



Fed Watch

February 18th, 2009

FOMC Minutes January 27-28, 2009

- Downside risks to growth intensified
- FOMC discussed additional measures to boost recovery
- We expect interest rates to remain unchanged

FOMC viewed credit conditions as extremely tight, *“with financial markets fragile and some parts of the banking sector under substantial stress.”* Yet, FOMC highlighted signs of recovery in markets receiving relief from the different liquidity facilities.

Staff revised downwards its forecast for 1H09, as weaker-than-expected economic releases more than offset the expected impact of the fiscal stimulus package. Inflation was forecasted to remain low for a prolonged period of time. Meanwhile, members indicated that they were surprised *“by the speed and magnitude of the slowdown in economic growth abroad and the resulting drop in demand for U.S. exports.”* In addition, they perceived that the housing sector was still far from bottoming out and emphasized the risks of a sharp deterioration in commercial real estate. Moreover they expressed concerns on a rapid retrenchment in business investment and weaker state and local government finances.

Therefore, FOMC seemed more worried of a *“sharp and widespread economic contraction both domestically and abroad, reflecting in large part the adverse effects of the intensification of the financial crisis and the interaction between deteriorating economic and financial conditions.”* Yet, members expect a gradual recovery during the third or fourth quarter as the economy responds to the fiscal stimulus, lower energy prices, and increased credit availability.

Some members noted that FOMC could establish quantitative guidelines or targets for a monetary aggregate (the monetary base or M2) if this would be useful to anchor inflation expectations. However, some were skeptical that *“a single quantitative measure could adequately convey the Federal Reserve’s current approach to monetary policy”*. Although, FOMC considered necessary to expand liquidity facilities, there were different views on the implementation. Most agreed to continue purchasing agency debt and MBS, but others doubted on the size and duration of such measures.

The minutes confirmed that downside risks to economic growth intensified. FOMC economic outlook continues moving towards a weaker and slower recovery, with significant uncertainty on the impact of the fiscal stimulus. We expect the discussion on the balance sheet and quantitative easing to step up, increasing the likelihood of a bold move on the quantitative front and an explicit numerical objective for inflation. Finally, for the first time FOMC provided its long-run forecasts as part of the new communication strategy.

Fed Funds: 0 to 0.25%
Next Meeting: March 17-18th
Minutes Release: April 8th

FOMC Central Tendency Forecasts

	2009	2010	2011	Longer Run
Change in real GDP	-1.3 to -0.5	2.5 to 3.3	3.8 to 5.0	2.5 to 2.7
October projection	-0.2 to 1.1	2.3 to 3.2	2.8 to 3.6	n.a.
Unemployment rate	8.5 to 8.8	8.0 to 8.3	6.7 to 7.5	4.8 to 5.0
October projection	7.1 to 7.6	6.5 to 7.3	5.5 to 6.6	n.a.
PCE inflation	0.3 to 1.0	1.0 to 1.5	0.9 to 1.7	1.7 to 2.0
October projection	1.3 to 2.0	1.4 to 1.8	1.4 to 1.7	n.a.
Core PCE inflation	0.9 to 1.1	0.8 to 1.5	0.7 to 1.5	
October projection	1.5 to 2.0	1.3 to 1.8	1.3 to 1.7	

The central tendency excludes the three highest and three lowest projections for each variable in each year

Fed Funds Expectations
 (Fed Funds futures, end of contract, %)

