Economic Research Department

BBVA

Fedwatch

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Luis Arregoces
luis.arregoces@bbvausa.com

FOMC October 30-31, Meeting

- **The FOMC cut the fed funds rate by 25 basis points to 4.50 percent**
- **The statement indicated that "the upside risks to inflation roughly balance the downside risks to growth"**
- **We maintain a downward bias on further interest rate cuts**

Fed Funds: 4.50%
Minutes Release: November 21st
Next FOMC Meeting: December 11th

As we expected, FOMC cut the fed funds rate by 25 bp to 4.5%; although, with one dissenting vote, from Kansas City President, Hoenig. The statement signaled that "economic growth was solid in the third quarter, and strains in financial markets have eased somewhat on balance" However, the Fed also indicated that "the pace of economic expansion will likely slow in the near term, partly reflecting the intensification of the housing correction".

In addition, in relation to the inflation outlook FOMC members were less upbeat than in the previous meeting, as they considered that "readings on core inflation have improved modestly this year, but recent increases in energy and commodity prices, among other factors, may put renewed upward pressure on inflation."

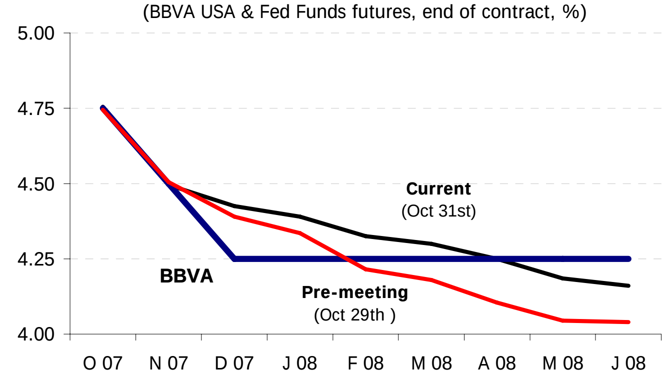
In our view, the rate cut responds to the risk management approach that the Fed has been following since August, as a broad strategy intended to "forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and promote moderate growth over time."

While the FOMC admits good news on the growth front and some concerns about inflationary pressures, the uncertainties prevailing regarding (i) the impact of the housing downturn on broad economic activity, and (ii) credit tightening conditions on other loans different from the subprime mortgage market, led them to keep a slight downward bias. In particular, the FOMC indicated that "after this action, the upside risks to inflation *roughly* balance the downside risks to growth".

In our view, recent economic data is not helpful enough to make a thorough assessment of the impact of the financial turmoil on the broader economy. Given that we expect financial conditions to deteriorate further, the Fed will probably consider an additional 25 basis point rate cut. While this move could very well occur on December 11, the wording was also intended to give them sufficient leeway to assess the data (both economic and financial) and to contain market expectations of additional rate cuts.

Fed Funds Expectations

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



BBVA USA Monthly Activity Index

(Index & 3MA)

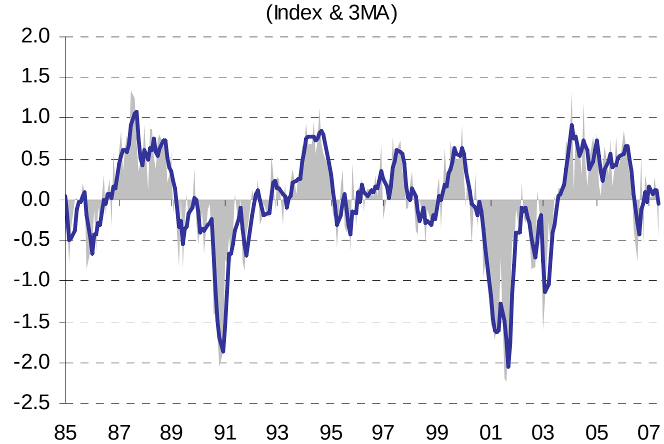


Table 1: FOMC's Statements

	June 27-28th	August 7th	September 18th	October 31st	Comments
Productivity	(No reference)	(No reference)	(No reference)	(No reference)	**----**
Activity	Economic growth appears to have been moderate during the first half of this year, despite the ongoing adjustment in the housing sector. The economy seems likely to continue to expand at a moderate pace over coming quarters	Economic growth was moderate during the first half of the year. and the housing correction is ongoing. Nevertheless, the economy seems likely to continue to expand at a moderate pace over coming quarters,	Economic growth was moderate during the first half of the year, but tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth more generally	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	**Downside risks**
Inflation	Readings on core inflation have improved modestly in recent months. However, a sustained moderation in inflation pressures has yet to be convincingly demonstrated. Moreover, the high level of resource utilization has the potential to sustain those pressures	Readings on core inflation have improved modestly in recent months. However, a sustained moderation in inflation pressures has yet to be convincingly demonstrated. high level of resource utilization sustain those pressures	Readings on core inflation have improved modestly this year. However, the committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.	Readings on core inflation have improved modestly this year, but recent increases in energy and commodity prices, among other factors, may put renewed upward pressure on inflation.	**Upside risks**
Risks	Inflation risks predominantly	Inflation risks predominantly	Growth risks predominantly	Risks to inflation balance risks to growth	**Balanced**
Monetary Policy	In these circumstances, the Committee's predominant policy concern remains the risk that inflation will fail to moderate as expected. Future policy adjustments will depend on the evolution of the outlook for both inflation and economic growth	the Committee's predominant policy concern remains the risk that inflation will fail to moderate as expected. Future policy adjustments will depend on the outlook for both inflation and economic growth, as implied by incoming information	The committee will continue to asses the effects of these and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth	The committee will continue to asses the effects of financial and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth	**Wait and see Downward bias**
Action	0	0	-50	-25	**9 vs. 1**
Fed Funds	5.25	5.25	4.75	4.50	**-25bp**

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

Relevant events before FOMC's December 11 meeting

November	
NA	Senior Loan Officer Opinion Survey on Bank Lending Practices
2	Employment
14	Retail Sales
21	Minutes from October 30-31st FOMC meeting
28	Durable goods
30	Personal Income and Outlays
December	
3	ISM Manufacturing Index
7	Employment situation