

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF MONETARY AFFAIRS

Date: May 17, 1994
To: Board of Governors
From: Vincent Reinhart
Subject: Market Reaction to System Action

---FOR INFORMATION ONLY---

The attached table records the reaction in financial markets to today's System action. The press release announcing the 50 basis point increase in the discount rate and the full pass through to reserve market conditions was released at 2:30 this afternoon. A variety of financial market quotes before (at 2 p.m.) and after (at 4 p.m.) are given in columns 1 and 2. I took a two-hour window about the policy action in order to include the market response to major commercial banks' announcements of increases in the prime rate. By 4 o'clock, a majority of the major banks had raised their prime rate 50 basis points, to 7-1/4 percent.

Charts 1 and 2 plot the movements in expected volatility inferred from options on futures on Treasury bonds, Treasury notes, and three-month Eurodollar contracts. This near-term measure of volatility dropped noticeably today for all three instruments, suggesting that System action served to resolve some rate uncertainty.

The Market Reaction to the System's Tightening

	Tuesday, May. 17 2 p.m. (1)	Tuesday, May. 17 4p.m. (2)	System's Tightening (3)
<u>Treasury Bill rates</u>			basis points
Three months	4.19	4.23	4
Six months	4.67	4.60	-7
One year	5.09	5.02	-7
<u>Treasury Bond yields</u>			
Three years	6.33	6.21	-12
Ten-years	7.19	7.05	-14
Thirty years	7.42	7.27	-15
<u>Implied one-year forward rates</u>			
Three-years ahead	7.37	7.20	-17
Ten-years ahead	7.86	7.69	-17
Thirty-years ahead	7.82	7.65	-17
<u>Equity indexes</u>			Percent Change
DJIA	3684.40	3720.61	0.98
S&P 500	445.43	449.37	0.88
Yen/Dollar	104.30	104.40	0.10
DM/Dollar	1.66	1.67	0.60
CRB Future Index	229.54	229.53	-0.01

Chart 1

Implied Volatility from Options on Bond Futures

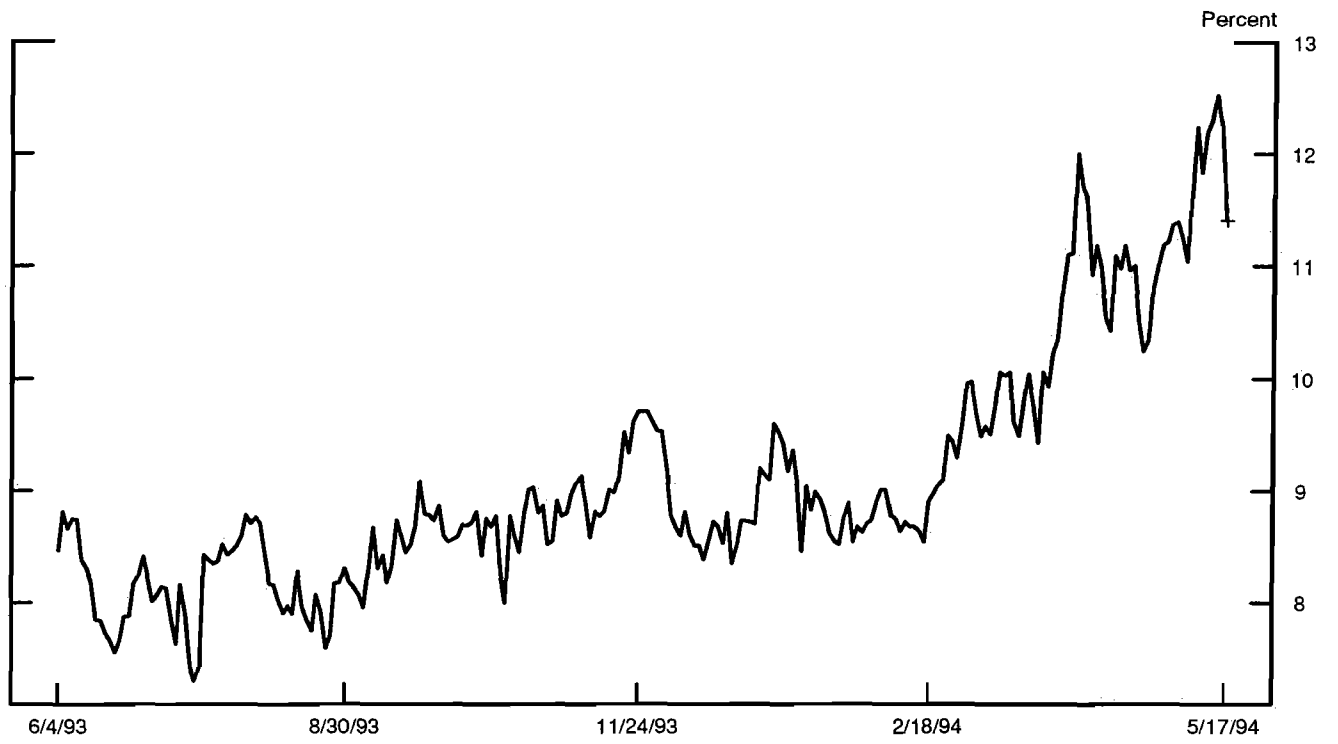
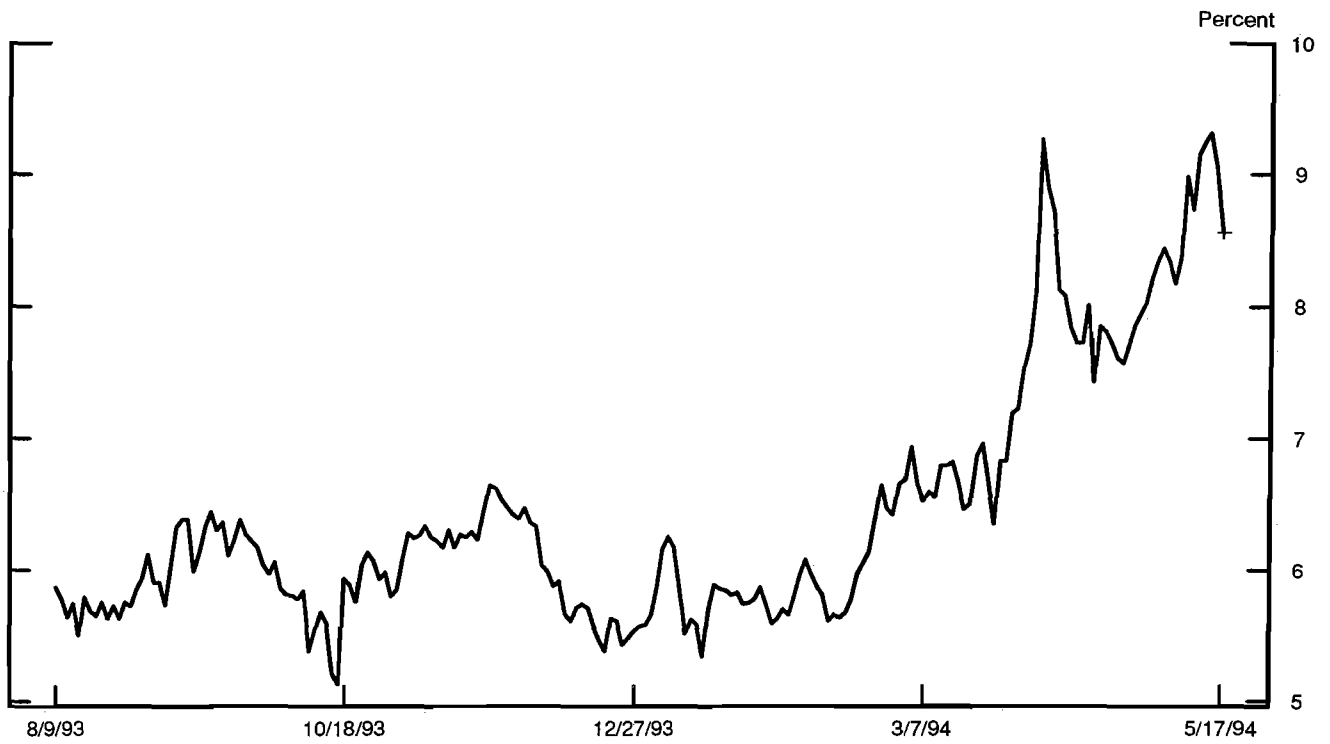


Chart 2

Implied Volatility from Options on 10-year Note Futures



Implied Volatility from Options on 90-day Eurodollar Futures

