Essentials of the Monetary Policy

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FEDERAL RESERVE

The Fed sees improvement in the economy

ACCORDING TO THE FEDERAL RESERVE (Fed)

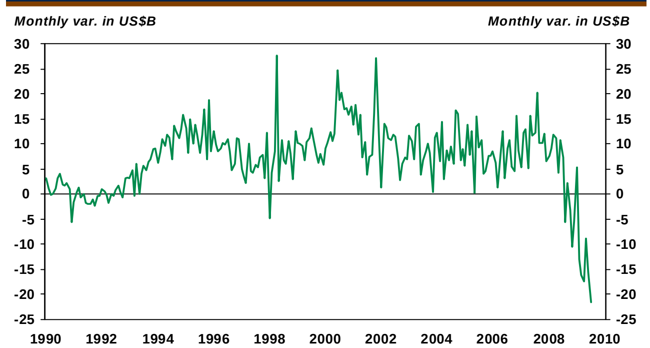
- The Federal Reserve keeps the target range for the federal funds rate at 0.00% to 0.25%.
- The economy has picked up following its severe downturn. Consumption is showing signs of stabilizing but remains constrained by job losses, sluggish income growth, lower housing wealth, and tight credit.
- While the level of economic activity should remain weak, measures aimed at stabilizing the markets and financial institutions, as well as monetary and fiscal stimuli will help strengthen economic growth.
- The underutilization of production capacities and stable inflation expectations mean that inflation will remain subdued.
- Key interest rates will remain exceptionally low for an extended period of time.
- As part of its quantitative policy, the Fed is maintaining its targets for the purchase of mortgage securities issued by Freddie Mac and Fannie Mae (US$1,250B), bonds issued directly by these agencies (US$200B) and U.S. Treasuries (US$300B). Purchases of agency and mortgage securities will be extended however over a longer period, until the end of the first quarter of 2010 (instead of the end of 2009).

COMMENTS

It comes as no surprise that Fed leaders have decided to keep the target range for federal funds intact. The objectives of the Fed's quantitative policy to purchase agency-issued securities or Treasuries are also unchanged. By extending the purchase period for securities (other than federal securities purchases slated to end by October 31, 2009), the Fed seeks to smooth the transition between its current heavy-handed involvement and more normal market conditions.

As an echo to Ben Bernanke's recent statement that the recession is most likely over from a technical standpoint, the Fed clearly signalled that the economy is getting better. In the same breath, the press release mentioned that the level of economic activity will remain weak, however. In fact, weak inflation pressures, a jobless rate that continues to climb and uncertainty about the private sector's ability to grow without government support are all arguments that call for caution from the Fed, which probably won't tighten its monetary policy anytime soon. Any talk of increasing key interest rates or making major cuts to its balance sheet therefore seems premature, especially since the credit market is still dealing with difficulties, as evidenced by the significant contraction in consumer credit in the past few months.

Outstanding consumer credit contracts again in the U.S.



Sources: Federal Reserve Board and Desjardins, Economic Studies

Implications: The Fed is now on hold. Before making any changes to its policy, the Fed wants to make sure the recovery is sustainable. Given the important role played by the Fed and the U.S. federal government in improving the current economic conditions, we will probably have to wait until the second half of 2010 before the Fed feels confident enough to proceed with a first increase in key interest rates.

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EXCERPT FROM THE FEDERAL RESERVE PRESS RELEASE

The Federal Reserve Board

« *Information received since the Federal Open Market Committee met in August suggests that economic activity has picked up following its severe downturn. Conditions in financial markets have improved further, and activity in the housing sector has increased. Household spending seems to be stabilizing, but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth, and tight credit. Businesses are still cutting back on fixed investment and staffing, though at a slower pace; they continue to make progress in bringing inventory stocks into better alignment with sales. Although economic activity is likely to remain weak for a time, the Committee anticipates that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will support a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability.*

With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.

In these circumstances, the Federal Reserve will continue to employ a wide range of tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve will purchase a total of $1.25 trillion of agency mortgage-backed securities and up to $200 billion of agency debt. The Committee will gradually slow the pace of these purchases in order to promote a smooth transition in markets and anticipates that they will be executed by the end of the first quarter of 2010. As previously announced, the Federal Reserve's purchases of $300 billion of Treasury securities will be completed by the end of October 2009 [...] »

Table 1
Schedule and key rates

Date	*Central Bank*	*Decision*	*Rate*
July 2008			
7	Reserve Bank of Australia	s.q.	3.00
9	Bank of England	s.q.	0.50
14	Bank of Japan	s.q.	0.10
17	Bank of Mexico	-25 b.p.	4.50
21	Bank of Canada	s.q.	0.25
22	Bank of Brazil	-50 b.p.	8.75
29	Reserve Bank of New Zealand	s.q.	2.50
August 2008			
4	Reserve Bank of Australia	s.q.	3.00
6	European Central Bank	s.q.	1.00
6	Bank of England	s.q.	0.50
10	Bank of Japan	s.q.	0.10
12	Bank of Norway	s.q.	1.25
12	Federal Reserve	s.q.	0.00 / 0.25
21	Bank of Mexico	s.q.	4.50
September 2008			
1	Reserve Bank of Australia	s.q.	3.00
2	Bank of Brazil	s.q.	8.75
3	European Central Bank	s.q.	1.00
3	Bank of Sweden	s.q.	0.25
9	Reserve Bank of New Zealand	s.q.	2.50
10	Bank of England	s.q.	0.50
10	Bank of Canada	s.q.	0.25
16	Bank of Japan	s.q.	0.10
17	Swiss National Bank	s.q.	0.25
18	Bank of Mexico	s.q.	4.50
23	Bank of Norway	s.q.	1.25
23	Federal Reserve	s.q.	0.00 / 0.25

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

Table 2
Coming soon

Date	*Central Bank*
October 2009	
6	Reserve Bank of Australia
8	European Central Bank
8	Bank of England
13	Bank of Japan
16	Bank of Mexico
20	Bank of Canada
21	Bank of Brazil
22	Bank of Norway
28	Reserve Bank of New Zealand
28	Bank of Japan
29	Bank of Sweden
November 2009	
2	Reserve Bank of Australia
4	Federal Reserve
5	European Central Bank
5	Bank of England
19	Bank of Japan
27	Bank of Mexico
30	Reserve Bank of Australia
December 2008	
3	European Central Bank
8	Bank of Canada
9	Reserve Bank of New Zealand
9	Bank of Brazil
10	Bank of England
10	Swiss National Bank
16	Bank of Norway
16	Bank of Sweden
16	Federal Reserve

Source: Desjardins, Economic Studies