

Essentials of the Monetary Policy

January 28, 2009

FEDERAL RESERVE

As key rates are almost zero, the Fed moves ahead with its other actions

ACCORDING TO THE FEDERAL RESERVE (Fed)

- The Fed has decided to keep its target range for the federal funds rate at 0.00% to 0.25%.
- The economy has weakened further. Conditions in some financial markets have improved, reflecting government efforts, but credit conditions remain extremely tight.
- Inflation pressures will remain subdued. The Fed sees an ongoing risk that inflation will be too low.
- The Fed will employ all available tools to promote resumption of economic growth and preserve price stability. Key rates should remain exceptionally low for some time. The Fed's balance sheet will remain at a high level.

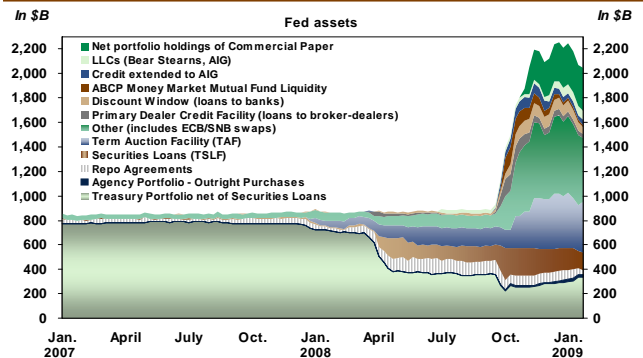
COMMENTS

As key rates are already at a point at which they can go no lower, traditional monetary policy has been put aside, which does not mean that the Fed is sitting on its hands. It continues to use its balance sheet to provide financial institutions with liquidity and help the most fragile markets. This approach is already showing results: most of the money market's rate spreads have narrowed somewhat from their dramatic situation in the fall. Among other things, the pressure on the commercial paper sector has improved substantially. Unfortunately, as the Fed remarks, the economy is still deteriorating and credit conditions are limiting consumer and business activity. Moreover, mortgage rates are still too high to hope for a lasting stabilization by the housing market. The work is not done.

The economy's contraction and flagging inflation should prompt the Fed to take more action. It will soon expand its presence in the mortgage- and consumer debt-backed securities market. The Fed also repeated that, if necessary, it intends to buy up long-term government securities to keep market rates low. However, it would have to make sure it sterilizes its operations as much as possible, so as not to create too much inflation once the crisis winds down.

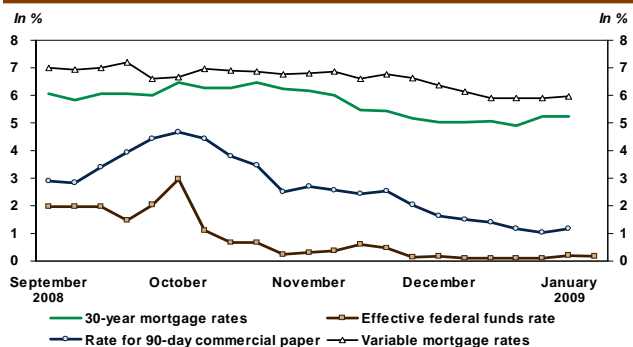
Implications: The Fed will continue to use its balance sheet and all of its power to limit the size of the recession and

The Fed is still giving financial institutions a lot of liquidity, even though amounts have declined recently



Sources: Federal Reserve Board and Desjardins, Economic Studies

The Fed's policy has been effective for commercial paper, while mortgage interest rates have not come down much



Sources: Bloomberg, Datastream, Federal Reserve Board and Desjardins, Economic Studies

stabilize and improve conditions in the credit and housing markets. Key rates should remain close to 0% for a long time. The ball is now more in the government's court, as it puts its recovery plan and other financial rescue measures into action.

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EXCERPT FROM THE FEDERAL RESERVE PRESS RELEASE


“The Federal Open Market Committee decided today to keep its target range for the federal funds rate at 0 to 1/4 percent. The Committee continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time.

Information received since the Committee met in December suggests that the economy has weakened further. Industrial production, housing starts, and employment have continued to decline steeply, as consumers and businesses have cut back spending. Furthermore, global demand appears to be slowing significantly. Conditions in some financial markets have improved, in part reflecting government efforts to provide liquidity and strengthen financial institutions; nevertheless, credit conditions for households and firms remain extremely tight. The Committee anticipates that a gradual recovery in economic activity will begin later this year, but the downside risks to that outlook are significant.

In light of the declines in the prices of energy and other commodities in recent months and the prospects for considerable economic slack, the Committee expects that inflation pressures will remain subdued in coming quarters. Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.

The Federal Reserve will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability [...]”

**Table 1
Schedule and key rates**

Date	Central Bank	Decision	Rate
November 2008			
6	Bank of England	-150 b.p.	3.00
6	European Central Bank	-50 b.p.	3.25
6	Swiss National Bank	-50 b.p.	2.00
20	Bank of Japan	s.q.	0.30
20	Swiss National Bank	-100 b.p.	1.00
28	Bank of Mexico	s.q.	8.25
December 2008			
1	Reserve Bank of Australia	-100 b.p.	4.25
1	Bank of Japan	s.q.	0.30
3	Reserve Bank of New Zealand	-150 b.p.	5.00
4	Bank of England	-100 b.p.	2.00
4	European Central Bank	-75 b.p.	2.50
4	Bank of Sweden	-175 b.p.	2.00
9	Bank of Canada	-75 b.p.	1.50
10	Bank of Brazil	s.q.	13.75
11	Swiss National Bank	-50 b.p.	0.50
16	Federal Reserve	-100 b.p. / -75 b.p.	0.00 / 0.25
17	Bank of Norway	-175 b.p.	3.00
18	Bank of Japan	-20 b.p.	0.10
January 2009			
8	Bank of England	-50 b.p.	1.50
15	European Central Bank	-50 b.p.	2.00
16	Bank of Mexico	-50 b.p.	7.75
20	Bank of Canada	-50 b.p.	1.00
21	Bank of Brazil	-100 b.p.	12.75
21	Bank of Japan	s.q.	0.10
28	Reserve Bank of New Zealand	-150 b.p.	3.50
28	Federal Reserve	s.q.	0.00 / 0.25

**Table 2
Coming soon**

Date	Central Bank
February 2009	
3	Reserve Bank of Australia
4	Bank of Norway
5	Bank of England
5	European Central Bank
10	Bank of Sweden
19	Bank of Japan
12	Bank of Mexico
March 2009	
3	Reserve Bank of Australia
3	Bank of Canada
5	Bank of England
5	European Central Bank
11	Bank of Brazil
12	Reserve Bank of New Zealand
12	Swiss National Bank
17	Bank of Japan
17	Federal Reserve
20	Bank of Mexico
25	Bank of Norway
April 2009	
2	European Central Bank
7	Reserve Bank of Australia
7	Bank of Japan
9	Bank of England
17	Bank of Mexico
20	Bank of Sweden
21	Bank of Canada
28	Bank of Japan
29	Bank of Brazil

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

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