

January 22, 2008



## U.S. FEDERAL RESERVE

### The Fed goes on the offensive: Surprise 75 basis point cut!

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

- With a week to go until its next official meeting, the Fed has cut its key rates by 75 basis points. The target interest rate for federal funds goes from 4.25% to 3.50%. The discount rate has also been decreased by 75 basis points, from 4.75% to 4.00%.
- The Fed's decision is based on a weakening of the economic outlook and increasing downside risk to growth.
- The strains on the funding market eased a little, but the situation on financial markets continues to deteriorate. Credit conditions for business and consumers have tightened further.
- The housing market situation is continuing to crumble, and the job market is showing signs of weakness. The Fed expects inflation to moderate in the coming quarters.
- The downside risks to growth remain. The Fed will continue to watch the situation and act as needed.

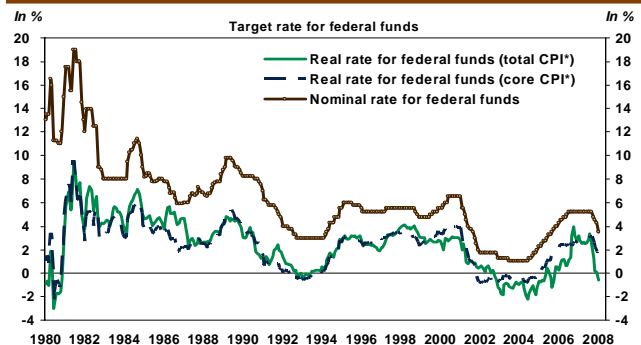
#### COMMENTS

Today's action by Ben Bernanke and his colleagues is a surprise. First, it came just one week before the beginning of the next two-day monetary policy committee meeting (FOMC), scheduled to start on January 29. The last intermeeting decision came in September of 2001. Secondly, the size of the interest rate cut is unusual. The last time key rates came down this much was in November of 1982, when a 75 basis point cut took rates to 8.00%. Even in 2001, Greenspan's Fed never went further than 50 basis points in a single move.

Today's decision sheds new light on recent remarks by Chair Ben Bernanke. In recent speeches, he has clearly stated that the Fed was ready to take substantive additional action to support growth (flexible monetary policy). This action bears out his words.

What made the Fed decide to take this daring action? Clearly, some economic data have proven disappointing since the

#### The Fed picks up the pace on monetary easing



\* Consumer price index.  
Sources: Bureau of Labor Statistics, Federal Reserve Board and Desjardins, Economic Studies

year began (ISM, unemployment rate, Philly Fed, housing starts, etc.) and discussion about a potential recession has taken a new twist. Yet the response to these aggravating factors could probably have waited another week. It is, therefore, the difficult situation in financial markets (the stock market panic in the last few days) and the repercussions for credit conditions, business investment and household assets (pummelled by the stock market and real estate market) that prodded the Fed to take this action, and take it today.

**Implications:** The Fed was resolutely ready to go on the offensive to counter the economy's slowdown. It wants to avoid a recession at all costs. Using the total consumer price index, the real rate for federal funds is now in negative territory, a sign of substantial monetary easing. The rate decrease should continue next week with a 50 basis point cut. The target rate for federal funds could come as low as 2% this year.

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**EXCERPT FROM THE U.S. FEDERAL RESERVE PRESS RELEASE  
JANUARY 22, 2008**


The Federal Open Market Committee has decided to lower its target for the federal funds rate 75 basis points to 3-1/2 percent.

The Committee took this action in view of a weakening of the economic outlook and increasing downside risks to growth. While strains in short-term funding markets have eased somewhat, broader financial market conditions have continued to deteriorate and credit has tightened further for some businesses and households. Moreover, incoming information indicates a deepening of the housing contraction as well as some softening in labor markets.

The Committee expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.

Appreciable downside risks to growth remain. The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed to address those risks.

**Table 1  
Schedule and key rates**

Date	Central Bank	Decision	Rate
<b>October 2007</b>			
17	Bank of Brazil	s.q.	11.25
24	Reserve Bank of New Zealand	s.q.	8.25
30	Bank of Mexico	+25 b.p.	7.50
30	Bank of Sweden	+25 b.p.	4.00
31	Bank of Japan	s.q.	0.50
30	Bank of Norway	s.q.	5.00
31	U.S. Federal Reserve	-25 b.p.	4.50
<b>November 2007</b>			
6	Reserve Bank of Australia	+25 b.p.	6.75
8	European Central Bank	s.q.	4.00
8	Bank of England	s.q.	5.75
8	Bank of Japan	s.q.	0.50
23	Bank of Mexico	s.q.	7.50
<b>December 2007</b>			
4	Reserve Bank of Australia	s.q.	6.75
4	Bank of Canada	-25 b.p.	4.25
5	Reserve Bank of New Zealand	s.q.	8.25
5	Bank of Brazil	s.q.	11.25
6	European Central Bank	s.q.	4.00
6	Bank of England	-25 b.p.	5.50
7	Bank of Mexico	s.q.	7.50
11	U.S. Federal Reserve	-25 b.p.	4.25
<b>January 2008</b>			
10	European Central Bank	s.q.	4.00
10	Bank of England	s.q.	5.50
18	Bank of Mexico	s.q.	7.50
21	Bank of Japan	s.q.	0.50
22	U.S. Federal Reserve	-75 b.p.	3.50
22	Bank of Canada	-25 b.p.	4.00

s.q.: status quo; b.p. : basis points  
Source: Desjardins, Economic Studies

**Table 2  
Coming soon**

Date	Central Bank
<b>January 2008</b>	
23	Bank of Norway
23	Bank of Brazil
24	Reserve Bank of New Zealand
29 - 30	U.S. Federal Reserve
<b>February 2008</b>	
5	Reserve Bank of Australia
6 - 7	Bank of England
7	European Central Bank
12	Bank of Sweden
14 - 15	Bank of Japan
15	Bank of Mexico
<b>March 2008</b>	
4	Reserve Bank of Australia
4	Bank of Canada
5 - 6	Bank of England
6	European Central Bank
6	Reserve Bank of New Zealand
6 - 7	Bank of Japan
13	Bank of Norway
13	Swiss National Bank
14	Bank of Mexico
18	U.S. Federal Reserve
<b>April 2008</b>	
1	Reserve Bank of Australia
8 - 9	Bank of Japan
9 - 10	Bank of England
10	European Central Bank
18	Bank of Mexico
22	Bank of Sweden
22	Bank of Canada

Source: Desjardins, Economic Studies