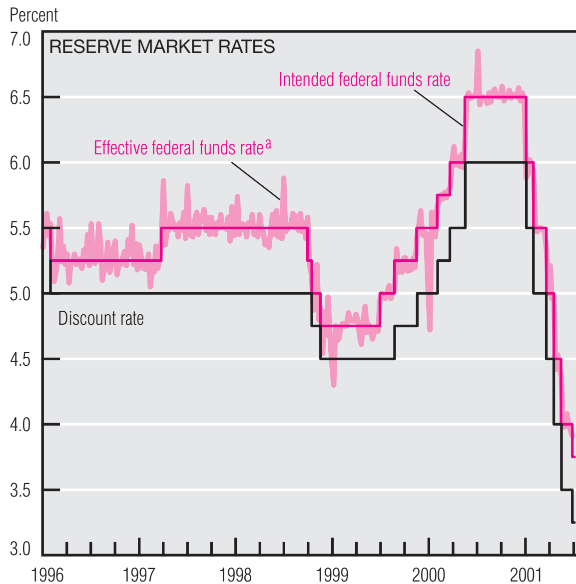
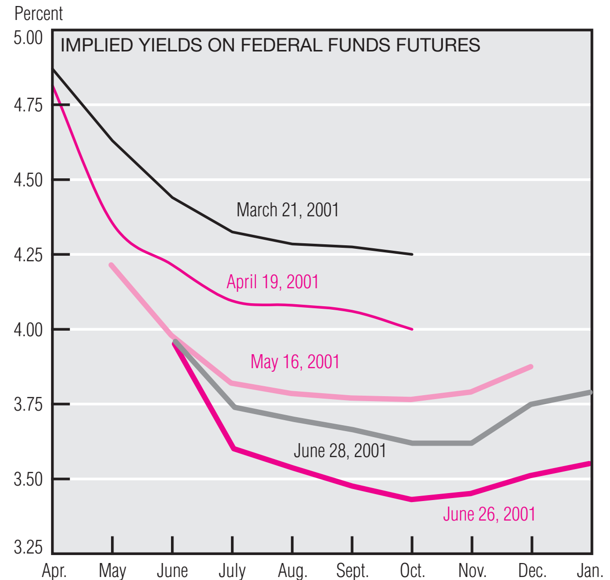
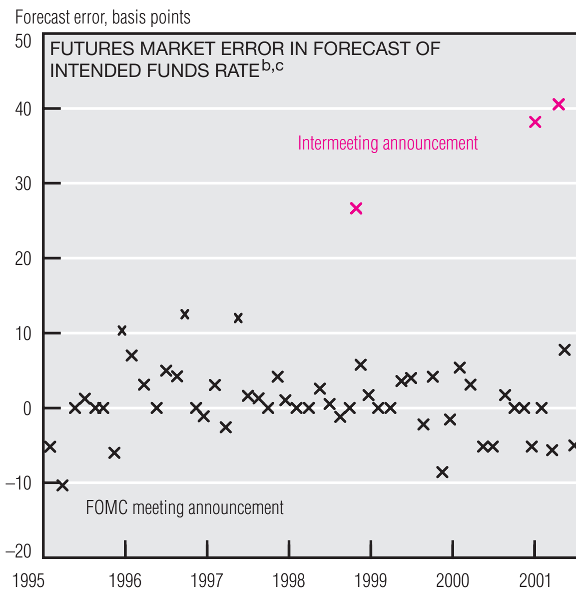
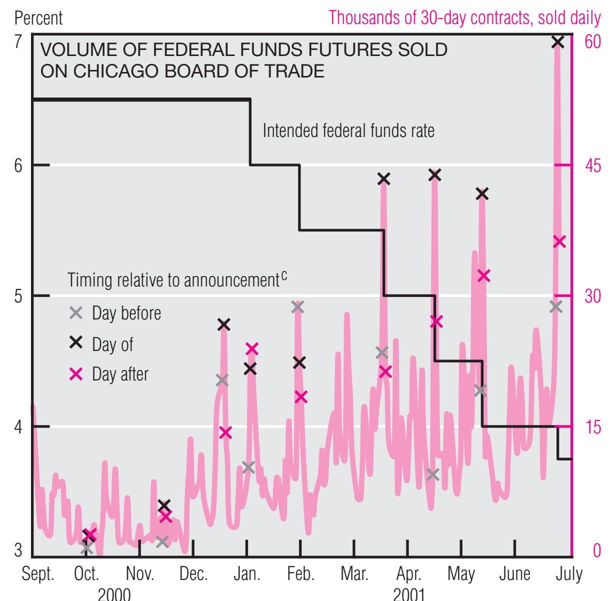
# Monetary Policy




a. Weekly average.

b. The forecast error is taken as the negative of the unanticipated change in the target rate as described in Kenneth N. Kuttner, *Monetary Policy Surprises and Interest Rates: Evidence from the Fed Funds Futures Market*, Federal Reserve Bank of New York, Staff Report no. 99, February 2000.

c. Announcements occur on scheduled FOMC meeting dates and on intermeeting dates when a change in the target rate is announced. When a scheduled meeting lasts two days, the second day is taken as the meeting date.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; Federal Reserve Bank of New York; Chicago Board of Trade; and Bloomberg Financial Information Services.

On June 27, the Federal Open Market Committee (FOMC) lowered the intended federal funds rate 25 basis points (bp) to 3.75%, citing "declining profitability and business capital spending, weak expansion of consumption, and slowing growth abroad" as reasons for the rate cut. In a related action, the Board of Governors approved Reserve Bank requests to reduce the discount rate 25 bp to 3.25%.

Implied yields on federal funds futures often are used to gauge the expected course of monetary policy actions. Just after the recent rate cut, implied yields rose 13 bp–24 bp across the various maturities. Previous 2001 rate cuts were followed by decreases in implied yields. As of July 2, the September contract implied a yield of 3.66%.

Fed funds futures predict short-term movements in the intended rate fairly well, typically within 10 bp of rate actions at FOMC meetings. Market participants tend to underestimate the extent of rate changes in both directions. Intermeeting actions, however, catch them off guard, with errors close to the size of the rate changes.

Trading in fed funds futures began in 1988 at the Chicago Board of Trade. Trading volume so far this year already exceeds all of last year's, perhaps because of the increased number of FOMC actions. Volume picks up on days surrounding FOMC actions. This may come from speculators trading contracts immediately before and after FOMC actions and from hedgers adjusting positions in other short-term financial instruments. Increased futures-price volatility (around meeting dates) may have driven up volume as well, as it has in other futures markets.