



Fedwatch

November 20, 2007

FOMC Minutes October 30-31 Meeting

- Both Staff and FOMC members revised down their GDP projections for 2008, acknowledging that risks to growth are tilted to the downside
- While at the time of the FOMC meeting, a rate cut in December did not seem to be the most likely scenario, under current conditions, an additional cut in the near term continues to be likely

The minutes of the most recent FOMC meeting reinforced the view that, despite some improvement in financial conditions and solid GDP growth in the third quarter, members considered that the tightening in credit markets is likely to affect the broader economy in the near term. In fact, the minutes showed that the staff expected growth to slow down considerably in the fourth quarter of 2007, and to levels a bit below potential in 2008.

FOMC projections were released with the minutes as part of Fed's new communication strategy. Members expect GDP growth in 2008 to slow down to a (central tendency) range of 1.8 to 2.5%, well below the 2.5-2.75% range expected in June 2007. Moreover, FOMC members expect GDP growth at 2.3-2.7% in 2009 and 2.5-2.6% in 2010. We judge that these projections not only reflect a gradual recovery in real GDP growth over the next three years, but also a less upbeat view about potential growth. Most participants believe that downside risks to growth dominate the outlook for the next three years. These risks reflect a situation in which financial market conditions remain strained, the housing sector deteriorates further and business and household spending slows down as a consequence of tighter conditions in the credit market.

Concerns on inflation did not seem to be too high, although some upside risks stemming from rising energy and commodity prices and the pass-through of the dollar depreciation were acknowledged. According to the minutes, not only inflation expectations appear to be contained and the readings on core inflation continue to be favorable, but FOMC projections are for core PCE inflation to remain below 2% as from 2008 onwards.

While the assessment that the *"upside risks to inflation roughly balance the downside risks to growth"* indicates that additional rate cuts were far from being imminent at the time of the last meeting, the high degree of uncertainty that the FOMC attached to their GDP estimates — *"...above typical levels seen in the past"* — opens the door to future rate cuts if economic and financial indicators continue to deteriorate. Even though *"many members noted that [the latest] policy decision was a close call."* — the odds are still on for a rate cut in the very near term.

Fed Funds: 4.50%
Next FOMC Meeting: December 11
Minutes Release: January 2

FOMC Meeting Minutes – October 30-31

Discussion on growth: "Even with some further easing of monetary policy, participants expected economic growth to slow over the next few quarters, reflecting continued sharp declines in the housing sector and tighter lending standards and terms across a broad range of credit products."

Discussion on inflation: "Readings on core inflation ...continued to be generally favorable, and...the recent moderation in core inflation would likely be sustained..." However, "The recent increases in the prices of energy and other commodities, along with the significant decline in the foreign exchange value of the dollar...could exert upward pressure on prices of some core goods and services in the near term."

Discussion on monetary policy: "Many members noted that this policy decision was a *close call*. However, on balance, nearly all members supported a 25 basis point reduction in the target federal funds rate...most members saw substantial downside risks to the economic outlook and judged that a rate reduction at this meeting would provide valuable additional insurance against an unexpectedly severe weakening in economic activity."

Discussion on financial markets: "Financial market functioning was judged to have improved somewhat..., but the situation in a number of markets remained strained, and credit market conditions were thought likely to weigh on economic growth over coming quarters. In light of some improvement in the commercial paper and leveraged loan markets over the inter-meeting period, participants were somewhat less concerned that banks would not have sufficient balance-sheet capacity to absorb large volumes of assets. Conditions in corporate credit markets also had improved in recent weeks, and most businesses were apparently having little difficulty raising external funds, as evidenced by strong issuance of investment-grade corporate bonds, a pickup in speculative-grade issuance, and surging C&I loans."

Economic Projections of Federal Reserve Governors and Reserve Bank Presidents*

Central Tendencies	2007	2008	2009	2010
Real GDP Growth	2.4 to 2.5	1.8 to 2.5	2.3 to 2.7	2.5 to 2.6
June Projections	2½ to 2½	2½ to 2½		
Unemployment Rate (%)	4.7 to 4.8	4.8 to 4.9	4.8 to 4.9	4.7 to 4.9
June Projections	4½ to 4¾	about 4¾		
PCE Inflation	2.9 to 3.0	1.8 to 2.1	1.7 to 2.0	1.6 to 1.9
Core PCE Inflation	1.8 to 1.9	1.7 to 1.9	1.7 to 1.9	1.6 to 1.9
June Projections	2 to 2¼	1¾ to 2		

* GDP growth, PCE inflation and Core PCE inflation are 4Q to 4Q percentage changes