



U.S. FEDERAL RESERVE

Minutes of the meeting of October 30-31: economic growth and inflation will remain modest

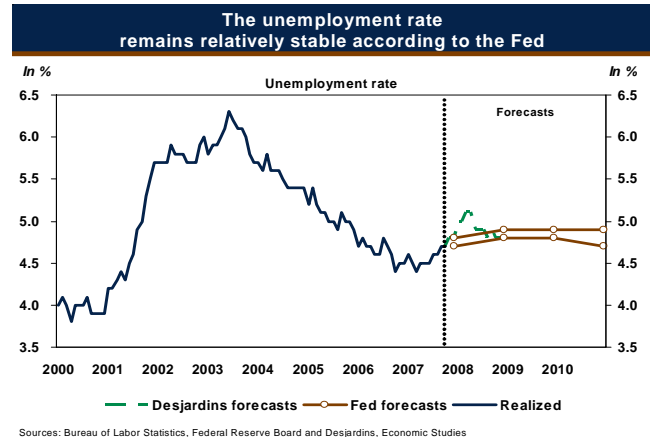
ACCORDING TO THE U.S. FEDERAL RESERVE (Fed)

- The Fed published the minutes of its meeting of October 30-31: the target for the federal funds rate was cut 0.25% to 4.50%.
- Many members noted that the decision to cut rates was a close call. Tighter credit conditions tipped the balance in favour of a rate reduction, which is considered as “additional insurance.”
- Mr. Hoenig of the Kansas City Fed dissented, believing that the rates should remain unchanged.
- With these minutes, the Fed now publishes its economic forecasts four times a year.
- For 2007, the Fed's projections for real GDP are slightly higher than the figures released in June. Core inflation forecasts were marked down and the unemployment rate is expected to edge higher.
- Forecasts for real GDP growth in 2008 were revised downward, closer to 2%. Expectations regarding the unemployment rate are slightly higher. Total inflation should be about the same as core inflation, i.e., an annual rate of about 2%.
- The Fed forecasts growth to be below potential for 2009 and 2010. Inflation should remain slightly under 2% until 2010.

COMMENTS

The minutes of the Fed's Federal Open Market Committee (FOMC) meeting indicate that most Fed authorities are less concerned about inflation and more worried about the economy than the press release issued at the end of the meeting would have us believe. While considered a close call by many participants, the policy decision to cut rates was ultimately deemed necessary due to fears that the economy would further weaken.

Tighter credit conditions and fragile financial markets are viewed as rather substantial risks. Participants expressed concern that an additional deterioration in credit quality or the disclosure of unusually large and unanticipated losses could further dent investor confidence and significantly increase the downside risks to the economy. On the other hand, the Fed does not foresee strains in the housing market spilling over on consumer spending. All told, participants envisioned that the most likely scenario was for consumer spending to advance at a moderate rate supported by the labour market and gains in personal income. In this regard, the Fed is forecasting unemployment to remain stable, rising modestly to just under 5%.



However, participants' projections for real GDP (Q4/Q4) growth in 2008 were revised to 1.8% to 2.5%, down from the 2.5% to 2.75% projected in June. Moreover, four of the individual forecasts now put growth at below 2% whereas in June none of the participants had projected annual real GDP growth below 2.4%. None of the participants foresee

François Dupuis
Vice-President and Chief Economist

Yves St-Maurice
Director and Deputy Chief Economist

Mathieu D'Anjou
Economist

Francis Généreux
Senior Economist

Martin Lefebvre
Senior Economist

Hendrix Vachon
Economist

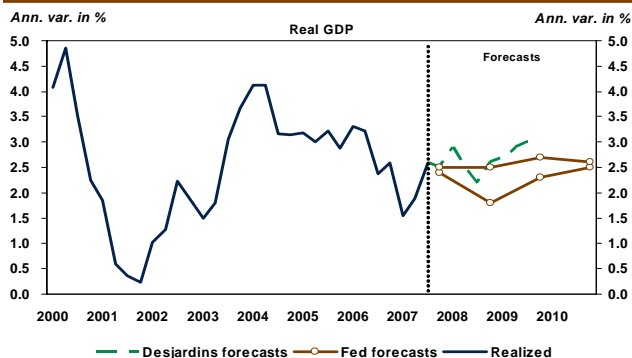
514-281-2336 or 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

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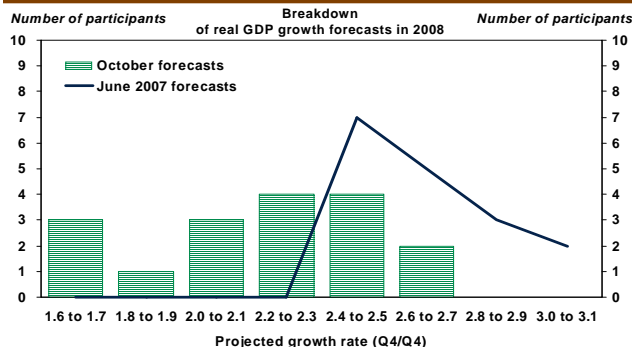
growth above 3% from 2009 and 2010, the majority forecasting real GDP growth of about 2.5%. It bears recalling that the Congressional Budget Office is estimating real potential GDP growth at 2.8%. Growth below potential should not create much core inflation.

The Fed is forecasting weak economic growth



Sources: Bureau of Economic Analysis, Federal Reserve Board and Desjardins, Economic Studies

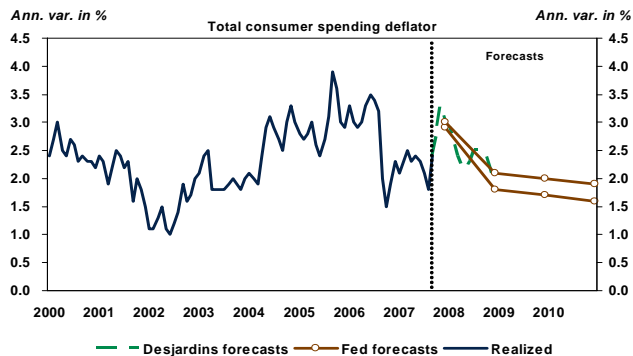
Economic growth forecasts for 2008 revised downward



Sources: Federal Reserve Board and Desjardins, Economic Studies

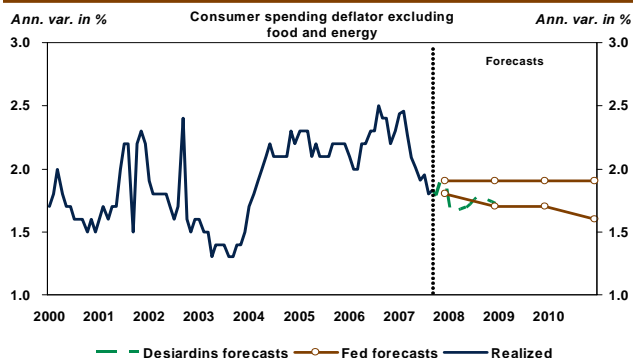
FOMC participants generally expect that inflation would edge down over the next few years, thus at about the same pace as actual core inflation, which excludes food and energy. In the press release accompanying the October 31 decision, the Fed stated that readings on core inflation were generally favourable. The minutes list the risks that could put upward pressure on inflation: recent increases in energy and commodity prices, the depreciation of the greenback against other currencies, increase in unit labour costs and an upward drift in inflation expectations. However, the press release mentions that modest economic growth will keep inflation contained. As such, the decision to cut rates should not have a negative impact on the inflation situation. Moreover, unit labour costs fell in the third quarter and inflation expectations according to the consumers surveys remain very stable.

Energy prices should have less impact on total inflation



Sources: Bureau of Economic Analysis, Federal Reserve Board and Desjardins, Economic Studies

Core inflation to remain moderate



Sources: Bureau of Economic Analysis, Federal Reserve Board and Desjardins, Economic Studies

Implications: The minutes of the meeting of October 30-31 indicate that many Fed participants are concerned about the economic situation and the financial markets. And the situation has not improved in November. On the contrary, the financial markets remain unstable and economic statistics issued by the FOMC participants confirm that the Fed is forecasting modest economic and inflation growth over the next few years. Given that nothing in these minutes indicates that the Fed will not resort to further rate reductions, we believe that the target for the federal funds rate will probably be cut again in December.

Francis Généreux
Senior Economist