

Monetary Trends



The Market's View of FOMC Announcements

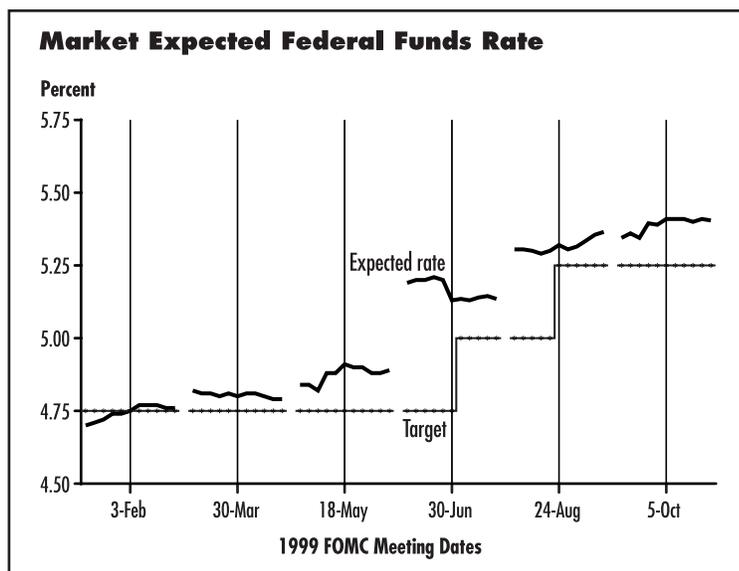
Since 1994, the Federal Open Market Committee has announced changes in its target for the federal funds rate immediately upon making them. After every meeting since May 18, 1999, the FOMC has also announced any bias, or asymmetry, in its expectations for the direction of future policy moves. The precise meaning of an asymmetric directive and the horizon over which it applies have, however, been subject to differing interpretations. Some observers have interpreted an asymmetric directive as indicating a likely policy move in the direction of the bias at the next scheduled FOMC meeting, while others have interpreted asymmetry as signaling a possible move, perhaps at the chairman's discretion, before the next scheduled meeting. To help clarify its decisions, the FOMC has recently established a subcommittee to review both the wording of its policy directive and the Committee's announcement following its meetings.

An indication of the market's response to FOMC announcements can be gleaned from trading in the federal funds futures market. For each of the first six meetings of 1999, the chart plots implied expected yields on federal funds during the month following the next scheduled FOMC meeting date, as reflected in trading on each FOMC meeting date and five days before and five days after those dates. Thus, for the Feb. 3 meeting, the plotted yields are derived from trading in April futures contracts on Feb. 3—as well as the five days on each side of that date. Also plotted is the FOMC's current funds rate target on each date. Vertical lines on June 30 and Aug. 24 indicate the 25 basis point target increases by the FOMC on those dates. The chart thus provides an indication of whether FOMC announcements affected market expectations for policy changes at the next scheduled FOMC meeting (though not about market expectations of policy changes before the next FOMC meeting).

The FOMC press releases issued after the May 18 and Oct. 5 meetings indicated that the Committee had adopted directives that were tilted toward the possibility of a future firming of policy. Press releases issued following the meetings of June 30 and Aug. 24, in contrast, indicated that the FOMC had adopted directives that contained no bias regarding the direction of future actions.

The chart illustrates that since March, market participants have expected the federal funds rate to rise above the FOMC's current target. The chart also reveals that expectations for future changes in the funds rate did not change markedly on most FOMC meeting dates, even on May 18 and Oct. 5 when the FOMC announced that it had adopted directives that were biased toward future tightening. On June 30, however, the implied expected federal funds rate yield for September fell from 5.20 percent to 5.13 percent, suggesting that despite raising its funds rate target from 4.75 percent to 5 percent, the FOMC's adoption of a symmetric directive regarding the outlook for near-term policy action caused market participants to downgrade their expectations for future tightening.

—David C. Wheelock



Views expressed do not necessarily reflect official positions of the Federal Reserve System.

