At its January 31 meeting, the Federal Open Market Committee (FOMC) lowered the target federal funds rate 50 basis points (bp) to 5.5%. In a related action, the Board of Governors approved recommendations by most Reserve Banks’ boards of directors to lower their discount rates a total of 50 bp to 5%. Reasons cited for the rate cuts included erosion in consumer and business confidence as well as weakness in retail sales and business capital equipment spending. This was the second decrease in the target federal funds rate in a month, the first being a 50 bp rate cut on January 3.

Implied yields on federal funds futures often are used to gauge market participants’ expectations of the future course of monetary policy. Participants placed a high probability on a 50 bp cut in the federal funds rate at the January 31 meeting; they have also revised upward the probability of future cuts. On February 1, the July contract traded at 4.73%, a decrease of nearly 75 bp since the end of last year. As predictors of movements in the target federal funds rate, federal funds futures perform well. The average error for the period 1996–present is 11 bp on the 3-month future and only 5 bp on the 1-month future.

Before the current easing period, the last round of reductions in the federal funds rate occurred from September 1998 to November 1998, when the intended rate was cut by a total of 75 bp. The cumulative 100 bp decrease in the target has come relatively quickly in this round. Since 1985, the FOMC typically has taken between three and four moves to achieve a cumulative decline of 100 bp.