



# Fed Watch

July 16<sup>th</sup>, 2008

## FOMC Minutes of June 24-25

- Members recognized that risks to growth persisted and that risks to inflation had risen
- Less consensus on risk assessments. All members saw rising risks, but some viewed the balance of risks tilted towards inflation.
- The Board is managing growing uncertainty about the outlook, thus justifying a “wait and see” policy.

One day after Bernanke's testimony in Congress, The Fed released the minutes for last month's FOMC meeting. As it was expected after the hawkish statement that accompanied the maintenance of the 2% target rate, FOMC members were then extremely concerned with rising inflationary risks. Back in July, the released statement acknowledged the continuing existence of risks to growth, but stated that these risks seemed to be receding, thus left in the back burner. The emphasis of the statement was clearly tilted to rising inflationary risks.

We now learn from the minutes that the internal debate was more heated and less consensual than what could have been presumed from the statement. Although FOMC members' projections for 2009 and 2010 did not change much from March's projections, their projections for 2008 inflation and 2008 growth were clearly higher than before. This concerted shift in expectations should have made consensus easier, with all members betting for a more hawkish stance. However, that consensus did not materialize. The reason was an ever-growing divergence in members' risk assessments. While some of them saw rising inflationary risks as tilting the balance towards inflation, others deemed rising risks to inflation and continuing risks to growth as balancing each other.

On growth, members recognized that risks persist. They acknowledged that the current financial market remains weak and that cyclical forces will now start playing against the economy. In their opinion, the better than expected economic performance during 2008:Q1 and 2008:Q2 was due to Fed intervention and to the fiscal rebate. This policy boost is transitory and the balance sheets of regional banks remain fragile.

On inflation, FOMC members expressed growing concerns. Though they pointed out that readings on core prices improved in the past months, they were increasingly worried about the possibility of high headline inflation triggering a vicious cycle through inflation expectations and/or through the wage setting process. They concluded that both wage inflation and inflation expectations should be thoroughly followed in subsequent months. The minutes clearly show Board members managing growing uncertainty about the outlook. This uncertainty translates into the “wait and see” policy recently stated by Bernanke before Congress.

Alejandro Neut  
[alejandro.neut@bbvany.com](mailto:alejandro.neut@bbvany.com)

