

Monetary Trends



What Accounts for the Reduced Frequency of Fed Actions?

Between January 1994 and January 2001, the Fed adjusted its target for the federal funds rate just 22 times, an average of about one change every four months. In contrast, there were 55 target changes during a period of similar length from 1987 through 1993—an average of one change about every month and a half.

The average number of changes per unit of time can be somewhat misleading because several long periods without a target change have been followed by periods of frequent target changes. Consequently, a different, and perhaps somewhat better, measure of the frequency of target changes is the median number of business days between target changes. The median number of business days between target changes since 1994 is 53. Between 1987 and 1993, the median number of business days between changes was just 18. Eight of the 55 target changes in this period were small, 6.25 basis point changes. If these “technical adjustments” are ignored, the median increases only to 19 days. By either measure, target changes were more than 2.8 [53/19] times more frequent before 1994 than after. What accounts for the marked decrease in frequency of Fed actions?

One possibility is that changes in Federal Open Market Committee (FOMC) procedures since 1994 have slowed the FOMC’s response to changing economic conditions. At its February 1994 meeting, the FOMC began the practice of announcing adjustments to its federal funds rate target immediately upon making them. About the same time, the Fed began the practice of changing the funds rate target primarily at regularly scheduled meetings. Of the 22 target changes since 1994, all but three were made at regularly scheduled FOMC meetings. In the seven prior years, four changes in five were made

between meetings. In addition, since 1994 the Fed has followed the practice of holding a teleconference meeting before making adjustments to its federal funds rate target between regularly scheduled meetings. Previously, intermeeting changes in the funds rate target were made at the discretion of the Chairman with no formal Committee consultation.

It is commonly believed that the Fed adjusts its funds rate target in response to new information about inflation or economic activity. While the procedural changes noted above might have slowed the Fed’s response to such shocks, it seems unlikely that they account for the marked reduction in the frequency of target changes. If the Fed responds to information about changing economic conditions in setting its funds rate target, one might expect to see more frequent target adjustments during periods when there are relatively large swings in output growth or inflation, and less frequent adjustments when economic conditions are relatively calm. Hence, the relatively benign economic conditions since 1994 have likely played an important role in the reduced frequency of Fed actions.

The decade of the 1990s was unusually calm.¹ Inflation has been relatively low and steady since 1994, while output growth has been relatively strong and steady. From the end of 1993 to the fourth quarter of 2000, the annualized quarterly growth rate of real GDP was below 2.0 percent in only three quarters, including the 1.1 percent growth in the fourth quarter of 2000. Therefore, until recently, there has been relatively little need to adjust the funds rate target because of a weakening economy. Indeed, the three reductions of the funds rate target in 1998 were prompted by financial market concerns following Russia’s announcement that it was defaulting on its sovereign debt. As long as inflation remains relatively low and steady, and the economy remains relatively stable, the Fed would seem to have little need to make frequent adjustments to the funds rate target.

— Daniel L. Thornton

¹ See *National Economic Trends* (March 2000).

