

26 June 2008

Economic news

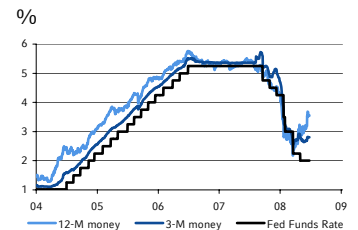
US MONETARY POLICY

Fed holds off on hiking rates

The US central bank has left its key rate unchanged at 2.0%. The Fed cited risks to growth, but has shifted its focus now slightly more towards inflation risks. However, it gave no signal of a near-term rate hike. We expect a modest rate hike in the autumn (probably in September), followed by three more hikes to 3% by the summer of 2009. The Fed's monetary policy would still remain expansionary.

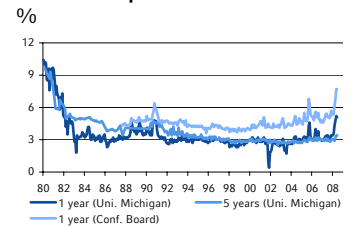
- As expected, the US central bank yesterday kept its funds rate at 2.0%. The decision to leave rates unchanged was not unanimous. FOMC member **Fischer**, who had voted for a less aggressive cut in March and for unchanged rates in April, spoke out this time in favour of a hike.
- The Fed's statement reveals a **slight shift of emphasis regarding growth and inflation risks**. In the past few months, risks to growth have figured more prominently in the Fed's interest rate decisions due to the financial market crisis. The Fed now sees risks to growth diminishing somewhat but believes that inflation risks appear to be on the rise.
- The latest economic data reinforce the impression that the US economy again narrowly escaped from the jaws of recession thanks to stimulus from monetary and fiscal policy. Nevertheless, the **economic environment remains uncertain**. High energy prices, a weak labour market and falling house prices are all reflected in the recent slump in consumer confidence; moreover, they represent serious drags on the economy and could significantly curb growth in the fourth quarter if the effect of the tax rebate wears off. Consequently, **downside risks to growth** cannot be ruled out entirely.
- At the same time, the Fed is increasingly **concerned** about the **high inflation rates** and sharply **rising inflation expectations**. Fed Chairman Bernanke had hinted early this month that the Fed would not allow inflation expectations to rise unchecked and prepared the markets for the likelihood that policy rates would not remain at their crisis-related low level for an extended period. Accordingly, the Fed is likely to reverse at least some of the aggressive rate cuts made in response to the financial market crisis in an effort to normalise the key rate level.
- When – and how swiftly – the very **loose monetary reins** will be **tightened** will depend on the next set of growth and inflation data. In its statement accompanying yesterday's interest rate decision, the Fed gave **no signal of a near-term rate hike**. We expect a modest rate hike in the autumn (probably in September), followed by three more hikes by the summer of 2009.

Fed funds rate and money market rates



Source EcoWin, WestLB Research

Inflation expectations



Source EcoWin, WestLB Research

FOMC meetings in 2008/2009

5 Aug. 08	27/28 Jan. 09
16 Sep. 08	17 Mar. 09
28/29 Oct. 08	28/29 Apr. 09
16 Dec. 08	23/24 Jun. 09

Additional FOMC meetings in 2009:
11 Aug., 22 Sep., 3/4 Nov. 15 Dez.

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