On November 6, the Federal Open Market Committee lowered its target for the federal funds rate by 50 basis points (bp) to 1.25%. In a related action, the Board of Governors lowered the discount rate 50 bp to 0.75%. The magnitudes of the moves surprised markets. Although the fed funds futures market had priced in a rate cut, the implied yield indicated an expectation of a 25 bp change in November, with a possible further cut sometime later.

The implied yields on eurodollars—a measure of the expected fed funds rate over long horizons—has shifted up in future years, suggesting that participants in this market expect the current rate reduction to be reversed within a year. Interestingly, expected rate increases will arrive sooner than they would have in the absence of the recent change. Moreover, the yield curve became more steeply sloped after the policy announcement, a reaction consistent with the belief that policy had become more accommodative.

The FOMC’s announcement recognized the deterioration in the economic outlook but characterized it as a “soft spot,” that is, a transitory weakness. The Committee emphasized its belief that the action taken should prove helpful as the economy works its way through the period of weakness. The FOMC also indicated its belief that with this action, the risks are balanced with regard to the prospects for price stability and sustainable growth in the foreseeable future. On the other hand, it noted that incoming economic data have tended to confirm that greater uncertainty, resulting partly from heightened geopolitical risks, is inhibiting spending, production, and employment.