supported quantitative base or reserve targets did so because they saw them as helping to coordinate the actions of the Board of Governors, which is responsible for authorizing most special liquidity and lending facilities, and the Committee, which is responsible for open market operations. Most participants, however, were of the view that such coordination would best be achieved by continued close cooperation and consultation between the Committee and the Board. Going forward, consideration will be given to whether various quantitative measures would be useful in calibrating and communicating the stance of monetary policy.