On September 21, the Federal Open Market Committee (FOMC) raised the target federal funds rate to 1.75%, 25 basis points (bp) higher than the target established on August 10. Following the decision, the Federal Reserve’s Board of Governors raised the primary credit rate 25 bp to 2.75%. The next probable move will occur in November 2004, as implied by yields on federal funds futures. The probability of a 25 bp increase at the November meeting (there is no meeting in October) was estimated at 81% on September 29, compared to 57% on September 15, a week before the previous meeting.

The FOMC stated that “even after this action, the stance of monetary policy remains accommodative” and, together with steady underlying productivity growth, supports economic activity. The FOMC also believes that “output growth appears to have regained some traction” and that “labor market conditions have improved modestly” despite the hike in energy prices.

Higher energy prices did not seem to increase long-term inflation expectations. The yield curve has flattened continuously over the last few months and over the past year. The rate reduction was most significant at the long end. The 10-year rate moved down 24 bp from August’s meeting and 59 bp from June’s.

The increases in the federal funds rate appear to reinforce public confidence that the Fed will not let inflation accelerate.