Economic Research Department

BBVA

US

Fedwatch

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FOMC Meeting, March 18th

- The Fed lowered its target rate by 75 basis points to 2.25%. The statement continued to stress the downside risks to growth, acknowledging higher uncertainty on the inflation side
- The outlook remains fraught with danger, recognizing the deterioration of credit conditions and the overall economy since their last scheduled meeting in January 30th
- FOMC was more pessimistic regarding inflation. It recognized that inflation expectations have risen, adding more uncertainty to the inflation outlook. Still, the Committee expects inflation to moderate in coming quarters
- With Fed Funds rate at 2.25%, the room for further cuts has diminished; recent actions and today's statement explicitly acknowledge this fact by pledging to include policy measures other than target rate cuts.

As it was widely expected after the measures announced this past weekend, the Federal Open Market Committee (FOMC) reduced the fed funds rate 75 basis points to 2.25%. Fed negative bias was evident after last week's $30 billion rescue package for Bear Stearns and Sunday's reduction in the discount rate and the creation of an open ended lending program for the biggest investment firms in the US.

Today's statement highlighted the risk inherent in the current tightening of credit conditions and reiterated the Fed commitment to help forestall its effects on the economy. It pledged to "act in a timely manner as needed to promote sustainable economic growth and prices stability." Regarding the economic outlook, FOMC was more pessimistic than in the previous statement. This is in line with recent economic releases and the trends pointed out by our leading indicators.

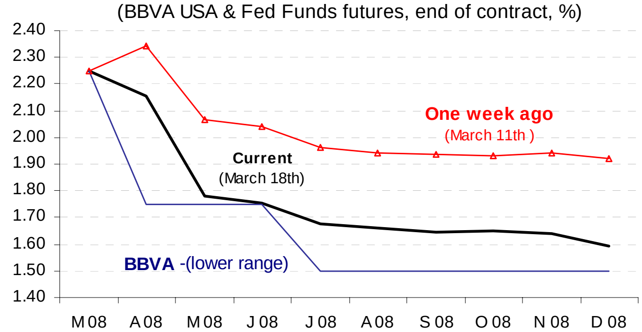
For the Fed, inflation risks have risen but are still deemed under control. Both uncertainty and inflation expectations have increased. This is consistent with still elevated inflation readings. Presumably, higher uncertainty about inflation led two members to vote against this rate cut for considering it too aggressive.

With this reduction, the room for further cuts has diminished. Recent actions and today's statement explicitly acknowledge this fact by pledging to use policy measures other than rate cuts. Other potential measures include direct intervention to rescue financial intermediaries in distress and straightforward liquidity injections through windows other than open market operations.

The Fed funds rate is approaching to the lower bound of our forecast for 2008 (currently at 1.5% by year end). Thus, we maintain our outlook on the Fed funds rate, but increase the probability for it to reach the lower bound of our estimates.

Fed Funds Expectations

(BBVA USA & Fed Funds futures, end of contract, %)



BBVA USA Probit Recession Index & Fed Funds Rate

(%)

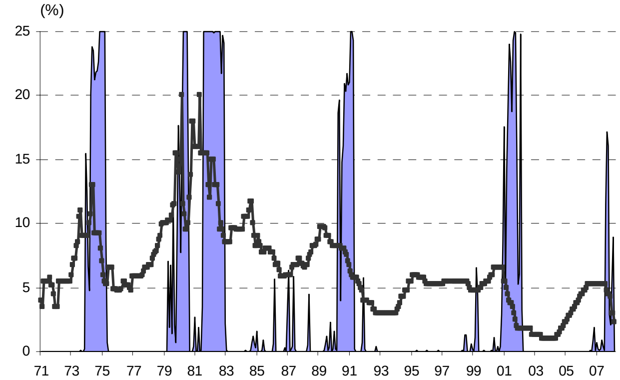


Table 1: FOMC's Statements

	December 11	January 22	January 30	March 18	Comments
Productivity	(No reference)	(No reference)	(No reference)	(No reference)	**----**
Activity	Economic growth is slowing, reflecting the intensification of the housing correction and some softening in business and consumer spending. Moreover, strains in financial markets have increased in recent weeks.	Economic growth was solid in the third quarter and strains in financial markets have eased somewhat on balance. However, the pace of economic expansion will likely slow in the near term	Financial markets remain under considerable stress, and credit has tightened further for some businesses and households. .. deepening of the housing contraction as well as some softening in labor markets.	…the outlook for economic activity has weakened further… Financial markets remain under considerable stress, and the tightening of credit conditions and the deepening of the housing contraction are likely to weigh on economic growth over the next few quarters.	**Downside risks remain as the correction in the housing sector, weakness in labor markets, and financial distress affect the rest of the economy**
Inflation	Readings on core inflation have improved modestly this year, but elevated energy and commodity prices, among other factors, may put upward pressure on inflation.	The Committee expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.	The Committee expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.	Inflation has been elevated, and some indicators of inflation expectations have risen. The Committee expects inflation to moderate in coming quarters. Still, uncertainty…has increased	**Uncertainty about inflation has risen. Specially worrisome for the Fed is the increase of some indicators of inflation expectations. But, the Committee still expects inflation to moderate**
Risks	Uncertainty surrounding the outlook for growth and inflation	Appreciable downside risks to growth remain.	However, downside risks to growth remain	However, downside risks to growth remain.	**The risks are again focused on low growth, even though uncertainty on inflation has increased**
Monetary Policy	The Committee will continue to assess the effects of financial and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth	The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed to address those risks.	The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed to address those risks.	The Committee will act in a timely manner as needed to promote sustainable economic growth and price stability.	**Growth and financial stability bias; the FOMC is willing to act as needed**
Action	-25	-75	-50	-75	**8 in favor – 2 against**
Fed Funds	4.25	3.50	3.00	2.25	**Reduction**

* BBVA USA Economic Research Department interpretation of FOMC's perception regarding the economic variables included in the statement

Relevant events before FOMC's April 30th meeting

March	
24	Fed Plans TAF Auction of $50 billion to Adress Liquidity
27	Fed Plans TSLF Auction to Promote Liquidity in Markets
Apr	
2	Bernanke Testifies Before Joint Economic Committee
3	Fed's Mishkin Speaks at Princeton Club in New York
4	Employment Situation (March)
8	FOMC Minutes (March 18th Meeting)
16	Consumer Price Index (March)
16	Beige Book
17	Fed's Kohn Speaks at Conference on Credit Markets

Source: Bloomberg