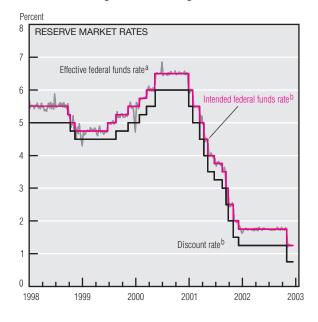
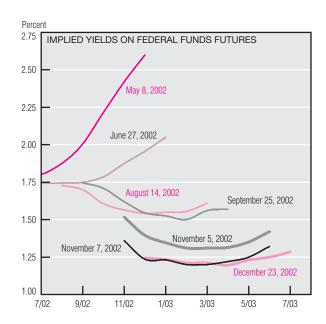
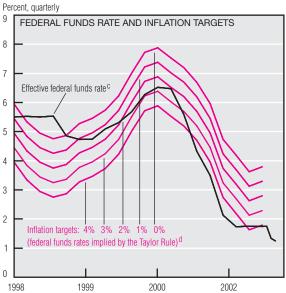
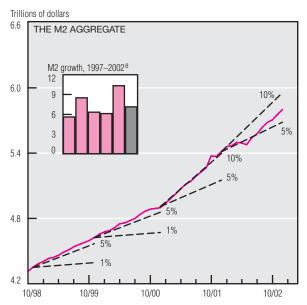
Monetary Policy









- a. Weekly average of daily figures.
- b. Daily observations.
- c. 2002:IVQ is plotted by months and December 17 is the last day included in the average for that month.
- d. The formula for the implied funds rate is taken from the Federal Reserve Bank of St. Louis, *Monetary Trends*, January 2002, which is adapted from John B. Taylor, "Discretion versus Policy Rules in Practice," *Carnegie-Rochester Conference Series* on Public Policy, vol. 39 (1993), pp. 195–214.
- e. Growth rates are calculated on a fourth-quarter over fourth-quarter basis. Data are seasonally adjusted.
- SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," Federal Reserve Statistical Releases, H.15; Federal Reserve Bank of New York; and Bloomberg Financial Information Services.

On November 6, the Federal Open Market Committee lowered the target federal funds rate 50 basis points, for a total reduction of 525 basis points since the beginning of 2001. At its December 10 meeting, the FOMC left the target rate constant at 1.25%.

Implied yields on federal funds futures contracts, which indicates the market's expectations of future rate changes, show only a small chance of further reductions in the near future, and little likelihood of increases even by the second half of 2003. However, a quick glance at May 2002 shows that these expectations can be spectacularly wrong.

Looking solely at the FOMC's actions can produce a poor description of policy. Policy might be better described as a strategy used by the FOMC to change rates in response to economic developments. One prominent model that is often used to describe Fed behavior is the Taylor rule, which has the FOMC lowering rates if real GDP growth slows and raising rates if inflation speeds up. The rates' exact pattern differs

according to the target inflation rate as well as the weights given to inflation and growth, but the Taylor rule does describe the general pattern of FOMC rate changes over the past several years. No one rule fits exactly, however. Currently monetary policy appears to be more expansive than the Taylor rule would suggest. Rates are slightly below what the rule would predict, with a 4% target inflation rate. This may also be reflected in an M2 growth rate that is running above 5% for the year.