Economic Research Department

BBVA

Fed Watch

October 29th, 2008

FOMC Meeting October 29th

- Fed appears more concerned on economic growth
- In contrast, the outlook for inflation has improved
- FOMC expects that the rate cut along with other measures, will help to alleviate the financial crisis
- However, members expect a slow recovery

Fed Funds: 1.00%
Next Meeting: November 19th, 2008
Minutes Release: December 16th, 2008

Weaker economic outlook

FOMC lowered its target for the federal funds rate 50 basis points to 1%. The move was widely expected by market participants.

On the economic front, the statement remained pessimistic as it stressed that "*the pace of economic activity appears to have slowed markedly*". This assessment mainly responded to declining consumer expenditures, weaker business equipment spending and industrial production, and economic moderation abroad. Members remained highly concerned that households and businesses face a difficult environment to access credit. This represents a significant risk to the economic outlook as "*the intensification of financial market turmoil is likely to exert additional restraint on spending*".

On the inflation side, FOMC lowered its risk perception once again noting that "*the Committee expects inflation to moderate in coming quarters to levels consistent with price stability.*" The improvement reflects "*declines in the prices of energy and other commodities and the weaker prospects for economic activity*".

The monetary policy paragraph emphasized that credit conditions are expected to improve and that economic growth is likely to return to a moderate pace. This assessment considers recent actions, including today's rate cut, and also "*coordinated interest rate cuts by central banks, extraordinary liquidity measures, and official steps to strengthen financial systems*". Nonetheless, FOMC highlighted that "*risks to growth remain*".

Bottom line

In our view, Fed significantly revised downward its outlook for economic growth as a result of deteriorating conditions for households, businesses and exports. Inflationary concerns eased off substantially. In addition, Fed highlighted that today's rate cut is one of several steps taken to alleviate the financial crisis. This confirms that rate reductions are necessary but not sufficient to eliminate financial strains. Thus, Fed signals that further rate cuts are still possible but not guaranteed as the solution depends on a broad set of measures. Finally, although these steps are expected to have a significant positive impact, members expect a slow recovery.

FOMC Statement October 29th 2008

The Federal Open Market Committee decided today to lower its target for the federal funds rate 50 basis points to 1 percent.

The pace of economic activity appears to have slowed markedly, owing importantly to a decline in consumer expenditures. Business equipment spending and industrial production have weakened in recent months, and slowing economic activity in many foreign economies is damping the prospects for U.S. exports. Moreover, the intensification of financial market turmoil is likely to exert additional restraint on spending, partly by further reducing the ability of households and businesses to obtain credit.

In light of the declines in the prices of energy and other commodities and the weaker prospects for economic activity, the Committee expects inflation to moderate in coming quarters to levels consistent with price stability.

Recent policy actions, including today's rate reduction, coordinated interest rate cuts by central banks, extraordinary liquidity measures, and official steps to strengthen financial systems, should help over time to improve credit conditions and promote a return to moderate economic growth. Nevertheless, downside risks to growth remain. The Committee will monitor economic and financial developments carefully and will act as needed to promote sustainable economic growth and price stability.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Elizabeth A. Duke; Richard W. Fisher; Donald L. Kohn; Randall S. Kroszner; Sandra Pianalto; Charles I. Plosser; Gary H. Stern; and Kevin M. Warsh.

In a related action, the Board of Governors unanimously approved a 50-basis-point decrease in the discount rate to 1-1/4 percent. In taking this action, the Board approved the requests submitted by the Boards of Directors of the Federal Reserve Banks of Boston, New York, Cleveland, and San Francisco.