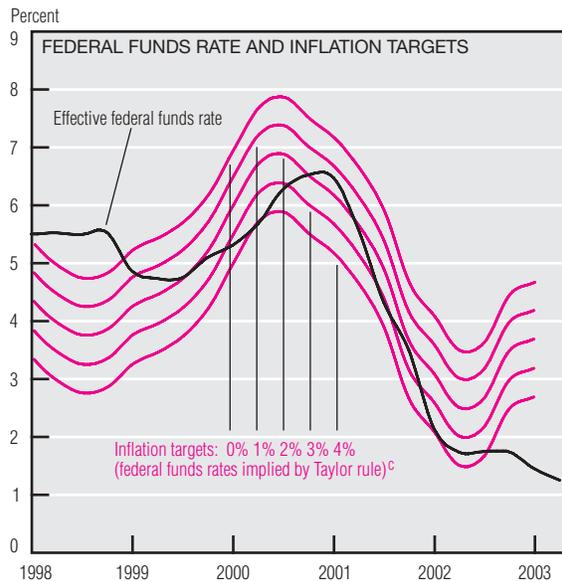
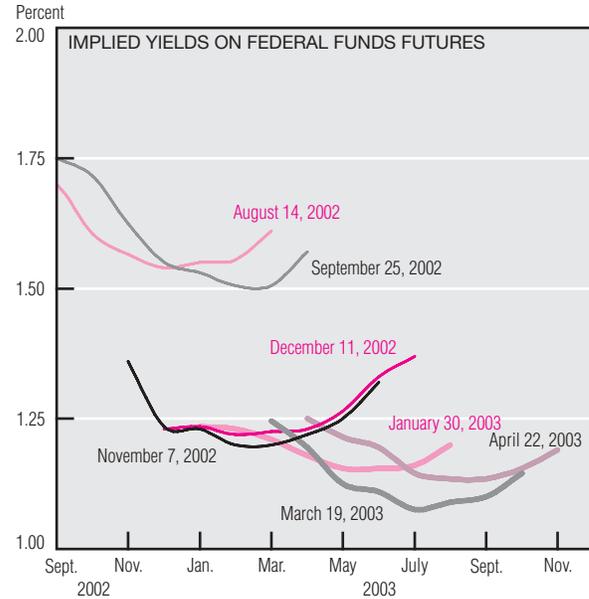
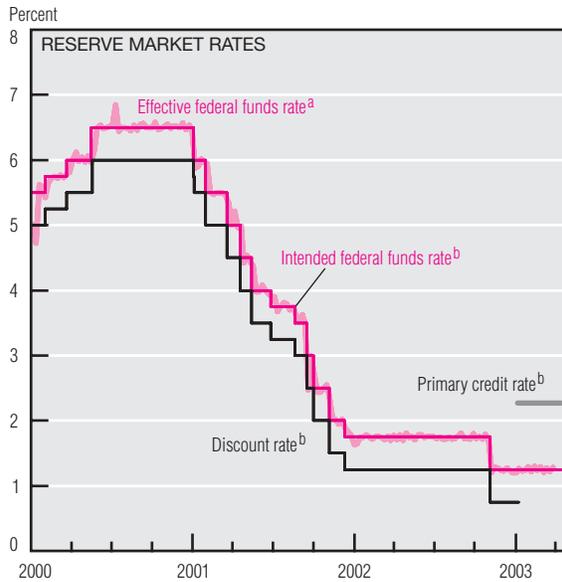


# Monetary Policy



## Balance of Risks<sup>d</sup>

### Change in federal funds target rate

Statement	prior to change	-0.5	-0.25	0	0.25	0.50
Inflationary		0	0	5	3	1
Balanced		0	0	7	2	0
Weakness		6	3	3	0	0
No statement		3	0	0	0	0

a. Weekly average of daily figures.

b. Daily observations.

c. 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.

d. Data taken from immediate press releases beginning in May 1999.

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

While the Federal Reserve has not changed the target federal funds rate this year (the May 6 meeting has not taken place as of this writing), the fed funds futures market sees at least a possibility that rates will be lowered from their current level of 1.25%. Futures prices are consistent with market participants' belief in a 50-50 chance of a 25 basis point cut by September.

One perhaps surprising aspect of monetary policy is the extent to which the target funds rate has diverged

from the Taylor rule, which posits that the FOMC chooses the target rate as a balanced response to weakness and inflation. The Taylor rule's form depends on the weights given to inflation and output and to the assumed inflation target. While the rule has generally predicted the direction of the fed funds rate's move accurately, it has predicted increasing rates since the second quarter of 2002, at odds with actual rates' downward trend.

Many people look for guidance to the balance-of-risk statement that the FOMC has issued after each meeting

since May 1999. Do such statements contain information about future FOMC actions? It's hard to say whether using the statements would improve on a shrewd guess based on the state of the economy, but some patterns emerge. A statement that there is a risk of weakness has most often been followed by a cut in rates, although the most common response after an inflationary risk statement has been no move. And a downward move has never followed a statement of balanced risks.