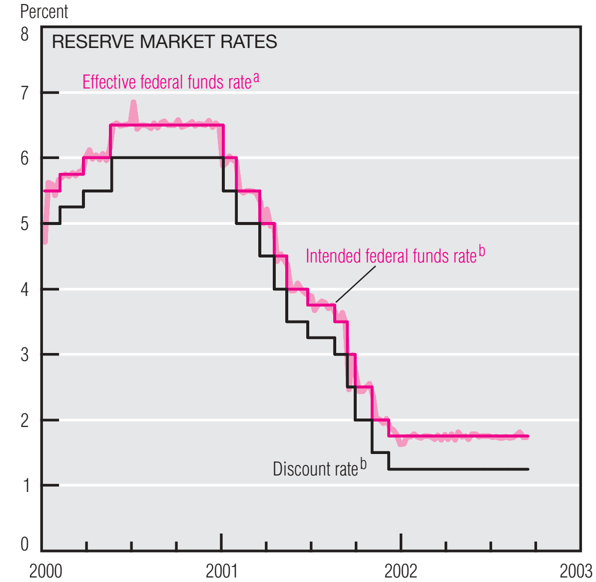
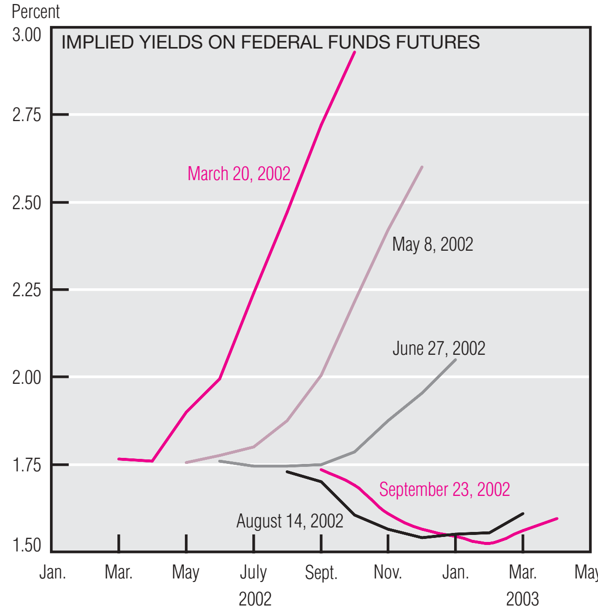
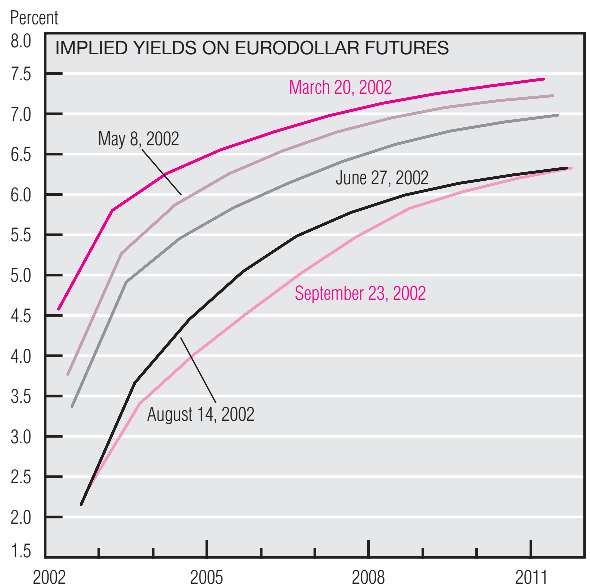
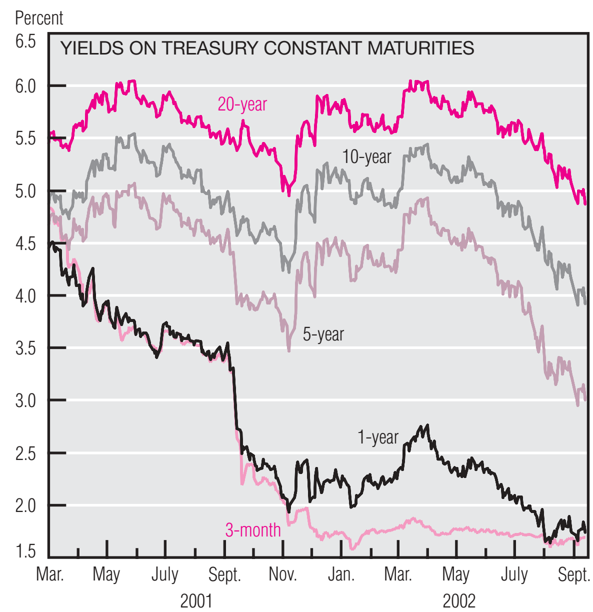
Monetary Policy









a. Weekly average of daily figures.
b. Daily observations.
SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," H.15; and Bloomberg Financial Information Services.

At its September 24 meeting, the Federal Open Market Committee (FOMC) left the federal funds rate target unchanged at 1.75%, citing "robust underlying productivity growth" as the basis for maintaining monetary policy's current stance. However, the Committee expressed concern over the extent and timing of the economic recovery, stating that "the risks are weighted mainly toward conditions that may generate economic weakness." The dissenters, Governor Gramlich and President McTeer, preferred reducing the federal funds rate target.

Implied yields on federal funds futures often are used to gauge market participants' expectations of monetary policy. By this measure, few expected the intended federal funds rate to change at the September meeting. However, current yields indicate that market participants estimate roughly a 90% probability of a 25 basis point (bp) rate cut by the end of February 2003. Eurodollar futures, too, can gauge expectations about federal funds rate changes and, unlike federal funds futures, can do so many years out. By September 23, the implied yield on the September 2012 contract had reached 6.33%, 458 bp above the current target rate, but this represents a decline of 110 bp since the March FOMC meeting.

Treasury yields have continued to decline over the past several months for maturities of one year and longer, a sign that market participants have lowered their expectations of future inflation and/or real interest rates. Since March, the decrease in the yield curve for eurodollar futures 10 years out has resembled the decline in the 10-year Treasury bond yield.