Minutes of the Federal Open Market Committee
January 29-30, 2008

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, January 29, 2008 at 2:00 p.m. and continued on Wednesday, January 30, 2008 at 9:00 a.m.

PRESENT:

Mr. Bernanke, Chairman
Mr. Geithner, Vice Chairman
Mr. Fisher
Mr. Kohn
Mr. Kroszner
Mr. Mishkin
Ms. Pianalto
Mr. Plosser
Mr. Stern
Mr. Warsh

Messrs. Evans, Lacker, and Lockhart, and Ms. Yellen, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Poole, and Rosengren, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Connors, English, and Kamin, Ms. Mester, Messrs. Rosenblum, Slifman, Sniderman, Tracy, and Wilcox, Associate Economists

Mr. Dudley, Manager, System Open Market Account

Mr. Struckmeyer,[1] Deputy Staff Director, Office of Staff Director for Management, Board of Governors

[1]Attended Wednesday's session.

Mr. Parkinson,[2] Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Clouse, Senior Associate Director, Division of Monetary Affairs, Board of Governors

Ms. Liang and Messrs. Reifschneider and Wascher, Associate Directors, Division of Research and Statistics, Board of Governors

Ms. Barger[2] and Mr. Greenlee,[2] Associate Directors, Division of Banking Supervision and Regulation, Board of Governors

Mr. Gibson,[2] Deputy Associate Director, Division of Research and Statistics, Board of Governors

Mr. Dale, Senior Adviser, Division of Monetary Affairs, Board of Governors

Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Messrs. Durham and Perli, Assistant Directors, Division of Monetary Affairs, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Mr. Bassett,[3] Senior Economist, Division of Monetary Affairs, Board of Governors

Mr. Doyle,[3] Senior Economist, Division of International Finance, Board of Governors

Ms. Kusko,[3] Senior Economist, Division of Research and Statistics, Board of Governors

[2]Attended portion of the meeting relating to the analysis of policy issues raised by financial market developments.
[3]Attended portion of the meeting relating to the economic outlook and monetary policy decision.

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

Mr. Driscoll, Economist, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Ms. Green, First Vice President, Federal Reserve Bank of Richmond

Messrs. Fuhrer and Judd, Executive Vice Presidents, Federal Reserve Banks of Boston and San Francisco, respectively

Messrs. Altig and Angulo,[2] Mses. Hirtle[2] and Mosser, Messrs. Peters [2] and Rasche, Senior Vice Presidents, Federal Reserve Banks of Atlanta, New York, New York, New York, New York, and St. Louis, respectively

Mr. Hakkio, Senior Adviser, Federal Reserve Bank of Kansas City

Mr. Krane, Vice President, Federal Reserve Bank of Chicago

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for a term beginning January 29, 2008 had been received and that these individuals had executed their oaths of office.

The elected members and alternate members were as follows:

Timothy F. Geithner, President of the Federal Reserve Bank of New York, with Christine M. Cumming, First Vice President of the Federal Reserve Bank of New York, as alternate.

Charles I. Plosser, President of the Federal Reserve Bank of Philadelphia, with Jeffrey M. Lacker, President of the Federal Reserve Bank of Richmond, as alternate.

Sandra Pianalto, President of the Federal Reserve Bank of Cleveland, with Charles L. Evans, President of the Federal Reserve Bank of Chicago, as alternate.

Richard W. Fisher, President of the Federal Reserve Bank of Dallas, with Dennis P. Lockhart, President of the Federal Reserve Bank of Atlanta, as alternate.

Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, with Janet L. Yellen, President of the Federal Reserve Bank of San Francisco, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were selected to serve until the selection of their successors at the first regularly scheduled meeting of the Committee in 2009:

Ben S. Bernanke	Chairman
Timothy F. Geithner	Vice Chairman
Brian F. Madigan	Secretary and Economist
Deborah J. Danker	Deputy Secretary
David W. Skidmore	Assistant Secretary
Michelle A. Smith	Assistant Secretary
Scott G. Alvarez	General Counsel
Thomas C. Baxter, Jr.	Deputy General Counsel
Richard M. Ashton	Assistant General Counsel
D. Nathan Sheets	Economist
David J. Stockton	Economist
Thomas A. Connors	
William B. English	
Steven B. Kamin	
Loretta J. Mester	
Arthur J. Rolnick	
Harvey Rosenblum	
Lawrence Slifman	
Mark S. Sniderman	
Joseph S. Tracy	
David W. Wilcox	Associate Economists

By unanimous vote, the Committee made a few amendments to its rules and to the Program for Security of FOMC Information. The amendments primarily addressed the Committee's practice of approving the minutes via notation vote, attendance at Committee meetings, and access to Committee information by System employees.

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account.

By unanimous vote, William C. Dudley was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

By unanimous vote, the Authorization for Domestic Open Market Operations was reaffirmed in the form shown below:

AUTHORIZATION FOR DOMESTIC OPEN MARKET OPERATIONS
(Reaffirmed January 29, 2008)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement;

(b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the System Open Market Account under agreements for repurchase of such securities or obligations in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers.

(c) To sell U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York and accounts maintained at the Federal Reserve Bank of New York as fiscal agent of the United States pursuant to Section 15 of the Federal Reserve Act, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such accounts on the bases set forth in paragraph l(a) under agreements providing for the resale by such accounts of those securities in 65 business days or less on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph l(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and such foreign, international, and fiscal agency accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in excep-

tional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

By unanimous vote, the Committee approved the Authorization for Foreign Currency Operations with an amendment to paragraph 1.D. regarding the maximum open position in all foreign currencies. Accordingly, the Authorization for Foreign Currency Operations was adopted, as shown below:

AUTHORIZATION FOR FOREIGN CURRENCY OPERATIONS
(Amended January 29, 2008)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Canadian dollars
Danish kroner
Euro
Pounds sterling
Japanese yen
Mexican pesos
Norwegian kroner
Swedish kronor
Swiss francs

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding \$25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies, excluding changes in dollar value due to foreign exchange rate movements and interest accruals. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Canada	2,000
Bank of Mexico	3,000

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1.A. above shall, unless otherwise ex-

pressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). Such investments may include buying or selling outright obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof; buying such securities under agreements for repurchase of such securities; selling such securities under agreements for the resale of such securities; and holding various time and other deposit accounts at foreign institutions. In addition, when appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

By unanimous vote, the Foreign Currency Directive was reaffirmed in the form shown below:

FOREIGN CURRENCY DIRECTIVE
(Reaffirmed January 29, 2008)

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S.

dollar reflect actions and behavior consistent with IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under IMF Article IV.

By unanimous vote, the Procedural Instructions with Respect to Foreign Currency Operations were reaffirmed in the form shown below:

PROCEDURAL INSTRUCTIONS WITH RESPECT TO FOREIGN CURRENCY OPERATIONS
(Reaffirmed January 29, 2008)

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System and about any operations that are not of a routine character.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. The Manager also reported on developments in domestic financial markets and on System open market operations in government securities and federal agency obligations during the period since the previous meeting. By unanimous vote, the Committee ratified these transactions.

The information reviewed at the January meeting, which included the advance data on the national income and product accounts for the fourth quarter, indicated that economic activity had decelerated sharply in recent months. The contraction in homebuilding intensified in the fourth quarter, the growth in consumer spending slowed, and survey measures of both consumer and business sentiment were at low levels. In addition, industrial production contracted in the fourth quarter. Conditions in the labor market deteriorated noticeably, with private payroll employment posting a small decline in December and the unemployment rate rising. Readings on both headline and core inflation increased in recent months, although the twelve-month change in prices of core personal consumption expenditures in December was about the same as its year-earlier value.

On average, private nonfarm payroll employment in November and December rose at only about half of the average pace seen from July to October. Over 2007 as a whole, the deterioration in labor demand was most pronounced in the construction and financial activities industries, which had been hardest hit by the difficulties in the housing and mortgage markets. Manufacturing employment declined yet again in December, while the decrease in employment in retail trade nearly reversed the sizable increase in that sector recorded in November. Aggregate hours of production or nonsupervisory workers were unchanged in December. The unemployment rate rose to 5.0 percent in December after having been at or near 4.7 percent since September.

Industrial production declined in the fourth quarter, as a drag from motor vehicles and construction-related industries more than offset a positive contribution from other industries. Output in high-tech industries moderated in the fourth quarter, largely because of a deceleration in production of computers and semiconductors. Utilities output climbed for a second consecutive quarter, and mining output was boosted by increases in natural gas extraction and in crude oil.

The rise in real consumer spending moderated in the fourth quarter, with outlays on non-auto consumer goods increasing weakly. Spending on services rose solidly in November (the most recent month available), led by energy services and commissions paid to stockbrokers, but warmer-than-usual temperatures in December likely damped expenditures for energy services in that month. Sales of light motor vehicles were moderate during the fourth quarter. Real disposable personal income was little changed in the fourth quarter, held down by higher consumer energy prices. Also, the wealth-to-income ratio ticked down in the third quarter, and appeared likely to decline again in the fourth quarter, as equity prices had fallen since the end of the third quarter and available indicators pointed to continued declines in house prices in the fourth quarter. In December, readings on consumer sentiment remained at relatively low levels by historical standards.

Both single-family housing starts and permit issuance fell in December. Meanwhile, multifamily housing starts plunged in December, but permit issuance pointed to a rebound in multifamily starts in the near term. New home sales dropped in November and December after having held relatively steady since August, keeping inventories of unsold homes at elevated levels. Sales of existing homes also moved down in December but, on balance, had declined less in recent months than sales of new homes. Demand for housing through the end of 2007 likely continued to be restrained by tight financing conditions for jumbo and nonprime mortgages.

Real spending on equipment and software rose at a sluggish rate in the fourth quarter after having posted a solid increase in the third quarter. Sales of medium and heavy trucks edged up after falling to a four-year low. Spending on high-tech capital goods increased at a moderate pace over the second half of last year. Outside of the transportation and high-tech sectors, spending on equipment appeared to have declined last quarter after having posted sizable gains over the summer. Orders and shipments rose somewhat in the fourth quarter, but imports in the first two months of the quarter were below their average in the third quarter. Nonresidential construction remained vigorous in the fourth quarter. However, indicators of future spending in this sector pointed to a slowdown in coming months, with a decline in architectural billings, a rise in retail-sector vacancy rates, and survey reports that contractors were experiencing more difficulty in obtaining funding. More generally, surveys of business conditions and sentiment deteriorated and suggested that capital spending would be reduced in the near term.

Real nonfarm inventory investment excluding motor vehicles appeared to have stepped up from its average rate over the first three quarters of 2007. In November, the ratio of manufacturing and trade book-value inventories (excluding motor vehicles) to sales ticked down.

The U.S. international trade deficit widened slightly in October and then more substantially in November, as increases in imports in both months more than offset increases in exports. The increases in imports almost entirely reflected a jump in the value of imported oil. Non-oil goods imports were boosted by a large increase in imports of consumer goods and small increases in several other categories, which more than offset a steep decline in imports of non-oil industrial supplies. Imports of automotive products and capital goods recorded modest gains, with the increase in capital goods primarily reflecting a jump in imports of telecommunications equipment. Imports of services grew strongly. Exports in both months were boosted by higher exports of services. Exports of industrial supplies also recorded a strong gain, aided by a large increase in exports of fuels in November. Higher exports of semiconductors, aircraft, and machinery pushed up exports of capital goods, while exports of agricultural goods increased only slightly following a large jump in the third quarter. In contrast, exports of consumer goods fell from their third-quarter level.

Economic growth in the advanced foreign economies appeared to have slowed in the fourth quarter, with recent data on household expenditures and retail sales weakening on balance and consumers and businesses considerably less upbeat about growth prospects. In Japan, the estimate of real GDP growth in the third quarter was revised down, and business sentiment declined in December amidst concerns about high oil prices. In the euro area, retail sales growth declined in October and November, and consumer and business surveys in November and December pointed to economic weakness. In the United Kingdom, although real GDP grew solidly in the fourth quarter, the estimate of third-quarter real GDP growth was revised down. In Canada, indicators suggested that growth in economic activity moderated in the fourth quarter. Private employment shrank in December after having posted very strong growth in November. Incoming data on emerging-market economies pointed, on balance, to a slowing of growth in the fourth quarter. Overall, growth in emerging Asia appeared to have moderated somewhat in the fourth quarter, with trade balances declining in several countries as exports slowed. Readings on economic activity in Latin America were more mixed. Incoming data suggested that growth slowed in Mexico in the fourth quarter. In Brazil, third-quarter growth was solid, but indicators for the fourth quarter were mixed. Economic activity appeared to be strong in Argentina in both the third and fourth quarters.

In the United States, headline consumer price inflation stepped up noticeably in November and December from the low rates posted in the summer. Part of the increase reflected the rapid rise in energy prices, but prices of core personal consumption expenditures (PCE) also moved up faster in those months than they had earlier in the year. The pickup in core PCE inflation over the second half of 2007 reflected an acceleration in prices that had been unusually soft earlier in the year, such as prices for apparel, prescription drugs, and nonmarket services. For the year as a whole, core PCE prices increased at about the same rate as they had in 2006. Household survey measures of expectations for year-ahead inflation picked up in November and remained at that level in December and January. Households' longer-term inflation expectations rose in December but ticked down in January. Average hourly earnings increased faster in November and December than they had in October, although over the twelve months that ended in December, this wage measure rose a bit more slowly than the elevated pace posted in 2006.

At its December meeting, the FOMC lowered its target for the federal funds rate 25 basis points, to 4¼ percent. In addition, the Board of Governors approved a decrease of 25 basis points in the discount rate, to 4¾ percent, leaving the gap between the federal funds rate target and the discount rate at 50 basis points. The Committee's statement noted that incoming information suggested that economic growth was slowing, reflecting the intensification of the housing correction and some softening in business and consumer spending. Moreover, strains in financial markets had increased in recent weeks. The Committee indicated that its action, combined with the policy actions taken earlier, should help promote moderate growth over time. Readings on core inflation had improved modestly during the year, but elevated energy and commodity prices, among other factors, might put upward pressure on inflation. In this context, the Committee judged that some inflation risk remained and said that it would continue to monitor inflation developments carefully. Recent developments, including the deterioration in financial market conditions, had increased the uncertainty surrounding the outlook for economic growth and inflation. The Committee stated that it would continue to assess the effects of financial and other developments on economic prospects and would act as needed to foster price stability and sustainable economic growth.

Over the intermeeting period, the expected path of monetary policy over the next year as measured by money market futures rates tilted down sharply, primarily in response to softer-than-expected economic data releases. The Committee's action at its December meeting was largely anticipated by market participants, although some investors were surprised by the absence of any indication of accompanying measures to address strains in term funding markets. Some of that surprise was reversed the next day, following the announcement of a Term Auction Facility (TAF) and associated swap lines with the European Central Bank and the Swiss National Bank. The subsequent release of the minutes of the meeting elicited little market reaction. However, investors did mark down the expected path of policy in response to speeches by Federal Reserve officials; the speeches were interpreted as suggesting that signs of broader economic weakness and additional financial strains would likely require an easier stance of policy. The Committee's decision to reduce the target federal funds rate 75 basis points on January 22 surprised market participants and led investors to mark down further the path of policy over the next few months. Consistent with the shift in the economic outlook, the revision in policy expectations, and the reduction in the target federal funds rate, yields on nominal Treasury coupon securities declined substantially over the period since the December FOMC meeting. The yield curve steepened somewhat further, with the two-year yield dropping more than the ten-year yield. Near-term inflation compensation increased in early January amid rising oil prices, but it retreated in later weeks, along with oil prices, and declined, on net, over the period.

Conditions in short-term funding markets improved notably over the intermeeting period, but strains remained. Spreads of rates on securities in interbank funding markets over risk-free rates narrowed somewhat following the announcement of the TAF on December 12 and eased considerably after year-end, although they remained at somewhat elevated levels. Spreads of rates on asset-backed commercial paper over risk-free rates also fell, on net, and the level of such paper outstanding increased in the first two weeks of January for the first time since August. In longer-term corporate markets, yields on investment-grade corporate bonds fell less than those on comparable-maturity Treasury securities, while yields on speculative-grade bonds rose considerably. As a result, corporate bond spreads climbed to their highest levels since early 2003, apparently reflecting increased concern among investors about the outlook for corporate credit quality over the next few years. Nonetheless, gross bond issuance in December remained strong. Commercial bank credit expanded briskly in December, supported by robust growth in business loans and in nonmortgage loans to households, and in the face of survey reports of tighter lending conditions. Over the intermeeting period, spreads on conforming mortgages over comparable-maturity Treasury securities remained about flat, as did spreads on jumbo mortgages, although credit availability for jumbo-mortgage borrowers continued to be tight. Broad stock price indexes fell over the intermeeting period on perceptions of a deteriorating economic outlook and additional write-downs by financial institutions. Similar stresses were again evident in the financial markets of major foreign economies. The trade-weighted foreign exchange value of the dollar against major currencies declined slightly, on balance, over the intermeeting period.

Debt in the domestic nonfinancial sector was estimated to have increased somewhat more slowly in the fourth quarter than in the third. The rate of increase of nonfinancial business debt decelerated in the fourth quarter from its rapid third-quarter pace despite robust bond issuance as the rise in commercial and industrial lending moderated. Household mortgage debt expanded at a slow rate in the fourth quarter, reflecting continued weakness in home prices, declining home sales, and tighter credit conditions for some borrowers. Nonmortgage consumer credit appeared to expand at a moderate pace. In December, the increase in M2 was up slightly from its November pace, boosted primarily by inflows into the relative safety and liquidity of money market mutual funds. The rise in small time deposits moderated but remained elevated, as several thrift institutions offered attractive deposit rates to secure funding. In contrast, liquid deposits continued to increase weakly and currency contracted noticeably, the latter apparently reflecting an ongoing trend in overseas demand away from U.S. dollar bank notes and towards the euro and other currencies.

In the forecast prepared for this meeting, the staff revised up slightly its estimated increase in aggregate economic activity in the fourth quarter of 2007 but revised down its projected increase for the first half of 2008. Although data on consumer spending and nonresidential construction activity for the fourth quarter had come in above the staff's expectations, most of the information received over the intermeeting period was weaker than had been previously expected. The drop in housing activity continued to intensify, conditions in labor markets appeared to have deteriorated noticeably near year-end, and factory output had weakened. Consumer confidence remained low, and indicators of business sentiment had worsened. Equity prices had also fallen sharply so far in 2008, and, while the functioning of money markets had improved, conditions in some other financial markets had become more restrictive. The staff projection showed the weakness in spending dissipating over the second half of 2008 and 2009, in response to the cumulative easing of monetary policy since August, the abatement of housing weakness, a lessening drag from high oil prices, and the prospect of fiscal stimulus. Still, projected resource utilization was lower over the next two years than in the previous forecast. The projection for core PCE price inflation in 2008 was raised slightly in response to elevated readings in recent months. The forecast for headline PCE price inflation also incorporated a somewhat higher rate of increase for energy prices for the first half of 2008; as a result, headline PCE price inflation was now expected to exceed core PCE price inflation slightly for that year. The forecasts for both headline and core PCE price inflation for 2009 were unchanged, with both receding from their 2008 levels.

In conjunction with the FOMC meeting in January, all meeting participants (Federal Reserve Board members and Reserve Bank presidents) provided annual projections for economic growth, unemployment, and inflation for the period 2008 through 2010. The projections are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, and in the projections that they had submitted for this meeting, participants noted that information received since the December meeting had been decidedly downbeat on balance. In particular, the drop in housing activity had intensified, factory output had weakened, news on business investment had been soft, and conditions in labor markets appeared to have deteriorated. In addition, consumer confidence had remained low and business confidence appeared to have worsened. Although the functioning of money markets had improved notably, strains remained evident in a number of other financial markets, and credit conditions had become generally more restrictive. Against this backdrop, participants expected economic growth to remain weak in the first half of this year before picking up in the second half, aided in part by a more accommodative stance of monetary policy and by likely fiscal stimulus. Further ahead, participants judged that economic growth would continue to pick up gradually in 2009 and 2010. Nonetheless, with housing activity and house prices still declining and with financial conditions for businesses and households tightening further, significant uncertainties surrounded this outlook and the risks to economic growth in the near term appeared to be weighted to the downside. Indeed, several participants noted that the risks of a downturn in the economy were significant. Inflation data had been disappointing in recent months, and a few participants cited anecdotal reports that some firms were able to pass on costs to consumers. However, with inflation expectations anticipated to remain reasonably well anchored, energy and other commodity prices expected to flatten out, and pressures on resources likely to ease, participants generally expected inflation to moderate somewhat in coming quarters.

Meeting participants observed that conditions in short-term funding markets had improved considerably since the December meeting, reflecting the easing of pressures related to funding around the turn of the year as well as the implementation of the TAF. However, broader financial conditions had tightened significantly, on balance, in the weeks leading up to the meeting, as evidence of further deterioration in housing markets and investors' more pessimistic view of the economic outlook adversely affected a range of financial markets. Many participants were concerned that the drop in equity prices, coupled with the ongoing decline in house prices, implied reductions in household wealth that would likely damp consumer spending. Moreover, elevated volatility in financial markets likely reflected increased uncertainty about the economic outlook, and that greater uncertainty could lead firms and households to limit spending. The availability of credit to consumers and businesses appeared to be tightening, likely adding to restraint on economic growth. Participants discussed the risks to financial markets and institutions posed by possible further deterioration in the condition of financial guarantors, and many perceived a possibility that additional downgrades in these firms' credit ratings could put increased strains on financial markets. To be sure, some positive financial developments were evident. Banks appeared to be making some progress in strengthening their balance sheets, with several financial institutions able to raise significant amounts of capital to offset the large losses they had suffered in recent quarters. Nevertheless, participants generally viewed financial markets as still vulnerable to additional economic and credit weakness. Some noted the especially worrisome possibility of an adverse feedback loop, that is, a situation in which a tightening of credit conditions could depress investment and consumer spending, which, in turn, could feed back to a further tightening of credit conditions.

In their discussion of individual sectors of the economy, meeting participants emphasized that activity in housing markets had continued to deteriorate sharply. With single-family permits and starts still falling, sales of new homes dropping precipitously, sales of existing homes flat, and inventories of unsold homes remaining elevated even in the face of falling house prices, several participants noted the absence of signs of stabilization in the sector. Of further concern were the reduced availability of nonconforming loans and the apparent tightening by banks of credit standards on mortgages, both of which had the potential for intensifying the housing contraction. The recent declines in interest rates had spurred a surge in applications for mortgage refinancing and would limit the upward resets on the rates on outstanding adjustable-rate mortgages, both of which would tend to improve some households' finances. Nonetheless, participants viewed the housing situation and its potential further effect on employment, income, and wealth as one of the major sources of downside risk to the economic outlook.

Recent data as well as anecdotal information indicated that consumer spending had decelerated considerably, perhaps partly reflecting a spillover from the weakness in the housing sector. Participants remarked that declining house prices and sales appeared to be depressing consumer sentiment and that the contraction in wealth associated with decreases in home and equity prices probably was restraining spending. In addition, consumption expenditures were being damped by slower growth in real disposable income induced by high energy prices and possibly by a softening of the labor market. The December employment report showed that job growth had slowed appreciably, and other indicators also pointed to emerging weakness in the labor market in the intermeeting period. And spending in the future could be affected by an ongoing tightening in the availability of consumer credit amid signs that lenders were becoming increasingly cautious in view of some deterioration of credit performance on consumer loans and widening expectations of slower income growth. Some participants, however, cited evidence that workers in some sectors were still in short supply and saw signs that the labor market remained resilient.

The outlook for business investment had turned weaker as well since the time of the December meeting. Several participants reported that firms in their districts were reducing capital expenditures in anticipation of a slowing in sales. Manufacturing activity appeared to have slowed or contracted in many districts. Although a few participants reported more upbeat attitudes among firms in the technology and energy sectors, business sentiment overall appeared to be declining. Moreover, a number of indicators pointed to a tightening in credit availability to businesses. For example, the Senior Loan Officer Opinion Survey on Bank Lending Practices indicated that banks had tightened lending standards and pricing terms on business loans. Lending standards had been raised especially sharply on commercial real estate loans. While real outlays for nonresidential construction apparently continued to rise through the fourth quarter, anecdotal evidence pointed to a weakening of commercial real estate spending in several districts, with some projects being canceled or scaled back.

Most participants anticipated that a fiscal stimulus package, including tax rebates for households and bonus depreciation allowances for businesses, would be enacted before long and would support economic growth in the second half of the year. Some pointed out, however, that the fiscal stimulus package might not help in the near term, when the risks of a downturn in economic activity appeared largest. In addition, the effects of the proposed package would likely be temporary, with the stimulus reversing in 2009.

With regard to the external sector, some participants noted that growth abroad had recently been strong and that increasing U.S. exports had been a significant source of strength for the U.S. economy of late. However, available data suggested that economic activity outside the United States appeared to be decelerating somewhat. Although slowing foreign growth would reduce a source of support for the U.S. economy at the same time that domestic spending was slackening, it could also damp commodity prices and help reduce global price pressures.

Participants agreed that the inflation data that were received since the December meeting had been disappointing. But many believed that the slow growth in economic activity anticipated for the first half of this year and the associated slack in resource utilization would contribute to an easing of price pressures. Moreover, a leveling-off of energy and commodity prices such as that embedded in futures markets would also help moderate inflation pressures. However, some participants cautioned that commodity prices had remained stubbornly high for quite some time and that inferences drawn in the past from futures markets about likely trends in such prices had often proven inaccurate. Participants also related anecdotal evidence of firms facing increasing input cost pressures and in some cases being able to pass on those costs to consumers. Moreover, headline inflation had been generally above 2 percent over the past four years, and participants noted that such persistently elevated readings could ultimately affect inflation expectations. Some survey measures of inflation expectations had edged up in recent months, and longer-term financial market gauges of inflation compensation had climbed. The latter probably reflected at least in part increased uncertainty—inflation risk—rather than greater inflation expectations; increases in nominal wages did not appear to be incorporating higher inflation expectations. On balance, expectations seemed to remain fairly well anchored, but participants agreed that continued stability of inflation expectations was essential.

In the discussion of monetary policy for the intermeeting period, most members believed that a further significant easing in policy was warranted at this meeting to address the considerable worsening of the economic outlook since December as well as increased downside risks. As had been the case in some previous cyclical episodes, a relatively low real federal funds rate now appeared appropriate for a time to counter the factors that were restraining economic growth, including the slide in housing activity and prices, the tightening of credit availability, and the drop in equity prices. Members judged that a 50 basis point reduction in the federal funds rate, together with the Committee's previous policy actions, would bring the real short-term rate to a level that was likely to help the economy expand at a moderate pace over time. Still, with no signs of stabilization in the housing sector and with financial conditions not yet stabilized, the Committee agreed that downside risks to growth would remain even after this action. Members were also mindful of the need for policy to promote price stability, and some noted that, when prospects for growth had improved, a reversal of a portion of the recent easing actions, possibly even a rapid reversal, might be appropriate. However, most members agreed that a 50 basis point easing at this meeting would likely not contribute to an increase in inflation pressures given the actual and expected weakness in economic growth and the consequent reduction in pressures on resources. Rather, members agreed that inflation was likely to moderate in coming quarters, but they also concurred that it would be necessary to continue to monitor inflation developments carefully.

The Committee agreed that the statement to be released after the meeting should indicate that financial markets remained under considerable stress, that credit had tightened further for some businesses and households, and that recent information pointed to a deepening of the housing contraction as well as to some softening in labor markets. The Committee again viewed it as appropriate to indicate that it expected inflation to moderate in coming quarters but also to emphasize that it would be necessary to monitor inflation developments carefully. The action taken at the meeting, combined with the cumulative policy easing already in place, should help to promote moderate growth over time and to mitigate the risks to economic activity. However, members concurred that downside risks to growth remained, and that the Committee would continue to assess the effects of financial and other developments on economic prospects and would act in a timely manner as needed to address those risks.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with reducing the federal funds rate to an average of around 3 percent."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "The Federal Open Market Committee decided today to lower its target for the federal funds rate 50 basis points to 3 percent.
>
> Financial markets remain under considerable stress, and credit has tightened further for some businesses and households. Moreover, recent information indicates a deepening of the housing contraction as well as some softening in labor markets.
>
> The Committee expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.
>
> Today's policy action, combined with those taken earlier, should help to promote moderate growth over time and to mitigate the risks to economic activity. However, downside risks to growth remain. The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed to address those risks."

Votes for this action: Messrs. Bernanke, Geithner, Kohn, Kroszner, and Mishkin, Ms. Pianalto, Messrs. Plosser, Stern, and Warsh.

Votes against this action: Mr. Fisher.

Mr. Fisher dissented because he preferred to leave the federal funds rate unchanged. The rate had been lowered by 75 basis points just one week earlier in a decision he supported, which brought the funds rate down 175 basis points since September. Given these actions, he felt that monetary policy was already quite stimulative, while headline inflation was too high at more than 3 percent over the last year. Demand-pull inflation pressures from emerging-market economies abroad appeared to be continuing, and anecdotal reports from business contacts suggested greater willingness domestically to pass rising costs through to prices. Moreover, Mr. Fisher was concerned that inflation expectations could become unanchored if the perception of negative real rates of interest were to become pervasive. At the same time, the economy appeared to be still growing, albeit at a substantially weakened pace. Given the policy tradeoffs confronting the FOMC at this time, Mr. Fisher saw the upside risks to inflation as being greater than the downside risks to longer-term economic growth, especially in light of the recent, aggressive easing of monetary policy and the lag before it would have its full effect on the economy.

The Committee then turned to a discussion of selected longer-term regulatory and structural issues raised by recent financial market developments. A staff presentation began by noting that the difficulties in financial markets started with unexpectedly heavy losses on subprime mortgages and related structured securities, which led investors to question the valuations of complex structured instruments more generally and to pull back from such investments. The resulting effects in markets put pressure on some large banking organizations, particularly through losses on subprime-mortgage-related securities and other assets, and through the unplanned expansion of balance sheets triggered by the disruption of various markets in which assets were securitized. The remainder of the presentation, and the discussion by meeting participants, focused on two issues: first, the important role of credit ratings in the securitization process, including the methods used to set ratings and the way investors use ratings in making their investment decisions; and second, how weaknesses in risk management practices at some large global financial services organizations appear to have led to outsized losses at those institutions, and the reasons that such weaknesses may have emerged at some firms and not at others.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 18, 2008.

The meeting adjourned at 1:15 p.m.

Notation Vote

By notation vote completed on December 31, 2007, the Committee unanimously approved the minutes of the FOMC meeting held on December 11, 2007.

Conference Calls

On January 9, 2008, the Committee reviewed recent economic data and financial market developments. The available information suggested that the downside risks to growth had increased significantly since the time of the December FOMC meeting. Participants discussed the possibility that the slowing in economic growth and associated softening in labor markets might exacerbate the tightening in credit conditions and the correction in housing market activity and prices, which could in turn weigh further on economic activity. Participants emphasized the risks that such adverse dynamics could pose to economic and financial stability.

Participants noted that core price inflation had edged up in recent months, boosted in part by the pass-through of higher energy costs to the prices of core consumer goods and services. Inflation was expected to edge lower this year as energy prices leveled off and pressures on resources eased. However, this slowing in inflation was dependent on inflation expectations remaining well anchored, and participants noted that considerable uncertainty surrounded the inflation outlook.

Most participants were of the view that substantial additional policy easing in the near term might well be necessary to promote moderate economic growth over time and to reduce the downside risks to growth, and participants discussed the possible timing of such policy actions.

On January 21, 2008, the Committee again met by conference call. Incoming information since the conference call on January 9 had reinforced the view that the outlook for economic activity was weakening. Among other developments, strains in some financial markets had intensified, as it appeared that investors were becoming increasingly concerned about the economic outlook and the downside risks to activity. Participants discussed the possibility that these developments could lead to an excessive pull-back in credit availability and in investment. Although inflation was expected to moderate from recent elevated levels, participants stressed that this outlook relied upon inflation expectations remaining well anchored and that the inflation situation should continue to be monitored carefully.

All members judged that a substantial easing in policy in the near term was appropriate to foster moderate economic growth and reduce the downside risks to economic activity. Most members judged that an immediate reduction in the federal funds rate was called for to begin aligning the real policy rate with a weakening economic situation. Such an action, by demonstrating the Committee's commitment to act decisively to support economic activity, might reduce concerns about economic prospects that seemed to be contributing to the deteriorating conditions in financial markets, which could feed back on the economy. However, some concern was expressed that an immediate policy action could be misinterpreted as directed at recent declines in stock prices, rather than the broader economic outlook, and one member believed it preferable to delay policy action until the scheduled FOMC meeting on January 29-30. Some members also noted that were policy to become very stimulative it would be important for the Committee to be decisive in reversing the course of interest rates once the economy had strengthened and downside risks had abated.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with reducing the federal funds rate to an average of around 3½ percent."

The vote encompassed approval of the text below for inclusion in the statement to be released at 8:30 a.m. on Tuesday, January 22:

> "The Federal Open Market Committee has decided to lower its target for the federal funds rate 75 basis points to 3½ percent.
>
> The Committee took this action in view of a weakening of the economic outlook and increasing downside risks to growth. While strains in short-term funding markets have eased somewhat, broader financial market conditions have continued to deteriorate and credit has tightened further for some businesses and households. Moreover, incoming information indicates a deepening of the housing contraction as well as some softening in labor markets.

> The Committee expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.
>
> Appreciable downside risks to growth remain. The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed to address those risks."

Votes for this action: Messrs. Bernanke, Geithner, Evans, Hoenig, Kohn, Kroszner, Rosengren, and Warsh.

Votes against this action: Mr. Poole

Absent and not voting: Mr. Mishkin

Mr. Poole dissented because he did not believe that current conditions justified policy action before the regularly scheduled meeting the following week.

Brian F. Madigan
Secretary

Summary of Economic Projections

In conjunction with the January 2008 FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in the deliberations of the FOMC, provided projections for economic growth, unemployment, and inflation in 2008, 2009, and 2010. Projections were based on information available through the conclusion of the January meeting, on each participant's assumptions regarding a range of factors likely to affect economic outcomes, and on his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future policy that, based on current information, is deemed most likely to foster outcomes for economic activity and inflation that best satisfy the participant's interpretation of the Federal Reserve's dual objectives of maximum employment and price stability.

The projections, which are summarized in table 1 and chart 1, suggest that FOMC participants expected that output would grow at a pace appreciably below its trend rate in 2008, owing primarily to a deepening of the housing contraction and a tightening in the availability of household and business credit, and that the unemployment rate would increase somewhat. Given the substantial reductions in the target federal funds rate through the January FOMC meeting as well as the assumption of appropriate policy going forward, output growth further ahead was projected to pick up to a pace around or a bit above its long-run trend by 2010. Inflation was expected to decline in 2008 and 2009 from its recent elevated levels as energy prices leveled out and economic slack contained cost and price increases. Most participants judged that considerable uncertainty surrounded their projections for output growth and viewed the risks to their forecasts as weighted to the downside. A majority of participants viewed the risks to the inflation outlook as broadly balanced, but a number of participants saw the risks to inflation as skewed to the upside.

The Outlook

The central tendency of participants' projections for real GDP growth in 2008, at 1.3 to 2.0 percent, was considerably lower than the central tendency of the projections provided in conjunction with the October FOMC meeting, which was 1.8 to 2.5 percent. These downward revisions to the 2008 outlook stemmed from a number of factors, including a further intensification of the housing market correction, tighter credit conditions amid increased concerns about credit quality and ongoing turmoil in financial markets, and higher oil prices. However, some participants noted that a fiscal stimulus package would likely provide a temporary boost to domestic demand in the second half of this year. Beyond 2008, a number of factors were projected to buoy economic growth, including a gradual turnaround in housing markets, lower interest rates associated with the substantial easing of monetary policy to date and appropriate adjustments to policy going forward, and an anticipated reduction in financial market strains. Real GDP was expected to accelerate somewhat in 2009 and by 2010 to expand at or a little above participants' estimates of the rate of trend growth.

With output growth running below trend over the next year or so, most participants expected that the unemployment rate would edge higher. The central tendency of participants' projections for the average rate of unemployment in the fourth quarter of 2008 was 5.2 to 5.3 percent, above the 4.8 to 4.9 percent unemployment rate forecasted in October and broadly suggestive of some slack in labor markets. The unemployment rate was generally expected to change relatively little in 2009 and then to edge lower in 2010 as output growth picks up, although in both years the unemployment rate was projected to be a little higher than had been anticipated in October.

The higher-than-expected rates of overall and core inflation since October, which were driven in part by the steep run-up in oil prices, had caused participants to revise up somewhat their projections for inflation in the near term. The central tendency of participants' projections for core PCE inflation in 2008 was 2.0 to 2.2 percent, up from the 1.7 to 1.9 percent central tendency in October. However, core inflation was expected to moderate over the next two years, reflecting muted pressures on resources and fairly well-anchored inflation expectations. Overall PCE inflation was projected to decline from its current elevated rate over the coming year, largely reflecting the assumption that energy and food prices would flatten out. Thereafter, overall PCE inflation was projected to move largely in step with core PCE inflation.

Participants' projections for 2010 were importantly influenced by their judgments about the measured rates of inflation consistent with the Federal Reserve's dual mandate to promote maximum employment and price stability and about the time frame over which policy should aim to attain those rates given current economic conditions. Many participants judged that, given the recent adverse shocks to both aggregate demand and inflation, policy would be able to foster only a gradual return of key macroeconomic variables to their longer-run sustainable or optimal levels. Consequently, the rate of unemployment was projected by some participants to remain slightly above its longer-run sustainable level even in 2010, and inflation was judged likely still to be a bit above levels that some participants judged would be consistent with the Federal Reserve's dual mandate.

Table 1: Economic Projections of Federal Reserve Governors and Reserve Bank Presidents

(Percent)

	2008	2009	2010
Central Tendency[1]			
Growth of real GDP	1.3 to 2.0	2.1 to 2.7	2.5 to 3.0
October projections	*1.8 to 2.5*	*2.3 to 2.7*	*2.5 to 2.6*
Unemployment rate	5.2 to 5.3	5.0 to 5.3	4.9 to 5.1
October projections	*4.8 to 4.9*	*4.8 to 4.9*	*4.7 to 4.9*
PCE inflation	2.1 to 2.4	1.7 to 2.0	1.7 to 2.0
October projections	*1.8 to 2.1*	*1.7 to 2.0*	*1.6 to 1.9*
Core PCE inflation	2.0 to 2.2	1.7 to 2.0	1.7 to 1.9
October projections	*1.7 to 1.9*	*1.7 to 1.9*	*1.6 to 1.9*
Range[2]			
Growth of real GDP	1.0 to 2.2	1.8 to 3.2	2.2 to 3.2
October projections	*1.6 to 2.6*	*2.0 to 2.8*	*2.2 to 2.7*
Unemployment rate	5.0 to 5.5	4.9 to 5.7	4.7 to 5.4
October projections	*4.6 to 5.0*	*4.6 to 5.0*	*4.6 to 5.0*
PCE inflation	2.0 to 2.8	1.7 to 2.3	1.5 to 2.0
October projections	*1.7 to 2.3*	*1.5 to 2.2*	*1.5 to 2.0*
Core PCE inflation	1.9 to 2.3	1.7 to 2.2	1.4 to 2.0
October projections	*1.7 to 2.0*	*1.5 to 2.0*	*1.5 to 2.0*

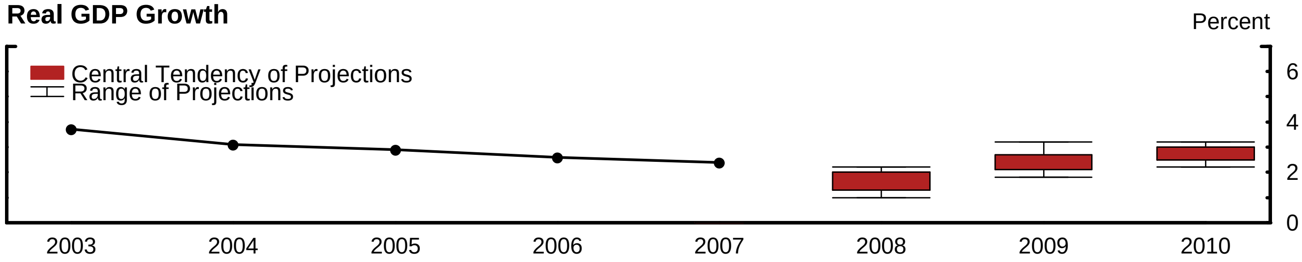
Note: Projections of the growth of real GDP, of PCE inflation, and of core PCE inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures and the price index for personal consumption expenditures excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.

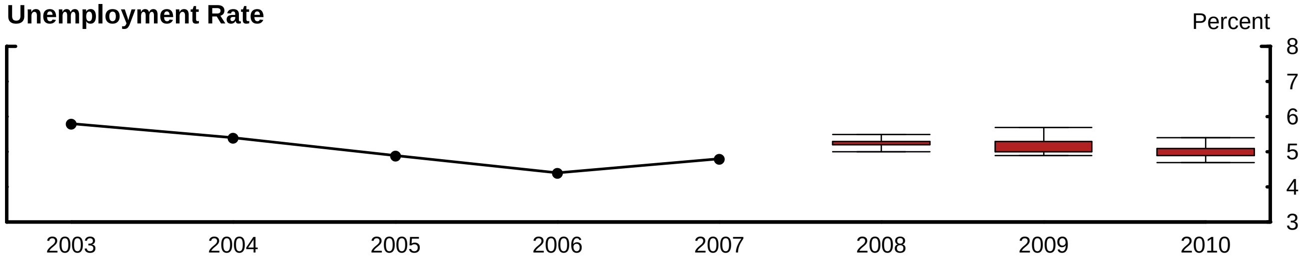
2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

Chart 1: Central Tendencies and Ranges of Economic Projections*

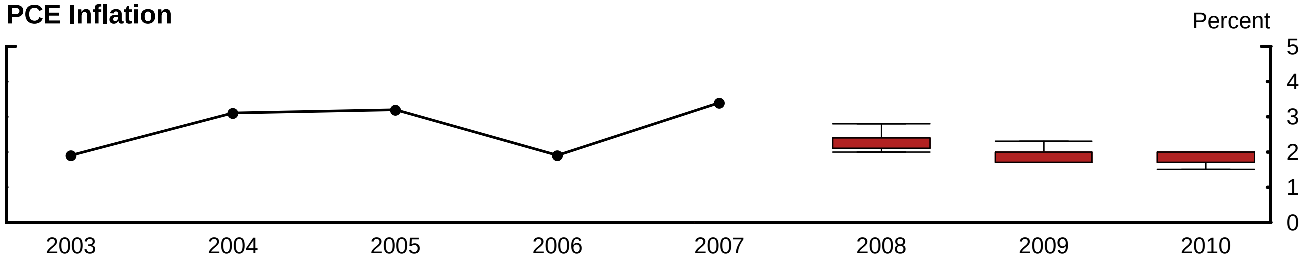
Real GDP Growth



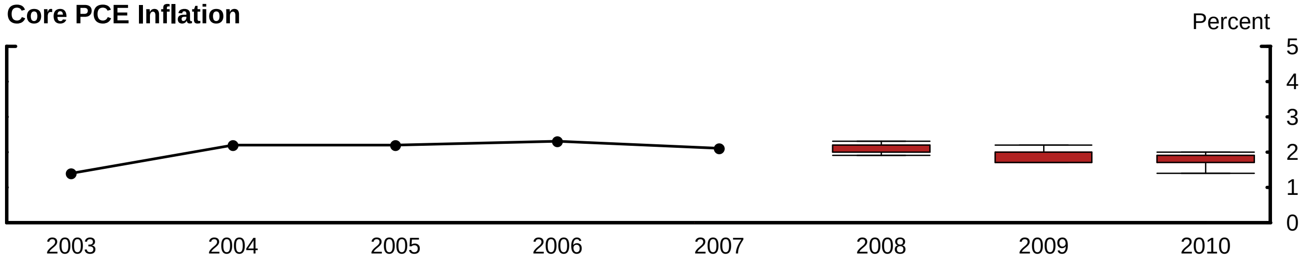
Unemployment Rate



PCE Inflation



Core PCE Inflation



* See notes to Table 1 for variable definitions.

Risks to the Outlook

Most participants viewed the risks to their GDP projections as weighted to the downside and the associated risks to their projections of unemployment as tilted to the upside. The possibility that house prices could decline more steeply than anticipated, further reducing households' wealth and access to credit, was perceived as a significant risk to the central outlook for economic growth and employment. In addition, despite some recovery in money markets after the turn of the year, financial market conditions continued to be strained—stock prices had declined sharply since the December meeting, concerns about further potential losses at major financial institutions had mounted amid worries about the condition of financial guarantors, and credit conditions had tightened in general for both households and firms. The potential for adverse interactions, in which weaker economic activity could lead to a worsening of financial conditions and a reduced availability of credit, which in turn could further damp economic growth, was viewed as an especially worrisome possibility.

Regarding risks to the inflation outlook, several participants pointed to the possibility that real activity could rebound less vigorously than projected, leading to more downward pressure on costs and prices than anticipated. However, participants also saw a number of upside risks to inflation. In particular, the pass-through of recent increases in energy and commodity prices as well as of past dollar depreciation to consumer prices could be greater than expected. In addition, participants recognized a risk that inflation expectations could become less firmly anchored if the current elevated rates of inflation persisted for longer than anticipated or if the recent substantial easing in monetary policy was misinterpreted as reflecting less resolve among Committee members to maintain low and stable inflation. On balance, a larger number of participants than in October viewed the risks to their inflation forecasts as broadly balanced, although several participants continued to indicate that their inflation projections were skewed to the upside.

The ongoing financial market turbulence and tightening of credit conditions had increased participants' uncertainty about the outlook for economic activity. Most participants judged that the uncertainty attending their January projections for real GDP growth and for the unemployment rate was above typical levels seen in the past. (Table 2 provides an estimate of average ranges of forecast uncertainty for GDP growth, unemployment, and inflation over the past twenty years.[1]) In contrast, the uncertainty attached to participants' inflation projections was generally viewed as being broadly in line with past experience, although several participants judged that the degree of uncertainty about inflation was higher than normal.

Table 2: Average Historical Projection Error Ranges

(Percentage Points)

	2008	2009	2010
Real GDP[1]	±1.2	±1.4	±1.4
Unemployment rate[2]	±0.5	±0.8	±1.0
Total consumer prices[3]	±1.0	±1.0	±0.9

Note: Error ranges shown are measured as plus or minus the root mean squared error of projections that were released in the winter from 1986 through 2006 for the current and following two years by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series #2007-60 (November).

1. Projection is percent change, fourth quarter of the previous year to fourth quarter of the year indicated.

2. Projection is the fourth quarter average of the civilian unemployment rate (percent).

3. Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated. The slightly narrower estimated width of the confidence interval for inflation in the third year compared with those for the second and third years is likely the result of using a limited sample period for computing these statistics.

Diversity of Participants' Views

Charts 2(a) and 2(b) provide more detail on the diversity of participants' views. The dispersion of participants' projections for real GDP growth was markedly wider than in the forecasts submitted in October, which in turn were considerably more diverse than

[1] The box "Forecast Uncertainty" at the end of this summary discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risks attending participants' projections.

those submitted in conjunction with the June FOMC meeting and included in the Board's *Monetary Policy Report to the Congress* in July. Mirroring the increase in diversity of views on real GDP growth, the dispersion of participants' projections for the rate of unemployment also widened notably, particularly for 2009 and 2010. The dispersion of projections for output and employment seemed largely to reflect differing assessments of the effect of financial market conditions on real activity, the speed with which credit conditions might improve, and the depth and duration of the housing market contraction. The dispersion of participants' longer-term projections was also affected to some degree by differences in their judgments about the economy's trend growth rate and the unemployment rate that would be consistent over time with maximum employment. Views also differed about the pace at which output and employment would recover toward those levels over the forecast horizon and beyond, given appropriate monetary policy. The dispersion of the projections for PCE inflation in the near term partly reflected different views on the extent to which recent increases in energy and other commodity prices would pass through into higher consumer prices and on the influence that inflation expectations would exert on inflation over the short and medium run. Participants' inflation projections further out were influenced by their views of the rate of inflation consistent with the Federal Reserve's dual objectives and the time it would take to achieve these goals given current economic conditions and appropriate policy.

Chart 2(a): Distribution of Participants' Projections (percent)

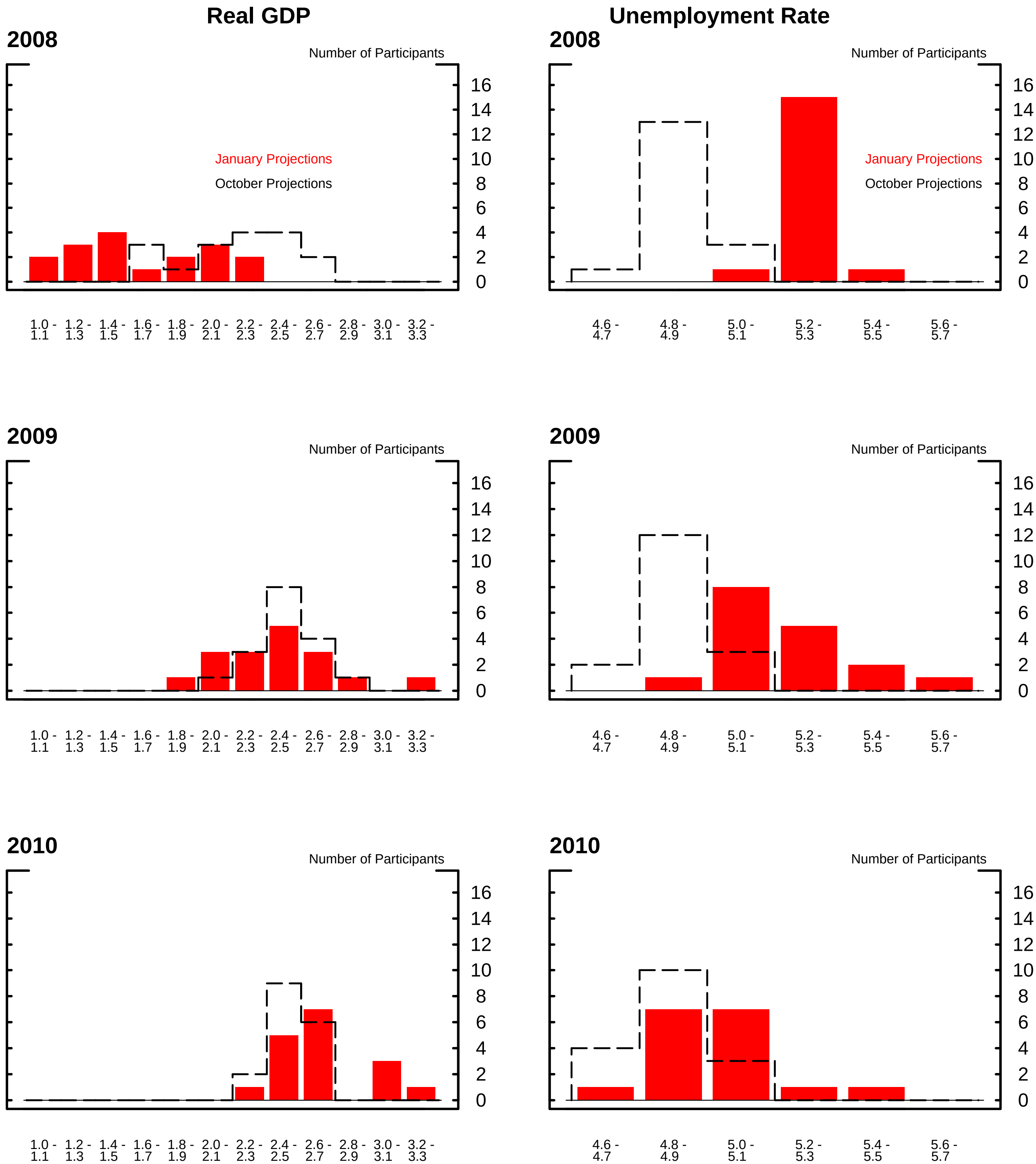
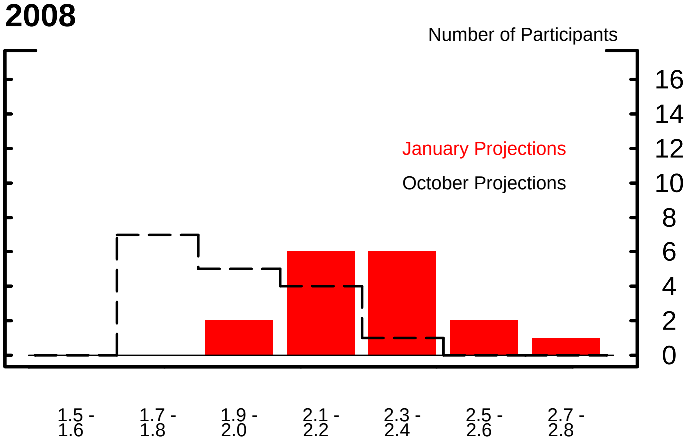


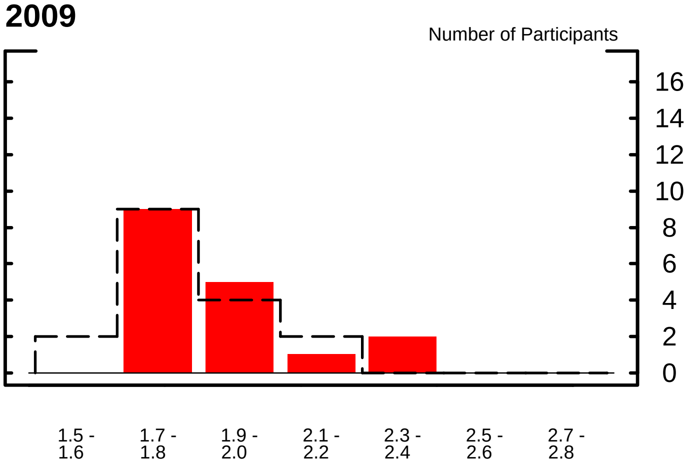
Chart 2(b): Distribution of Participants' Projections (percent)

PCE Inflation

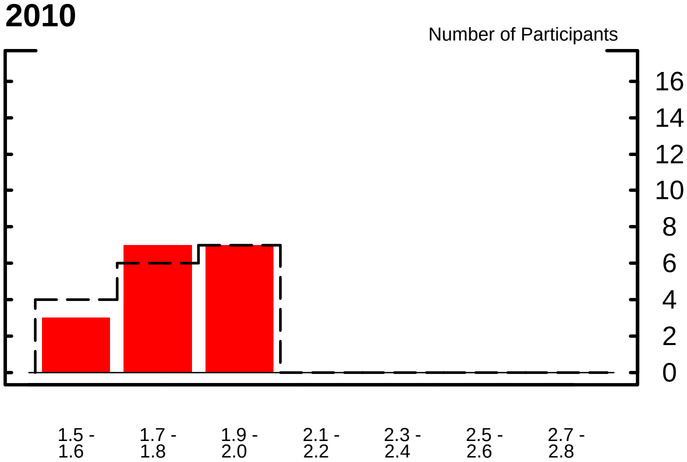
2008



2009

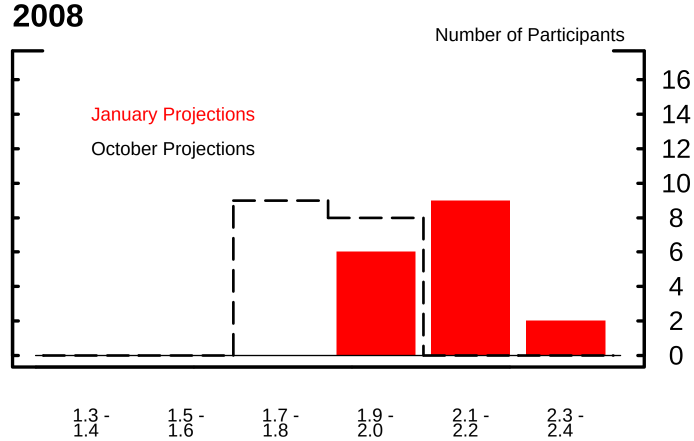


2010

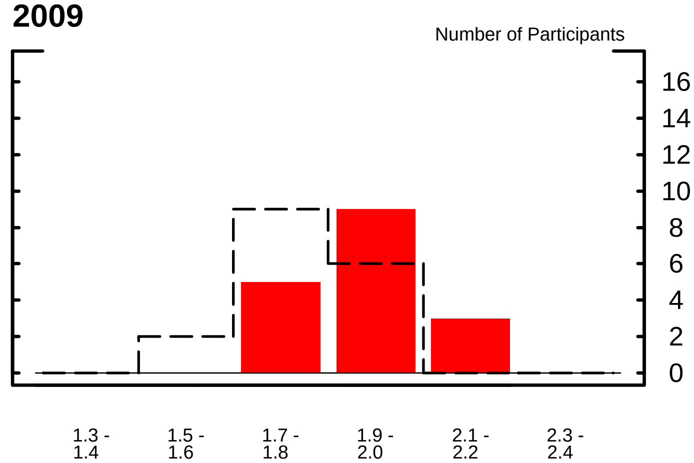


Core PCE Inflation

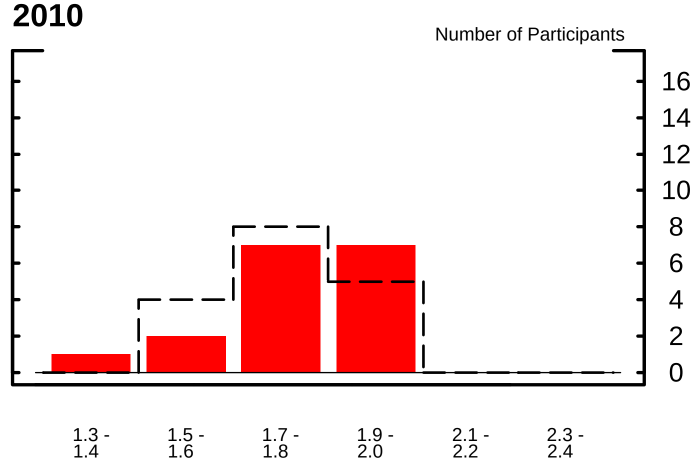
2008



2009



2010



Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks help shape monetary policy and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past Monetary Policy Reports and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real GDP and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 might imply a probability of about 70 percent that actual GDP would expand between 1.8 percent to 4.2 percent in the current year, and 1.6 percent to 4.4 percent in the second and third years. The corresponding 70 percent confidence intervals for overall inflation would be 1 percent to 3 percent in the current and second years, and 1.1 percent to 2.9 percent in the third year.

Because current conditions may differ from those that prevailed on average over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection, rather than with divergences across a number of different projections.