

Essentials of the Monetary Policy

September 16, 2008

FEDERAL RESERVE

The Fed maintains its leeway!

ACCORDING TO THE FEDERAL RESERVE (Fed)

- The Fed announced that it was keeping the target for the federal funds rate at 2.00%.
- All of the monetary policy committee's members voted for the status quo.
- Both the risks to economic growth and the inflation risks are of significant concern. The Fed will monitor economic and financial developments carefully and act as needed.
- Strains in financial markets have increased significantly and the labour market has weakened further. Tight credit conditions, the housing market contraction and some slowing in export growth are likely to weigh on economic growth over the next few quarters.
- The Fed expects inflation to moderate later this year and next year.

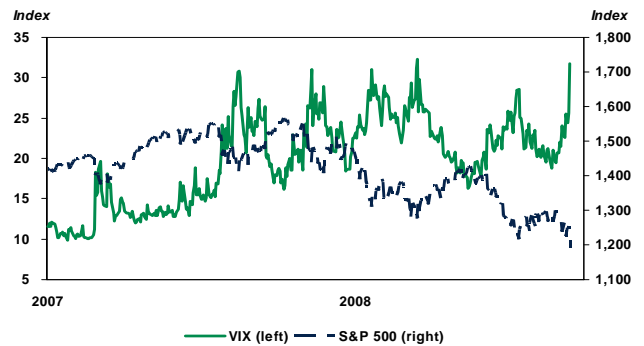
COMMENTS

The Fed was not faced with an easy job today. Just a few days ago, the consensus was that key rates would not be changed today. The Lehman Brothers bankruptcy, purchase of Merrill Lynch and uncertainty surrounding other major organizations quickly changed these anticipations and the market was increasingly expecting further monetary easing. Like its joint decision with the Treasury not to come to the financial sector's rescue last weekend, the Fed did not allow itself to be swayed by the problems that have been plaguing the markets since Monday.

By standing pat, Ben Bernanke and his colleagues are maintaining some leeway. They are increasingly trying to respond to credit market problems by relaxing the rules about injecting liquidity into financial institutions. Simultaneously, they are refocusing the monetary policy on the relationship between inflation and growth. If a key interest rate cut had been ordered today, it would have both muddied the waters and restricted the Fed's future manoeuvring room in the event of further problems in the real economy.

By rebalancing its perception of the inflation risks and risks to growth, the Fed is positioning itself to be able to take

The stock market tumble and financial uncertainty pushed heavily for a rate cut



Sources : Datastream et Desjardins, Études économiques

action if necessary. Today's statement also still paints a gloomy picture of the economic situation, even adding another element that could weigh down activity: the rise by exports could slow. Note that the major developed economies have been dragging for some time. For inflation, the major risk is starting to ease, with oil prices plummeting from their mid-July peaks.

Implications: The U.S. economic and financial situation is shot through with risks and, with its main key rate at 2.00%, the Fed does not have much in its arsenal. Despite pressure in favour of another rate cut, the Fed strove to maintain its leeway. It appears that it will only decide to order rate cuts in the event of even more pronounced deterioration in the economic situation. Our base scenario is still for key rates to be stable over the next few meetings. However, clearly, further easing is not as unlikely as it has been lately.

Francis Généreux
Senior Economist

François Dupuis
Vice-President and Chief Economist

Yves St-Maurice
Director and Deputy Chief Economist

Mathieu D'Anjou
Senior 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

NOTE TO READERS: The letters **K**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

IMPORTANT: This document is based on public information, obtained from sources that are deemed to be reliable. Desjardins Group in no way guarantees that the information is complete or accurate. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. The document may under no circumstances be construed as a commitment by Desjardins Group, which takes no responsibility for the consequences of any decision made based on the information herein. The prices and rates shown are for information purposes only as they may change at any time based on market conditions. Past returns are no guarantee of future performance, and Desjardins Group does not hereby purport to provide any investment advice. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the official position of Desjardins Group. **Copyright © 2008, Desjardins Group. All rights reserved.**

EXCERPT FROM THE FEDERAL RESERVE PRESS RELEASE



“The Federal Open Market Committee decided today to keep its target for the federal funds rate at 2 percent.

Strains in financial markets have increased significantly and labor markets have weakened further. Economic growth appears to have slowed recently, partly reflecting a softening of household spending. Tight credit conditions, the ongoing housing contraction, and some slowing in export growth are likely to weigh on economic growth over the next few quarters. Over time, the substantial easing of monetary policy, combined with ongoing measures to foster market liquidity, should help to promote moderate economic growth.

Inflation has been high, spurred by the earlier increases in the prices of energy and some other commodities. The Committee expects inflation to moderate later this year and next year, but the inflation outlook remains highly uncertain.

The downside risks to growth and the upside risks to inflation are both of significant concern to the Committee. The Committee will monitor economic and financial developments carefully and will act as needed to promote sustainable economic growth and price stability. [...]”

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
June 2008			
25	Bank of Norway	+25 b.p.	5.75
25	Federal Reserve	s.q.	2.00
July 2008			
1	Reserve Bank of Australia	s.q.	7.25
3	European Central Bank	+25 b.p.	4.25
3	Bank of Sweden	+25 b.p.	4.50
10	Bank of England	s.q.	5.00
15	Bank of Canada	s.q.	3.00
15	Bank of Japan	s.q.	0.50
18	Bank of Mexico	+25 b.p.	8.00
23	Reserve Bank of New Zealand	s.q.	8.00
23	Bank of Brazil	+75 b.p.	13.00
August 2008			
5	Reserve Bank of Australia	s.q.	7.25
5	Federal Reserve	s.q.	2.00
7	Bank of England	s.q.	5.00
7	European Central Bank	s.q.	4.25
13	Bank of Norway	s.q.	5.75
15	Bank of Mexico	+25 b.p.	8.25
18	Bank of Japan	s.q.	0.50
September 2008			
2	Reserve Bank of Australia	-25 b.p.	7.00
3	Bank of Canada	s.q.	3.00
4	Bank of England	s.q.	5.00
4	European Central Bank	s.q.	4.25
4	Bank of Sweden	+25 b.p.	4.75
12	Reserve Bank of New Zealand	-50 b.p.	7.50
19	Bank of Brazil	+75 b.p.	13.75
20	Federal Reserve	s.q.	2.00

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

**Table 2
Coming soon**

Date	Central Bank
September 2008	
16	Bank of Japan
18	Swiss National Bank
19	Bank of Mexico
24	Bank of Norway
October 2008	
2	European Central Bank
6	Bank of Japan
7	Reserve Bank of Australia
9	Bank of England
17	Bank of Mexico
21	Bank of Canada
22	Reserve Bank of New Zealand
23	Bank of Sweden
29	Bank of Norway
29	Bank of Brazil
29	Federal Reserve
30	Bank of Japan
November 2008	
3	Reserve Bank of Australia
6	Bank of England
6	European Central Bank
20	Bank of Japan
28	Bank of Mexico
December 2008	
1	Reserve Bank of Australia
3	Reserve Bank of New Zealand
4	Bank of England
4	European Central Bank
9	Bank of Canada

Source: Desjardins, Economic Studies