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The Effect of Federal Funds Rate Changes on Stock Prices: A Sector-Wise Analysis

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Oral Presentation O2.2

**THE EFFECT OF FEDERAL FUNDS RATE CHANGES ON STOCK PRICES:
A SECTOR-WISE ANALYSIS**

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The federal funds rate is an indicator of monetary policy that investors in the stock market scrutinize very closely. This paper determines the relationship between changes in the federal funds rate and sector wise stock indexes. Weekly returns of the Dow Jones ICB classified financial, energy, utilities, materials, industrials, consumer goods, consumer services, information technology, healthcare and telecommunications sectors are analyzed using separate OLS regression models for each sector. Since the financial sector, earnings are most directly affected by changes in the interest rate, I hypothesize ⁽¹⁾ that this sector will be the most responsive. The results show that the utilities, financials, telecom and materials sectors are the most interest rate sensitive in that order and that the relationship exhibited between the stock price and the federal funds rate is positive. I conclude by attributing the positive relationship to sector specific demand and supply effects related to the federal funds market.