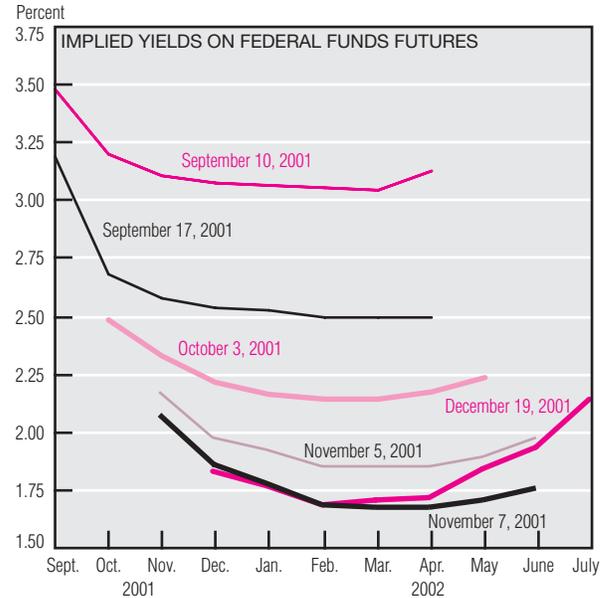
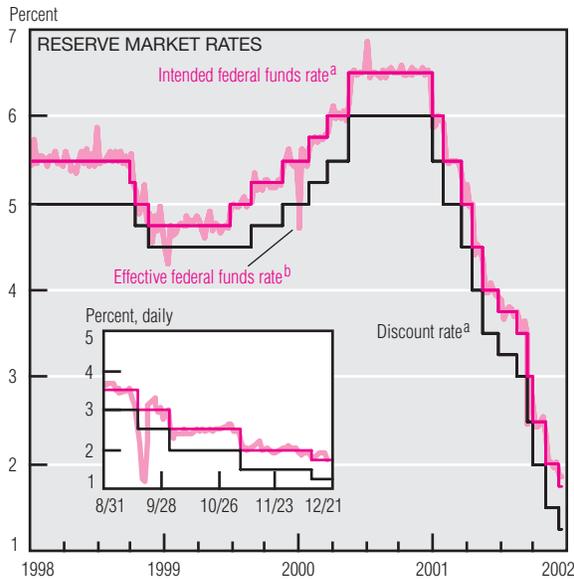
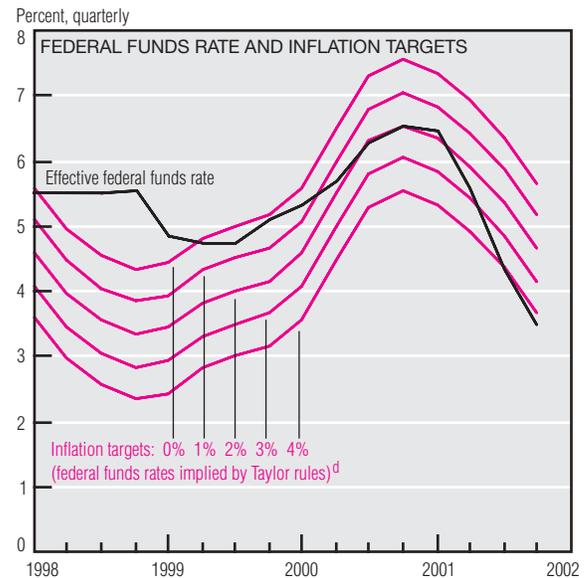


# Monetary Policy



**Bias in FOMC Statements as an Indicator of Monetary Policy<sup>c</sup>**

Risk cited in FOMC statement	Number of federal funds rate changes at meeting following FOMC statement				
	-50 bp	-25 bp	0 bp	+25 bp	+50 bp
Conditions that may generate economic weakness	8	3	0	0	0
Neutral	0	0	2	2	0
Conditions that may generate heightened inflation pressures	0	0	5	3	1



a. Daily.

b. Weekly average of daily figures.

c. Includes all scheduled and unscheduled FOMC meetings with accompanying statements, from May 18, 1999 until November 6, 2001.

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.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; Congressional Budget Office; Chicago Board of Trade; Haver Analytics; and Bloomberg Financial Information Services.

On December 11, 2001, the Federal Open Market Committee (FOMC) lowered the target federal funds rate 25 basis points (bp) to 1.75%. This was the eleventh decrease in 2001, the Committee having reduced the rate at each of its eight regularly scheduled meetings and three times at unscheduled (telephone) meetings. At one unscheduled meeting in April, the Committee held rates constant. The moves have reduced the target federal funds rate 475 bp from 6.5%, where it stood at the beginning of 2001.

One gauge of future policy is the implied yields on federal funds futures

contracts. Market participants apparently expect the rate reductions to stop fairly soon; the minimum rate of 1.68% in February further suggests that they see only a partial probability of further downward cuts. Rates are expected to rebound quickly, with a rise to 2.25% by July considered a distinct possibility.

Another popular gauge is the discussion of the weighting of risks in the FOMC statement, sometimes called the "tilt" or "bias." Since the middle of 1999, when it began to announce this weighting at all meetings, the FOMC has always followed a statement of

weakness by lowering the federal funds rate at the next meeting, although a statement of inflationary pressures has not always preceded a rate increase.

A third gauge, the Taylor rule, posits that the FOMC chooses the target rate as a balanced response to economic weakness and inflation. The form of the Taylor rule depends on the weights given to deviations of inflation and output from their target values. While the rule recently has predicted correctly the direction in which the federal funds rate would move, it has missed on magnitude.