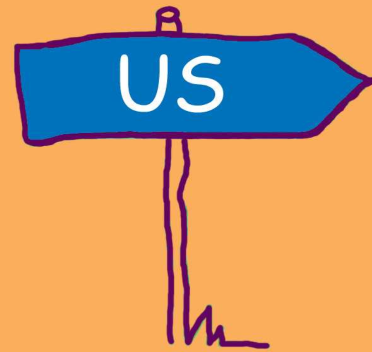
Economic Research Department

BBVA

Fedwatch



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Ben S. Bernanke testimony before the committee on the Budget, U.S. House of Representatives

- Bernanke indicated that the baseline scenario for economic activity has worsened and the downside risks to growth have increased
- The speech is consistent with our current expectations of a 25-50 bp cut in the next FOMC meeting
- The Fed supports the rapid implementation of temporary measures to stabilize economic activity, which includes a fiscal stimulus package

Mr. Bernanke indicated that the Fed has taken all the right measures to help markets return to more "orderly functioning"; however, monetary policy alone is not enough and a serious fiscal stimulus package is necessary to help revive economic growth.

His statement regarding current information points out to a worsening in the economic outlook for 2008 and increasing downside risks to growth. Various factors such as increasing energy prices combined with falling home prices are likely to curb consumer spending in 2008.

The Fed Chairman explained that a fiscal and monetary stimulus together could help economic activity in the near-term more than the monetary policy actions alone. Nevertheless, two of the shortcomings of the implementation of a fiscal stimulus are the timing, because it has to work its way through the economy within twelve months in order to be successful, and the negative impact that it might have on the future fiscal situation. The Fed Chairman speech supports the rapid implementation of temporary measures to stabilize economic activity; it is clear that the Fed wants to avoid, by all means, a recession path in coming months. Bernanke and Governor Mishkin have said in their last speeches that they favor greater "insurance" against the prospect of an economic downturn. This implies that more rate cuts are likely if there is no improvement in financial markets

The risk of inflation is present and the Fed recognized the fast pace of food prices and energy prices in 2007 as well as the recent increase in core price inflation.

In addition, Bernanke stated, once again, that the Fed monitoring closely all the developments in the economy and is ready to take "substantive additional action" to help the economy forestall the adverse effects of the ongoing adjustment in financial markets. The Fed actions could be restricted if inflation expectations do not remain well anchored.

The weakness in the economy and the need for additional monetary stimulus is consistent with a scenario of more drastic rate cuts in coming meetings. Our expectations are in line with a 25-50 bp rate cut in the next FOMC meeting.

Fed Funds: 4.25%
Next FOMC Meeting: January 29-30
Minutes Release: February 20

Bernanke on the near-term economic outlook and related issues

Washington D.C., January 17

Discussion Financial Markets: "The combination of larger balance sheets and unexpected losses prompted banks to become protective of their liquidity and balance sheet capacity and thus to become less willing to provide funding to other market participants, including other banks. Banks have also evidently become more restrictive in their lending to firms and households. More-expensive and less-available credit seems likely to impose a measure of restraint on economic growth."

Discussion on inflation: "Last year, food prices also increased exceptionally rapidly by recent standards, further boosting overall consumer price inflation. The most recent reading on overall personal consumption expenditure inflation showed that prices in November were 3.6 percent higher than they were a year earlier. Core price inflation (which excludes prices of food and energy) has stepped up recently as well, with November prices up almost 2-1/4 percent from a year earlier. Part of this rise may reflect pass-through of energy costs to the prices of core consumer goods and services, as well as the effects of the depreciation of the dollar on import prices, although some other prices--such as those for some medical and financial services--have also accelerated lately."

Discussion on the economic outlook: "Recently, incoming information has suggested that the baseline outlook for real activity in 2008 has worsened and that the downside risks to growth have become more pronounced. In particular, a number of factors, including continuing increases in energy prices, lower equity prices, and softening home values, seem likely to weigh on consumer spending as we move into 2008. Consumer spending also depends importantly on the state of the labor market, as wages and salaries are the primary source of income for most households. Labor market conditions in December were disappointing; the unemployment rate increased 0.3 percentage point, to 5.0 percent from 4.7 percent in November, and private payroll employment declined. Employment in residential construction posted another substantial reduction, and employment in manufacturing and retail trade also decreased significantly. Employment in services continued to grow, but at a slower pace in December than in earlier months. It would be a mistake to read too much into one month's data. However, developments in the labor market will bear close attention."