At its December 9 meeting, the Federal Open Market Committee (FOMC) decided to keep its target federal funds rate at 1%. The press release noted, however, that the FOMC now finds a reduced probability of “an unwelcome fall in inflation.” In line with the October 28 statement, policy accommodation is expected to continue for “a considerable period.”

Market expectations may have reacted more strongly to the minutes of the October meeting, which some market observers took to indicate that the target rate would remain at its current level longer than they had previously expected. They were perhaps reacting to the minutes’ statement that FOMC members felt current trends “were likely to hold inflation to very low levels over the next year or two.”

So it is not surprising that the implied yields of federal funds futures show only small increases through 2004, although a glance at the market’s predictions since 2000 shows it is far from infallible. The December decision also keeps rates well below a popular benchmark provided by the Taylor rule, which posits that the FOMC chooses the target rate as a balanced response to weakness and inflation. The form of the Taylor rule depends on the weights given to inflation and output and to the assumed inflation target. However, the low rates have not led to a surge in the money supply, which has grown less than 5% in 2003.