

U.S. FEDERAL RESERVE

Minutes of the meeting of January 29 and 30, 2008: Economic growth revised downward and risks remain high

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

- The Fed published the minutes of its meeting held last January 29 and 30. The target interest rate for the federal funds was reduced from 3.50% to 3.00%.
- The Fed also published the minutes of two conference calls held on January 9 and January 21 (when the surprise decision was made to lower rates by 75 points).
- These rate reductions were motivated by the weakened economic outlook. The purpose of the rate reductions was to highlight the Fed's efforts to actively counter the worsening economic conditions.
- Fed leaders stated that risks to growth remain despite previous interest rate cuts (including a 50-point rate cut on January 30). However, the rates could quickly be reversed, as would be appropriate, when the prospects for economic growth improve.
- For 2008, the Fed revised its forecast for the real GDP downward by 0.5%. The forecast now calls for growth to be between 1.3% and 2.0%. Unemployment rate and inflation expectations have been revised upward.
- For 2009, the forecasts for real GDP growth have been revised slightly downward. Growth should settle between 2.1% and 2.7%. The unemployment rate is expected to rise while forecasts on inflation have hardly changed.
- The Fed anticipates growth that is closer to potential in 2010 (between 2.5% and 3.0%). Inflation should fall to just below 2%, as in 2009.

COMMENTS

The minutes of the last meeting of the Fed's Federal Open Market Committee (FOMC) indicate that most of its leaders remain worried about the economic situation, citing ongoing damage from the real estate market slump. In fact, those in attendance at the meeting noted that the risks of an economic downturn were significant.

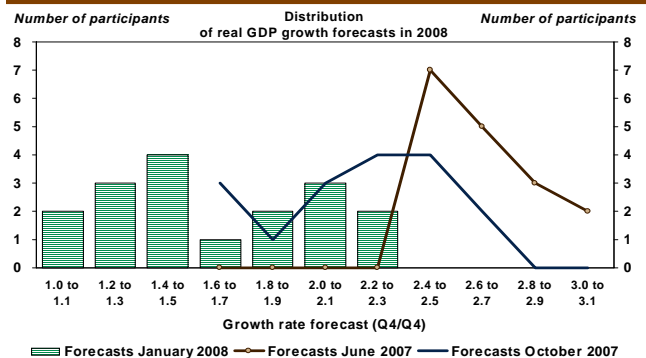
That said, the difficulties observed last fall in the interbank market showed signs of improvement, according to Fed

leaders. However, the financial situations in households and companies have darkened. There is particular concern that lower stock indexes coupled with reduced home values could soon put pressure on households, and personal balance sheets, to limit consumption.

On the corporate side, the outlook is getting gloomier. The tightening of credit conditions is increasingly being felt on corporate lending. Some investment projects, especially those involving commercial real estate, are either being cancelled outright or revised downward.

With this perspective, the Fed revised its forecasts for economic growth in 2008. Fed leaders are more pessimistic now than they were last October. The forecast range has been lowered by 0.5 percentage points to between 1.3% and 2.0% (previously situated between 1.8 % and 2.5 %). Nine attendees now anticipate that economic growth will be less than 1.5 %. Last October, none of the leaders had anticipated such weak economic growth for 2008.

The forecast for economic growth revised downward once again for 2008



Sources: Federal Reserve Board and Desjardins, Economic Studies

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

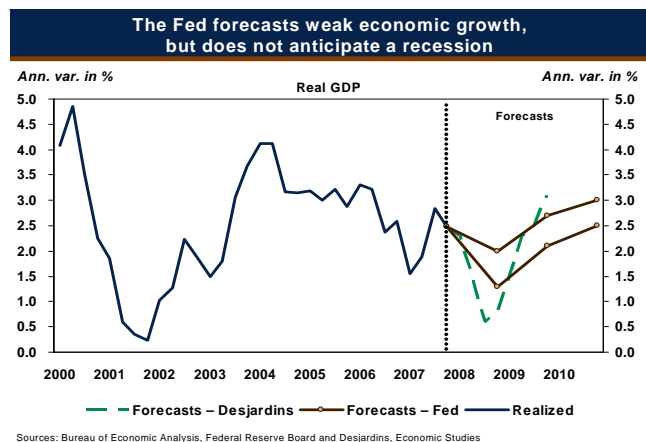
Hendrix Vachon
Economist

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

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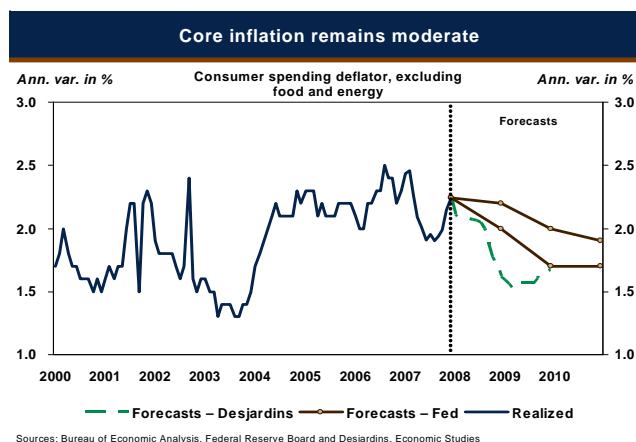
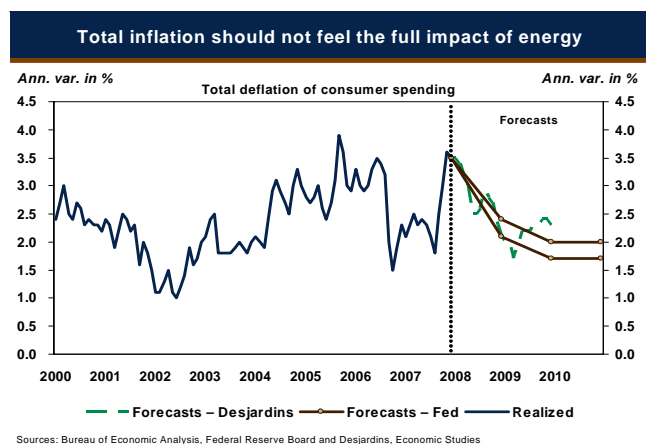
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These growth forecasts are quite similar to our own, with a projection of real GDP growth set at 1.3% for 2008. We anticipate, however, a downturn in the economy before we start feeling the positive effects of the fiscal stimulus put forth by the federal government.



Inflation seems to be what is making Fed leaders uncomfortable. Price progressions were already above the comfort zone of several FOMC members in December. The disappointing numbers for January published today are no doubt fuelling more concern. However, the economy's weak prospects for growth will lower the pressure on prices. High cost levels for energy and raw materials continue to worry the Fed.

Even if the Fed foresees a decisive deceleration of consumer spending deflators in 2008, the forecast range has been revised upward by 0.3 percentage points. The range for the total deflator is now between 2.1% and 2.4% while the range for the core deflator (which excludes food and energy) is between 2.0% and 2.2%. In reference to our own forecasts, these expectations are similar for the total index but are clearly much higher for the core deflator.



According to the Fed, the recent interest rate cuts should help the economy grow at a moderate pace. As such, the Fed still does not seem to anticipate a recession. However, the FOMC wishes to emphasize that the risks that threaten economic growth still exist despite the aggressive reduction in prime rates. This comes amid worry that the fiscal stimulation package put forth by the federal government will not have the full impact expected on economic activity. The Fed remains nonetheless cautious on its expectations regarding the labour market. The forecasts for the unemployment rate have obviously been revised upward by 0.4 percentage points. The range of 5.2% to 5.3% falls below our own projections.

Implications: The minutes of the meeting held on January 29 and 30 and the teleconferences that preceded it clearly demonstrate the level of worry of leaders at the Fed. The pessimism is palpable. Of particular concern is that financial conditions could limit the pace of household and corporate spending. On the one hand, it is clear the Fed will continue to soften its monetary policy during the next few meetings. Despite the disappointing situation on inflation, the Fed will be seeking to support economic growth as much as possible. On the other hand, this policy could be reversed quickly once the signs of economic growth are deemed more encouraging.

Francis Généreux
Senior Economist