30 October 2008

# Economic News

US MONETARY POLICY

## Fed leaves door open for even lower key rates

**Yesterday, the US central bank lowered its key interest rates 50 basis points to 1.0%. The primary concern remains the risks to growth. The door for even lower key rates remains open. It is, however, questionable whether this would have a stimulative effect to the economy, or whether the markets would tend to recall the not particularly successful zero rate policy of the Bank of Japan.**

- Following yesterday's rate cut, US key interest rates are at the record low already reached in 2003/2004. The press release that accompanied the interest rate decision reflects the Fed's growing concerns about growth, attributable primarily to a decline in consumer expenditures. The Fed also stated investment expenditure and industrial production have also weakened, and that slowing growth in many foreign economies is dampening the prospects for US exports. All this will probably be confirmed by the first estimate of real GDP for the third quarter scheduled for release this afternoon.

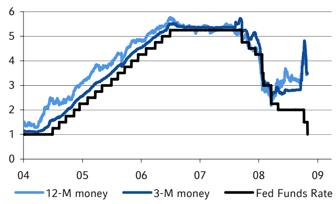
- According to the Fed, the **inflation risks** have clearly taken a **back seat**. The Open Market Committee expects inflation to moderate in the coming quarters to levels consistent with price stability. In contrast, the Fed points out that intensification of the financial market turmoil has **further increased the risks to growth**, even though it assumes all recent policy actions (rate cuts, additional liquidity, measures to stabilize the financial system) should help over time to improve credit conditions and promote a return to moderate economic growth.

- With the renewed rate cut, the Fed has, therefore, also signalled it will do everything in its power to avert an even deeper economic slump, even though the stimulus for the real economy from even lower key rates should be limited.

- The indicators already available for the current quarter, but also the anticipated fallout of the financial market crisis suggest the economic downswing will accelerate in the following quarters. There are signs that above all private consumption is facing a protracted phase of weakness. Against this backdrop, it is highly probable that the US Administration will put together a further economic stimulus program but that the US central bank will also lower its key interest rate further in the next three months to 0.50%.

- We are, therefore, not far removed **from an American zero interest rate policy,** which awakens associations with a "Japan scenario". We think such a scenario is improbable and expect the US economy to stage a slow recovery, at the latest in 2010. The coming months will have to show whether the financial markets share this assessment or whether the fear of a "Japan scenario" will gain the upper hand.

**Fed funds rate and money market rates**
(in %)




Source **EcoWin, WestLB Research**

**FOMC meetings in 2008/2009**

| | |
|---|---|
| 16 Dec. 08 | 11 Aug. 09 |
| 27/28 Jan. 09 | 22 Sep. 09 |
| 17 Mar. 09 | ¾ Nov. 09 |
| 28/29 Apr. 09 | 15 Dec. 09 |
| 23/24 Jun. 09 | |

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