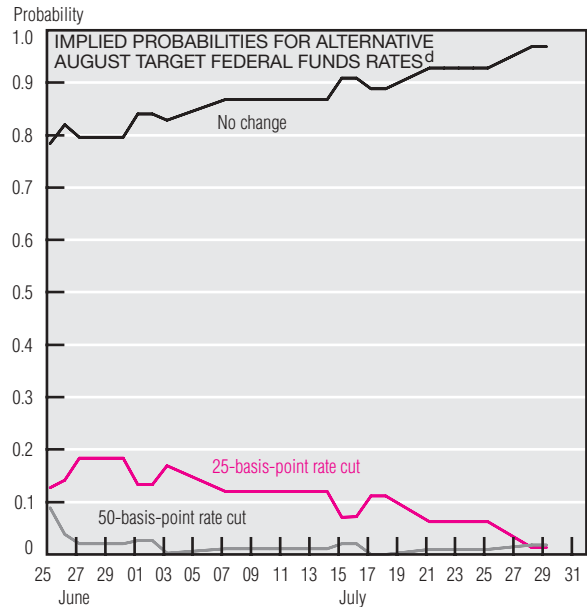
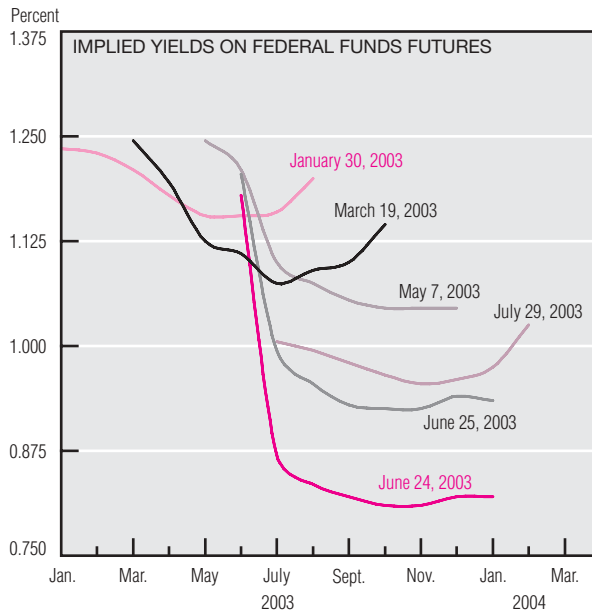
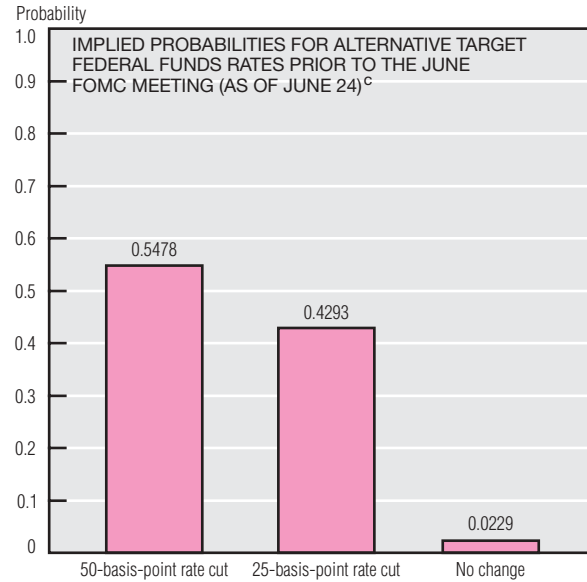
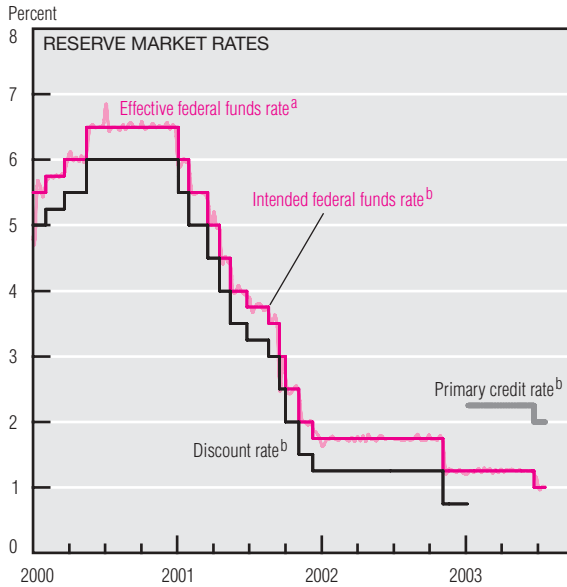


Monetary Policy



a. Weekly average of daily figures.

b. Daily observations.

c. Probabilities are calculated by using prices from options on July 2003 federal funds futures that trade on the Chicago Board of Trade.

d. Probabilities are calculated by using prices from options on August 2003 federal funds futures that trade on the Chicago Board of Trade.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; and Bloomberg Financial Information Services.

After the surprise of a smaller-than-expected cut in the federal funds rate at the June 24–25 meeting of the Federal Open Market Committee (FOMC), market participants see little chance of a further rate cut. Attention apparently has focused on the language of the FOMC's press release: "The Committee continues to believe that an accommodative stance of monetary policy, coupled with still robust underlying growth in productivity, is providing important ongoing support to economic activity. Recent signs point to a firming in

spending, markedly improved financial conditions, and labor and product markets that are stabilizing."

Since early spring, the Chicago Board of Trade has provided a market for options on federal funds futures. Prices on these options enable one to estimate the implied probabilities associated with alternative policy choices. Just before the FOMC's June meeting, the implied probability distribution showed that the odds favored a rate cut of 50 basis points, with a slight chance that no change would be made. This revealed concern

that the FOMC would need to act aggressively to avoid a potentially corrosive deflation. The choice of a smaller rate cut seemed to reassure markets that an unwelcome fall in inflation was unlikely.

Since then, there has been evidence of increasing confidence in the FOMC's belief that the current policy setting is sufficiently accommodative. As of July 29, options on the August fed funds futures assigned a 97% chance to the no-change scenario, up from less than 80% immediately after the June meeting.