

Probability of Fed Action in 2007

May 22, 2007



On April 4th, we published an analysis of the futures market which highlighted the probability of Fed action on each FOMC meeting date based on traded levels of the Fed Funds futures contracts. Over the last 7 weeks, the market has scaled back its expectation regarding Fed easing given the stronger than expected economic picture. If you compare the April 4th data with today's you can see the expectation of any easing has been significantly removed for the remainder of the year.

Using the changes implied between the scheduled FOMC meetings, a probability can be assigned to a 25 basis point ease in any given period. We can also assess the cumulative probability that a 25 basis point ease will occur prior to a specific date. The probabilities are path dependent in that they are based on the expected Fed Funds rate at the prior meetings.

April 4th Data

FOMC Meeting Dates	Implied Fed Rate	Implied Change	Discrete Probability of Fed Action			Cumulative Probability
			-25bp	No Change	+25bp	
Current	5.25000%					
5/9/2007	5.23577%	1.42 bps	5.693%	94.307%	0%	5.693%
6/28/2007	5.21639%	1.94 bps	7.751%	92.249%	0%	13.444%
8/7/2007	5.11785%	9.85 bps	39.417%	60.583%	0%	52.861%
9/18/2007	5.06787%	5.00 bps	19.990%	80.010%	0%	72.851%
10/31/2007	4.95500%	11.29 bps	45.149%	54.851%	0%	118.000%
12/11/2007	4.83705%	11.79 bps	47.179%	52.821%	0%	165.179%

May 22nd Data

FOMC Meeting Dates	Implied Fed Funds Rate	Implied Change	Discrete Probability of Fed Action			Cumulative Probability
			-25bp	No Change	+25bp	
Current	5.25000%					
6/28/2007	5.24000%	1.00 bps	4.000%	96.000%	0%	4.000%
8/7/2007	5.22708%	1.29 bps	5.167%	94.833%	0%	9.167%
9/18/2007	5.19297%	3.41 bps	13.645%	86.355%	0%	22.812%
10/31/2007	5.15990%	3.31 bps	13.228%	86.772%	0%	36.040%
12/11/2007	5.10100%	5.89 bps	23.560%	76.440%	0%	59.600%
1/30/2008	5.03500%	6.60 bps	26.400%	73.600%	0%	86.000%

Kensington Capital Advisors is a derivative advisory firm focused on assisting borrowers and users of derivative products in evaluating, pricing and executing hedge structures. As always, we welcome your questions and look forward to providing independent and expert advice.