How Has the Federal Reserve's New Policy of Immediate Disclosure Affected Financial Markets?

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For release: April 17, 1997

ST. LOUIS - Research by an economist at the Federal Reserve Bank of St. Louis indicates that the magnitude of market reaction to a change in the target for the federal funds rate under the Fed's new policy of immediate disclosure is virtually the same as it was under the previous policy of delayed disclosure. Immediate disclosure, however, may have reduced the financial markets' uncertainty.

Historically, the Fed had maintained that immediate disclosure of its policy decisions would create an "announcement effect" a significant reaction by the market to changes in the federal funds rate. At the February 1994 meeting of the Federal Open Market Committee (FOMC), however, the Fed reversed its long-standing policy.

"Contrary to these past claims by the Federal Reserve, there was actually an announcement effect prior to the FOMC's decision to reverse its policy of delaying announcement of its federal funds rate target," said the economist, Daniel L. Thornton, whose findings appear in the recent edition of ***Review***, the St. Louis Fed's bimonthly journal of economic and business issues. "The magnitude of the announcement effect was not changed by immediate disclosure. The main difference is that the announcement effect occurs at once under immediate disclosure. On the other hand, that effect was strung out over several days when the market was left to decipher Federal Reserve policy changes on its own."

Thornton studied the period from Jan. 4, 1988, through Jan. 31, 1996, when the Fed conducted monetary policy by making relatively small adjustments to its target for the federal funds rate. The federal funds rate is the short-term interest rate that banks charge other banks for short-term loans. During this time, there were 48 changes in the Fed's funds rate target: 38 prior to 1994 and 10 after 1994. Fourteen of those announcements were accompanied by changes in the discount rate: nine prior to 1994 and five after 1994. The discount rate is the short-term interest rate that the Fed charges banks for loans.

Thornton also noted that the federal funds rate has been less volatile since the FOMC's decision to announce its policy immediately, although he said the decrease in volatility could be the result of factors other than, or in addition to, the change in the disclosure policy. When the reduced volatility is accounted for, Thornton found some evidence of reduced uncertainty, but he found it difficult to determine whether the apparent reduction in uncertainty is due solely to the policy of immediate disclosure.

Nevertheless, he concluded: "Overall, the evidence suggests that the Fed's policy of immediate disclosure has been beneficial. In monetary policy, as in most areas of economics, more information is preferable to less."

Subscriptions to ***Review*** are free and can be obtained by calling (314) 444-8809. The publication is also available on the Internet: http://www.stls.frb.org.

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