

US Weekly Economic Update

22 December 2008

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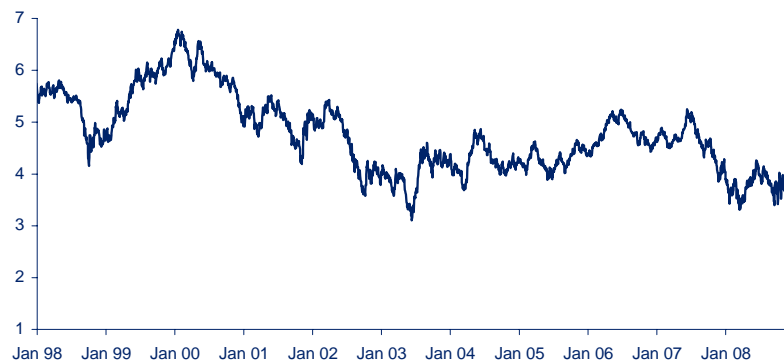
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- **The Federal Reserve took an historic step last week, lowering the funds rate to a 0–0.25% range.** This signalled an end to conventional monetary policy and a move to unorthodox measures.
- **The shift towards zero interest rates in the US and Japan does not mean that policymakers are out of options** (Click [here](#) to read about possible further measures), but it emphasises the scale of challenges facing the world economy in 2009. The Fed statement implied that it will throw everything at the economic/financial situation, pledging to, “employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability.” The Fed promised to keep rates down for a long time, which will help lower longer-term interest rates. Direct purchase of long-term securities is also under consideration. (In response, the ten year treasury yield fell to 2.08% from 3.5% just a month ago, see chart). Inflation trends reinforce the need for action, with record declines in October and November, led by energy price declines but with signs of broader-based weakness.
- **The best indicator of the policy stance will be the size and composition of the Fed’s balance sheet.** This will show the extent to which it is increasing the money supply and how aggressively it is targeting borrowing costs for households and firms (by buying mortgage backed securities, corporate bonds, etc). The dollar tumbled, losing 6.5% against the euro last week and the price of gold rose sharply in response to fears that “printing money” could ultimately debase the value of the dollar. However, as rates head towards zero around the world in the period ahead, other central banks will be forced to tread a similar path.
- **Inflation fell like a stone in the euro area, coming in just 0.1ppt above the 2% target ceiling in November,** and will fall much further in the New Year. As it does so, the last barrier to deeper ECB rate cuts will disappear. We look for rates to fall to 1.5% in 2009. China, the eastern engine of global growth, slowed in October. Industrial production growth fell to 5.4% y/y, the slowest since 1999. China’s manufacturing PMI survey suggests that activity will slow further. Overall economic growth could halve to 5% in 2009.
- **Merry Christmas to all our readers. The next weekly brief will be published on January 12th.**

Chart of the week: US 10 year Treasury yield

Source: Thomson Datastream



MARKET RATES MONITOR	19 th December 2008	12 th December 2008	21 st December 2007
Fed Funds Rate Target	0.25%	1.00%	4.25%
10-yr US Treasury yield	2.13%	2.60%	4.18%
30-yr Mortgage (Freddie Mac)	5.19%	5.47%	6.14%
US dollar/Japanese Yen	89.53	91.35	113.91
Euro/US Dollars	1.39	1.34	1.44
British Pound/US dollars	1.49	1.49	1.98