



Fed Watch

June 25th, 2008

FOMC Meeting June 24-25

- The Fed maintained its target rate at 2%. But the statement was hawkish in tone, in line with recent speeches of Board members
- FOMC is now more concern with risks to inflation than with risks to the growth outlook
- While we expect a pause in its next meeting August 5th, the Fed will not hesitate to act if inflationary pressures increase further or if inflation expectations continue to deteriorate

Inflationary Risks continue to rise, while growth drags.

The Federal Open Market Committee maintained its target for the federal funds rate at 2% and the pause and the accompanying press release were in line with our expectations. The vote was not unanimous as one of the ten members voted in favor of a rate hike for this meeting, showing a glimpse of the heated debate that probably ensued.

As in recent speeches by Board members, FOMC raised the tone regarding the inflationary threat, reflecting its worries regarding the deterioration of headline inflation and inflation expectations since the last FOMC meeting. A more hawkish statement is an immediate and expected line of action of any Central Bank to try to avoid contagion of inflation expectations.

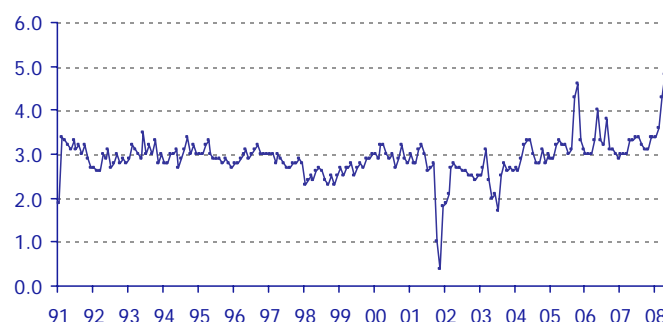
The Fed's assessment on growth was more optimistic than in previous meetings, stating that "Although downside risks to growth remain, they appear to have diminished somewhat". That said, the statement acknowledged that credit tightening still exists and will continue to slow the economy in the future quarters: "Recent information indicates that overall economic activity continues to expand ... although (several factors) are likely to weigh on economic growth over the next few quarters."

The Fed signals the possibility of rate hikes if the inflation outlook continues to deteriorate.

The changes to the wording suggest that FOMC worries on growth have eased significantly. Thus, as in our baseline scenario, the worst pressures on growth may be behind us. In addition, the Fed expects inflationary pressures to yield as commodities and oil prices edge down. However, inflationary pressures continue to mount up and inflation expectations are moving closer to unwelcome levels. Thus, while we still expect the Fed to keep rates stable in the next meeting, the probability of rate hikes in 2H08 has increased substantially.

Fed Funds: 2.00%
Next Meeting: August 5th, 2008
Minutes Release: July 16th, 2008

Inflation Expectations
 (University of Michigan, %, 1 year-ahead)



BBVA Compass Leading inflation Index & core inflation
 (%)

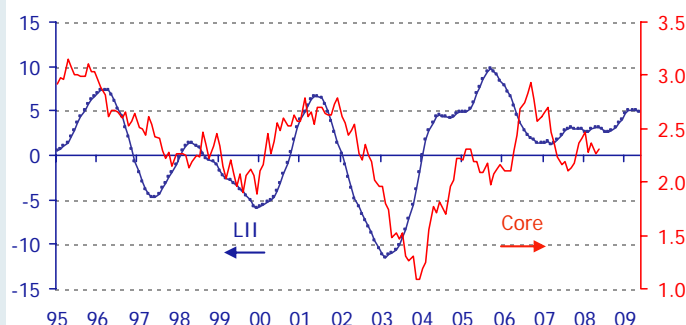


Table 1: FOMC's Statements

	January 30	March 18	April 30	June 24-25	Comments
Productivity	(No reference)	(No reference)	(No reference)	(No reference)	----
Activity	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.	... economic activity remains weak. Household and business spending has been subdued and labor markets have softened further. Financial markets remain under considerable stress, and tight credit conditions and the deepening housing contraction are likely to weigh on economic growth over the next few quarters.	Recent information indicates that overall economic activity continues to expand, partly reflecting some firming in household spending ...Tight credit conditions, the ongoing housing contraction, and the rise in energy prices are likely to weigh on economic growth over the next few quarters.	Recovering slowly
Inflation	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	... readings on core inflation have improved somewhat... some indicators of inflation expectations have risen... The Committee expects inflation to moderate in coming quarters. Still, uncertainty ... remains high.	The Committee expects inflation to moderate later this year and next year.	Uncertainty has risen
Risks	However, downside risks to growth remain	However, downside risks to growth remain.	substantial easing of monetary policy to date, ... should help to promote moderate growth over time and to mitigate risks to economic activity..	Although downside risks to growth remain, they appear to have diminished somewhat, and the upside risks to inflation and inflation expectations have increased.	Tilted towards inflation
Monetary Policy	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.	will act as needed to promote sustainable economic growth and price stability.	The Committee will continue to monitor economic and financial developments and will act as needed to promote sustainable economic growth and price stability.	Bias to rise
Action	-50	-75	-25	0	9 vs. 1
Fed Funds	3.00	2.25	2.00	2.00	Pause

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

June	
26	Michigan sentiment
26	Kohn speaks at ECB conference
July	
1	Lockhart speaks on economy & financial turmoil
3	Employment report
7	Yellen speaks on economic outlook
16	CPI
23	Fed's beige book