Economic Research Department

BBVA

Fed Watch

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Semiannual Monetary Policy Report to the Congress

- **Fed assistance to Fannie and Freddie is temporary, while Congress decides how to proceed**
- **Bernanke indirectly supported Congress proposal to help households facing foreclosure**
- **Rising uncertainty for both future growth and inflation. FOMC will assess incoming information as it becomes available**

Bernanke testified before Congress amid growing concerns about the financial condition of the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. Bernanke assured Congress that the Federal Reserve is aware of the importance of these firms to the mortgage market, reason why the Board authorized the Federal Reserve Bank of New York to lend to Fannie Mae and Freddie Mac, should that become necessary. Bernanke highlighted that Fed assistance would be temporary and only a “bridge” to the time when Congress decides how to proceed.

Bernanke indirectly supported Congress proposal to help households facing foreclosure –which could be sent to President Bush next week- by explicitly describing the vicious cycle between foreclosures and falling home prices.

Regarding the long term outlook, Bernanke stated that most FOMC participants expected that, over the remainder of this year, output would expand at a pace appreciably below its trend rate, primarily because of continued weakness in housing markets, elevated energy prices, and tight credit conditions. He added that growth is projected to pick up gradually over the next two years as residential construction bottoms out and begins a slow recovery, and as credit conditions gradually improve. However, he warned that there was a high degree of uncertainty to this outlook and that risks were skewed to the downside.

On the outlook for inflation he was equally negative. He reiterated that the elevated level of overall consumer inflation largely reflects a continued sharp run-up in the prices of many commodities –especially oil. He dismissed the claim that high oil prices may be due solely to speculation, and seemed to defend the thesis of structural “long term” trends of rising demand and decelerating supply.

He concluded by saying that, given the high degree of uncertainty, the Board will need to carefully assess incoming information bearing on the outlook for both inflation and growth. In light of the increase in upside inflation risk, the Board will be particularly alert to any indication of inflationary pass-through from high oil prices and dollar depreciation into long-term inflation expectations and price and wage setting processes. On the other hand, tighter credit conditions and a still-deeper contraction in housing markets still pose significant downside risks to growth. Therefore, we expect Fed funds to remain stable at 2% in the near future.

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

Bernanke’s Semiannual Monetary Policy Report to the Congress

July 15, 2008

“At present, accurately assessing and appropriately balancing the risks to the outlook for growth and inflation is a significant challenge for monetary policy makers. The possibility of higher energy prices, tighter credit conditions, and a still-deeper contraction in housing markets all represent significant downside risks to the outlook for growth. At the same time, upside risks to the inflation outlook have intensified lately, as the rising prices of energy and some other commodities have led to a sharp pickup in inflation and some measures of inflation expectations have moved higher. Given the high degree of uncertainty, monetary policy makers will need to carefully assess incoming information bearing on the outlook for both inflation and growth.”

Economic projections of Federal Reserve Governors and Reserve Bank presidents, June 2008
Percent

Variable	2008	2009	2010
Central tendency[1]			
Change in real GDP	1.0 to 1.6	2.0 to 2.8	2.5 to 3.0
April projection	0.3 to 1.2	2.0 to 2.8	2.6 to 3.1
Unemployment rate	5.5 to 5.7	5.3 to 5.8	5.0 to 5.6
April projection	5.5 to 5.7	5.2 to 5.7	4.9 to 5.5
PCE inflation	3.8 to 4.2	2.0 to 2.3	1.8 to 2.0
April projection	3.1 to 3.4	1.9 to 2.3	1.8 to 2.0
Core PCE inflation	2.2 to 2.4	2.0 to 2.2	1.8 to 2.0
April projection	2.2 to 2.4	1.9 to 2.1	1.7 to 1.9
Range[2]			
Change in real GDP	0.9 to 1.8	1.9 to 3.0	2.0 to 3.5
April projection	0.0 to 1.5	1.8 to 3.0	2.0 to 3.4
Unemployment rate	5.5 to 5.8	5.2 to 6.1	5.0 to 5.8
April projection	5.3 to 6.0	5.2 to 6.3	4.8 to 5.9
PCE inflation	3.4 to 4.6	1.7 to 3.0	1.6 to 2.1
April projection	2.8 to 3.8	1.7 to 3.0	1.5 to 2.0
Core PCE inflation	2.0 to 2.5	1.8 to 2.3	1.5 to 2.0
April projection	1.9 to 2.5	1.7 to 2.2	1.3 to 2.0

Note: Projections of change in real gross domestic product (GDP) and of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy.

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

2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.