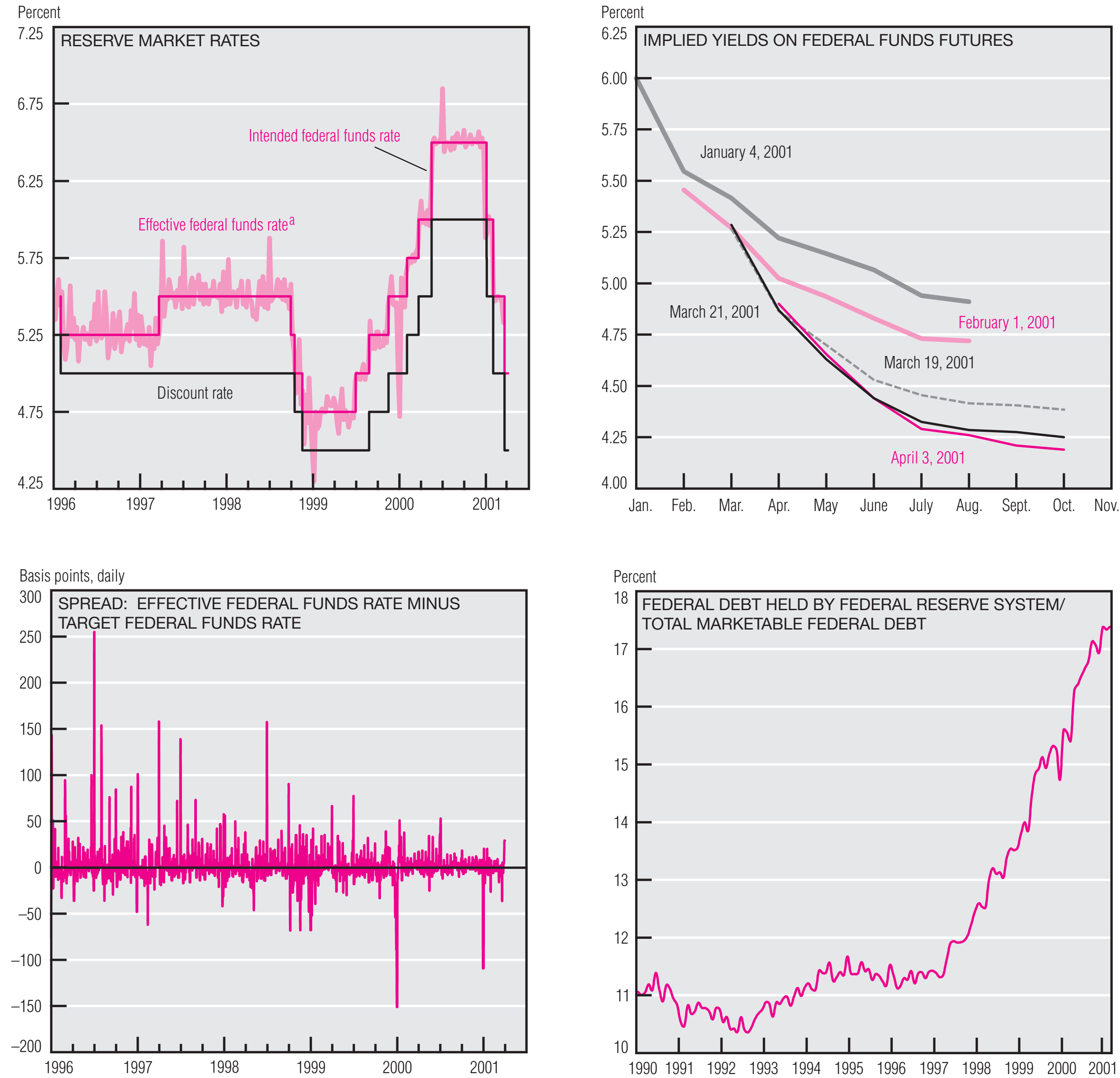
# Monetary Policy




a. Weekly average.
SOURCES: U.S. Department of the Treasury; Board of Governors of the Federal Reserve System; and Chicago Board of Trade.

At its March 20 meeting, the Federal Open Market Committee (FOMC) lowered the target federal funds rate 50 basis points (bp) to 5.0%, the third 50-bp cut in 2001. Its press release cited "substantial risks that demand and production could remain soft." Separately, the Board of Governors approved a 50 bp reduction in the discount rate to 4.5%.

Implied yields on federal funds futures, often used to predict monetary policy's future path, declined moderately after the meeting. Market participants place a significant probability on a further rate cut by the end of May. As of April 3, the October contract traded at 4.19%, 81 bp below the current federal funds rate target.

By altering the supply of bank reserves through open market operations, the Federal Reserve attempts to maintain the federal funds rate near its intended level. Typically, the effective funds rate is close to the target rate; since 1996, the average daily absolute deviation from target has been less than 12 bp. However, the effective rate deviates significantly from target at times, missing it by 100 bp or more on several days.

The New York Fed's trading desk conducts most of its open market operations in the form of U.S. Treasury securities. Since 1992, the Federal Reserve's share of these securities has trended upward, partially due to Treasury debt reduction. As of February 2001, this share exceeded 17%. There is some concern that if the Fed holds too large a proportion of Treasury securities, it may disrupt Treasury markets and impede open market operations. Currently, the Federal Reserve is studying the impact on its operations of further expected declines in the quantity of Treasury debt.