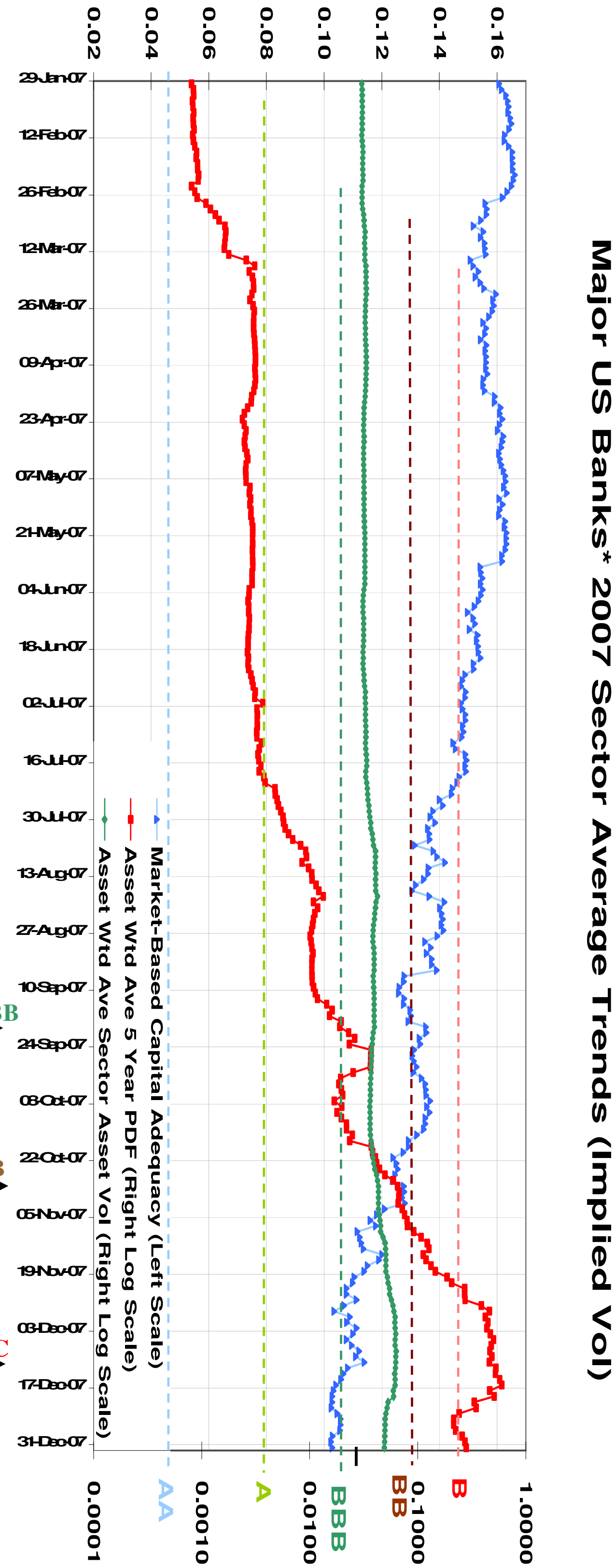
# 2007 FOMC Selected Commentary vs www.FirstKnow.It US Banks Sector Aggregate Default Probability (PDF)

18th January 2013 saw release of the Federal Reserve Open Market Committee (FOMC) transcripts for 2007. This was a critical period just months before the effective collapse of Bear Stearns in March 2008 and other major money-center and investment banks and AIG later in 2008, culminating in the collapse of Lehman Brothers in September 2008.

This analysis maps, with arrows, summaries of the FOMC perspectives at the 18th September, 30th October and 11th December 2007 meetings to a chart of the www.FirstKnow.It aggregate US banking system 5-year Default Probability (PDF – red line, log scale) calculated from individual banks' default probabilities weighted by bank assets. The implied ratings of these aggregate default probabilities are shown on the chart and the implied rating at the date of the meeting is shown beside the mapping arrowheads below the meeting summaries. Also shown on the chart are the primary determinants of the default probability – aggregate Asset Volatility (green line) and aggregate Market-Based Capital Adequacy (Equity Cap/Total Assets – blue line) both also weighted by assets.

The www.FirstKnow.It analysis is consistently ahead of the conclusions of the committee in forecasting the gravity of the crisis from October 2007, with the US banking system effectively collapsed and propped up by TARP by end-2008.




**18th Sept 2007:** Some participants cited concerns that a weaker economy could lead to a further tightening of financial conditions, which in turn could reinforce the economic slowdown. But participants also noted that the resilience of the economy in the face of a number of previous periods of financial market disruptions left open the possibility that the macroeconomic effects of the financial market turbulence would prove limited. Although financial markets were expected to stabilize over time, participants judged that credit markets were likely to restrain economic growth in the period ahead.

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**30th Oct 2007:** The Committee agreed the (meeting) statement to indicate economic growth was solid in the third quarter and strains in financial markets had eased somewhat on balance. Members also agreed economic growth seemed likely to slow over coming quarters, but easing action taken at the meeting - combined with 50 basis point cut in the target federal funds rate at the September meeting - should help promote moderate growth over time, although some downside risks to growth would remain.

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**11th Dec 2007:** BERNANKE. .. I'm in the camp of those who see a fundamental softening going on here..It does seem to have been a step-down in economic growth outside of housing. The other issue is the financial markets .. First are the losses and the downgrades that have hit capital.. we've seen about $75 billion in write-downs or losses in the financial sector, of which $45 billion has occurred since our last meeting, at a time when we thought things were clearing up... The second element of this is the pressure on balance sheets. Banks are taking off-balance-sheet assets onto the balance sheet... The result of this is that, although I do not expect insolvency or near insolvency among major financial institutions, they are certainly going to become much more cautious, and I think that will affect their lending behavior and their willingness to extend new credit...So I believe that the financial conditions are going to be a significant drag. Given the low growth expectations, it could lead us into a negative growth area.