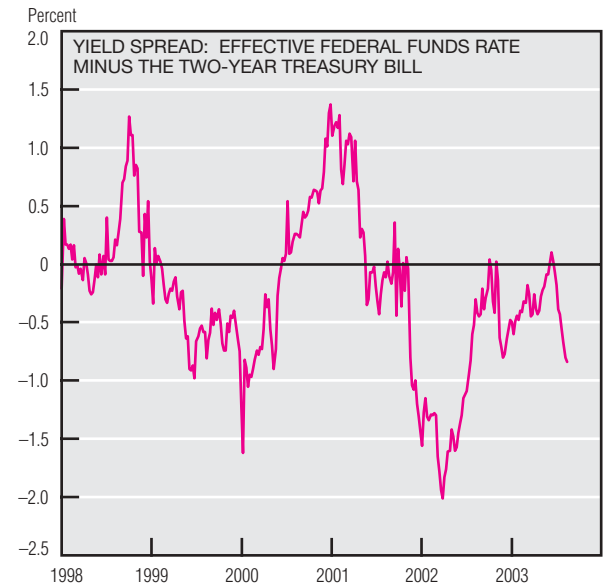
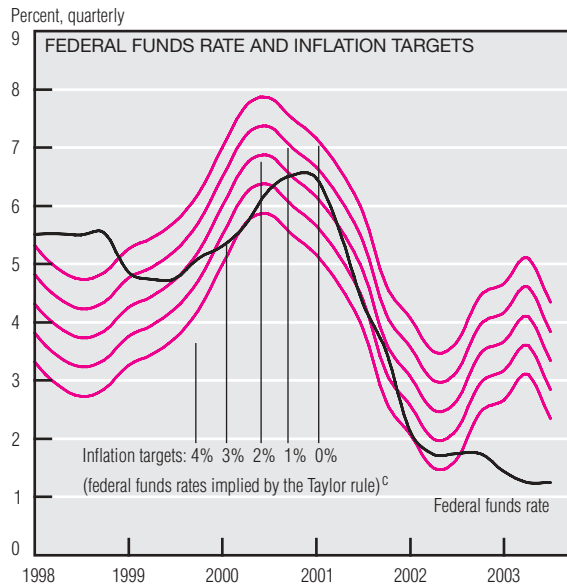
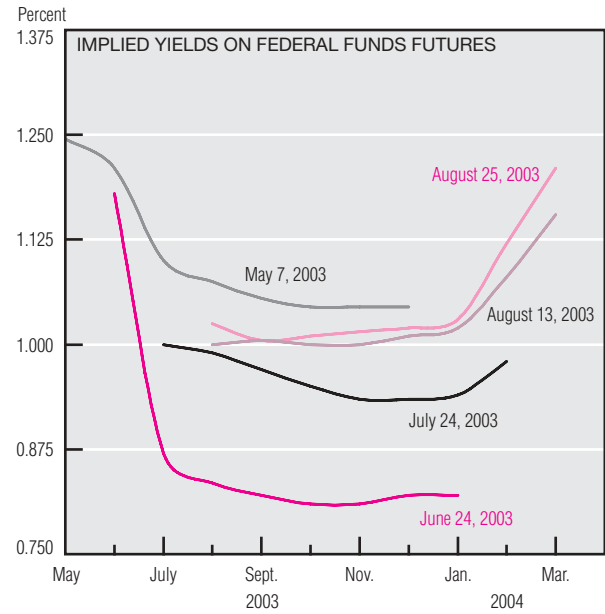
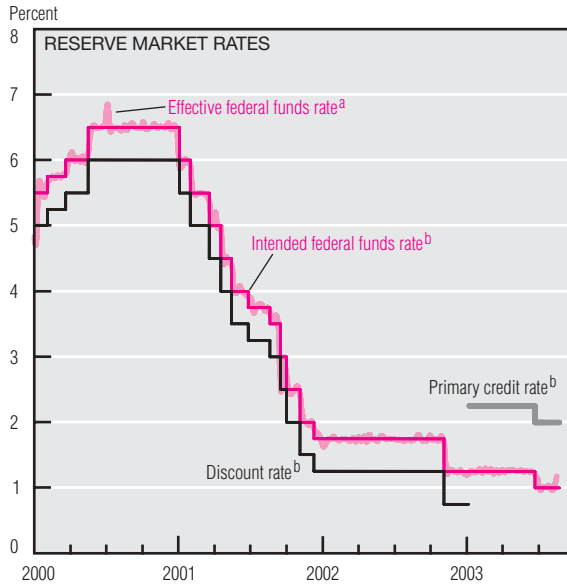


Monetary Policy



a. Weekly average of daily figures.

b. Daily observations.

c. The formula for the implied funds rate is taken from Federal Reserve Bank of St. Louis, *Monetary Trends*, January 2002, which is adapted from John B. Taylor, "Discretion versus Policy Rules in Practice," *Carnegie-Rochester Conference Series on Public Policy*, vol. 39 (1993), pp. 195–214.

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

The Federal Open Market Committee made no change in its target for the federal funds rate at its August 12 meeting. The Board of Governors of the Federal Reserve System also left the primary credit rate unchanged. Before that meeting, market participants had believed there was some chance of the FOMC lowering the target rate, a possibility reflected in yields in the federal funds futures market. Since then, however, the thought of rates lower than 1% has diminished, and the market seems to

be entertaining the thought of rates increasing in early 2004.

One popular benchmark for the federal funds rate is the Taylor rule, which posits that the FOMC chooses the target rate as a balanced response to weakness and inflation. The form of this rule depends on the weights given to inflation, output, and the assumed inflation target. Since fall 2002, rates have been well below those suggested by the Taylor rule, even assuming a rather high target inflation rate of 4%.

Another benchmark—whether the fed funds rate is “neutral” or “in line with the market”—is based on the ideas of Swedish economist Knut Wicksell. It compares the fed funds rate with other market rates. One logical comparison is with the yield on the two-year Treasury note, whose maturity is long enough to ensure that it is not just a reflection of immediate policy expectations. Although the spread between these two rates is now negative, it shows somewhat less easing than the Taylor rule benchmark would suggest.