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Fed Meetings and Tightenings - 1994

A Review of the Circumstances Surrounding Each Fed Move This Year

1. Friday, February 4th

Move: A 25 bp hike in the Fed funds rate from 3% to 3 1/4%, with the discount rate left unchanged at 3%. Prior to this move, the Fed had left the Fed funds rate unchanged at 3% since September 4, 1992, when the Fed had cut it from 3 1/2%, and had left the discount rate unchanged since July 2, 1992, when the Fed had cut it from 3 1/2%.

Timing: Press release issued at 11:00 a.m. stating Fed had voted for an immediate, slight tightening of reserves.

Fedtime: The Fed had triggered widespread speculation on Thursday (February 3rd) by staying out of the market with Fed funds at 3 1/8%, when the funds target had been perceived as 3% for the previous 17 months. Since the Fed tightened before Fedtime on Friday February 4, the lack of a Fed action that day was a moot point and was viewed simply as a signal that the new funds rate was 3 1/4%.

Surrounding Events: A weak non-farm payroll report had been released that morning before the tightening, leading many to believe a tightening would instead be postponed. The tightening came at the end of the major 2-day Fed meeting and was the first Fed move to involve a press release in the 80-year history of the Fed's existence.

Bond Market Reaction: The bond contract rallied more than a point off its opening level that day in the hour or so after the Fed tightened, but then fell rapidly to close near the low of the day. The contract closed lower that day and fell for the next two trading sessions. A month later the bond contract was 5 points lower than on February 3rd.

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2. Tuesday, March 22nd

Move: 25 bp hike in the Fed funds rate, from 3 1/4% to 3 1/2%, with the discount rate left at 3%.

Timing: Press release issued at 2:21 p.m. stating the Fed had voted to “narrow slightly” the degree of pressure on reserve positions. Press release also stated that short rates would rise as a result, but quantified it as only a “small” expected rise.

Fedtime: On Monday (March 21st) the Fed added via a 3-day System RP, which prodded many analysts to say the Fed tightening would come later in the week (presumably the Fed would not tighten during a term-adding operation). On Tuesday morning at Fedtime (before the Fed tightened) a 2-day System RP was arranged with Fed funds last trading at 3 3/8%, and with a stopout rate later confirmed at 3.30%. Despite the two term-adding operations, the Fed chose to tighten anyway, helping to confirm the NY Fed’s new procedure of scrupulously conducting open market operations under the old Directive until they receive word of a new Directive.

Surrounding Events: The tightening move came at the end of a 1-day FOMC meeting. Additionally the tightening came on the first day of the monthly 2 year/5 year auction cycle, with little damage done to the 2 year auction results. A trade deficit report had been released that morning which was generally viewed as bullish.

Bond Market Reaction: Bonds closed slightly higher on the day, although the day’s range was very narrow. Bonds held their levels through the next session, but then began a sharp slide on Thursday March 24. In less than two weeks, the bond market was 6 points lower. The stock market also took a calamitous drop, mainly blamed on the bond market dip.

3. Monday, April 18th

Move: 25 bp hike in Fed funds rate, from 3 1/2% to 3 3/4%, with no move on discount rate from 3%.

Timing: Press release at 10:00 a.m. stated the same sentence as at the March 22nd meeting. Press release went to great lengths to say that although Greenspan received the concurrence of the FOMC by phone, no official FOMC vote had been taken and Greenspan was exercising his own authority to raise rates by 25 bps.

Fedtime: Fed arranged a 3-day System RP that morning, with Fed funds at 3 13/16%, and with a stopout rate of 3.80%. The 3-day System RP extended two unwinding Fed operations from the prior week, a 4-day System RP on Thursday (April 14) and a \$1.5 bln weekend Customer RP on Friday (April 15).

Surrounding Events: On Sunday (April 17) Treasury's Bentsen fundamentally alerted the world that the tightening move was imminent, although his actual phrasing was that the Fed would raise rates by 50 bps before the year end. The Fed's press release also appeared to go to great lengths to dispel the April 8th *New York Times* story saying that the FOMC had removed Greenspan's authority to move rates by 25 bps between meetings. Despite that repudiation, the front page story on the *New York Times* the previous Friday (April 15) had sent bills into a tailspin, because it suggested the Fed would soon move rates closer to "neutrality." The tightening was also seen as a reaction to the sharp equity market losses earlier in the month.

Bond Market Reaction: Bonds closed that day 1 1/4 points lower than the previous close, but then proceeded to rally more than two points over the next week or so. These gains failed to hold, however, and the market came off about 4 points. It didn't catch its breath until it became clear the Fed would soon tighten again, and strongly.

4. Tuesday, May 17th

Move: Fed raised the discount rate by 50 bps, from 3% to 3 1/2%, and the Fed funds rate by 50 bps, from 3 3/4% to 4 1/4%.

Timing: Fed announced the tightening via press release at 2:26 PM. Language was similar to prior releases but with two notable exceptions: first, the Fed specified the actual target levels of the Fed funds target, one of the few official recognitions the Fed has ever offered that they are targeting the Fed funds rate. Second, the Fed offered a vaguely worded "pledge of neutrality" that was widely seen as a promise not to tighten again for a while.

Fedtime: An overnight System RP from the prior day, which had been executed at a 4% funds rate, unwound the day of the tightening. At Fedtime on the day of the tightening (prior to the tightening announcement, though), the Fed arranged another overnight System RP, with funds trading at 4 1/4% and with a stopout rate of 3.92%. Again, this clinched the notion that the Fed was not using Fedtime to signal impending policy changes.

Surrounding Events: In an issue the week before the tightening, the *Wall Street Journal* printed unattributed rumors from the White House that they were braced for a 50 bp move, instead of the 25 bp move that was more widely expected in the markets. Also, in *Barrons* (the weekend before the Fed move) an article suggested some of the Fed District Bank presidents were asking for a 100 bp hike in the discount rate. Also, earlier in the month multiple rounds of currency intervention had failed to stem the dollar's decline, and the rate hikes were viewed as the second shoe to drop.

Bond Market Reaction: The bond contract closed almost 1 1/2 points higher from the prior session, although the contract had been rising steadily in the week prior in anticipation of the tightening. With one or two notable exceptions, the bond held its strength for about 3 weeks after the tightening, when it started to weaken again in the face of continuing economic strength. The bond contract had lost about 5 points off its June high by mid-July, flirting with a break below par.

5. Wednesday, July 6

Move: None. Fed funds target still at 4 1/4%, discount rate still at 3 1/2%.

Timing: No Fed tightening took place despite widespread expectations that the scheduled 2-day FOMC meeting would generate a Fed rate hike at some point. However, at 2:18 p.m. news headlines reported the Fed had no plans to issue any type of announcement regarding the results of that day's FOMC meeting and vote. This was viewed as a signal that the Fed did not plan to tighten.

Fedtime: A \$2.5 bln Customer RP from the previous day (July 5th) unwound, and was replaced by an overnight System RP executed at 4 7/16%, with a stopout rate of 4.32%. Most analysts saw the move as necessary to fight rising settlement Wednesday pressures. Unfortunately, the lack of a Fed tightening move or even a press release stating that the Fed would leave policy unchanged undercut the progress that had been made in weaning the markets off the belief that signals are being sent at Fedtime - the overnight System RP was viewed as a deliberate signal, in retrospect, that the Fed would not tighten.

Surrounding Events: Two days later the non-farm payroll report showed a sharp 379k jump, causing some doubt as to whether the Fed's lack of a rate hike was wise.

Bond Market Reaction: Bonds continued to slip on the bear move that had been in place for more than a month. By mid-month, however, bonds found their footing, and began a sharp rally that took pause only for Greenspan's Humphrey-Hawkins testimony.

6. Tuesday, August 16th

Move: Fed raised the discount rate by 50 bps, from 3 1/2% to 4%, and the Fed funds rate by 50 bps, from 4 1/4% to 4 3/4%.

Timing: Fed issued a press release at 1:18 p.m. announcing the tightening. The press release was unique on two points: first, it went into greater detail as to why they tightened, blaming it mainly on increasing levels of "resource utilization" in the US economy. Second, it avoided speaking in terms of the "degree of pressure" applied to reserves, and spoke primarily in terms of interest rate levels, again showing a remarkable candor on the part of the Fed to admit to its interest rate targeting approach.

Fedtime: An overnight System RP unwound from the prior day (Monday August 15), and was rolled into another overnight System RP the day of the tightening. This System RP was executed with funds at 4 5/8%, and had a stopout rate of 4.53%. Again, the Fed appeared to be reinforcing the notion that Fed operations in the runup to a tightening give no hint of a pending policy change. No Fed action took place the day after the tightening, with funds trading at 4 11/16%, near their presumed new target level.

Surrounding Events: Uneven economic data in the weeks before the tightening had led to some doubt that the tightening would be as strong as it was, although in the last few days before the tightening most analysts were convinced that a move of some proportion would occur. Comments from Greenspan at his previous Humphrey-Hawkins testimony, plus comments after that by Parry, Lindsey, Laware, and Phillips all helped foreshadow the move. New Fed governor Janet Yellen had been put on the Board only days before, but apparently voted in favor of the discount rate increase.

Bond Market Reaction: The bond contract soared following the Fed move, as it was viewed as stronger than anticipated. Curve flattening trades predominated. The view quickly developed that the Fed would probably not tighten again for the rest of 1994. Traders reported heavy retail interest the day of the tightening.