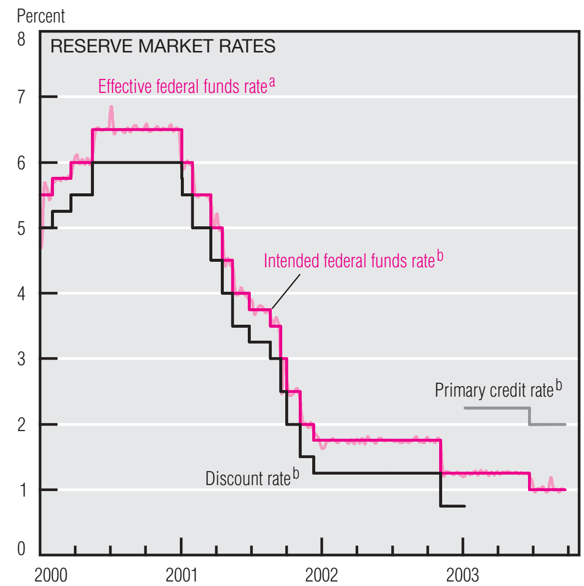
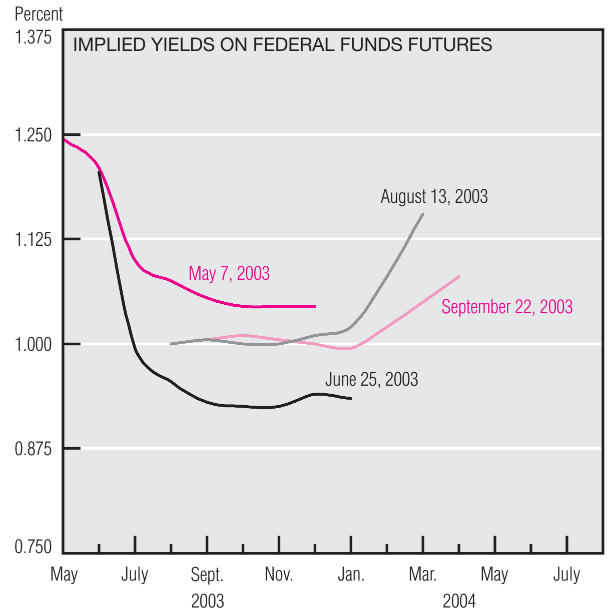
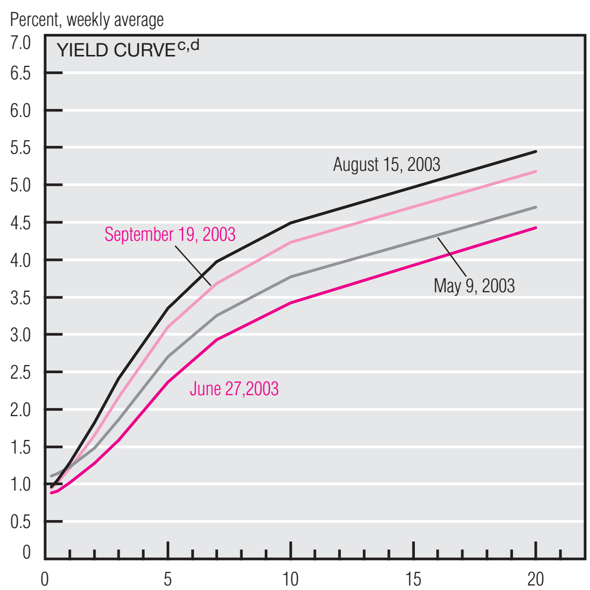
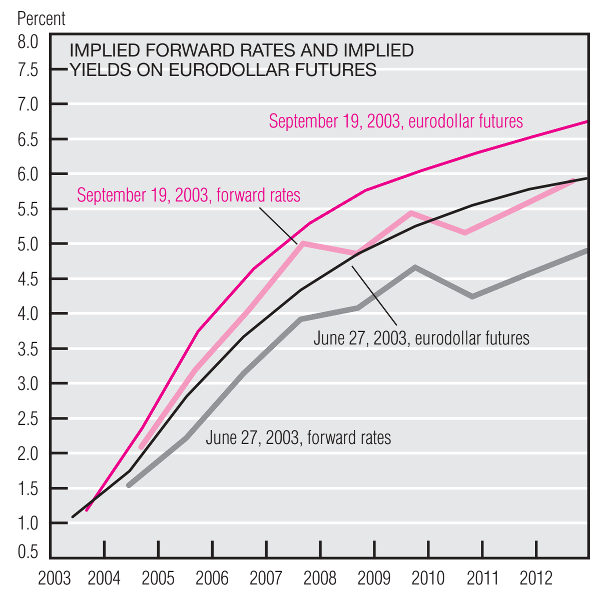
Money and Financial Markets









a. Weekly average of daily figures.
b. Daily observations.
c. All yields are from constant-maturity series.
d. Average for the week ending on the date shown.
SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases* H.15; and Bloomberg Financial Information Services.

At its September 16 meeting, the Federal Open Market Committee (FOMC) did not change either the federal funds rate target (1%) or the primary credit rate (2%). At its August and September meetings, the FOMC affirmed that "the accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity." Furthermore, it "believes that policy accommodation can be maintained for a considerable period."

Considering these statements, it is understandable that no future policy actions seem imminent. Virtually none of the participants in federal funds futures markets expect a rate hike this year, although a few are starting to bet that the FOMC might start hiking rates sometime in the first half of next year.

An important determinant of future interest rates is what funds rate the market expects will prevail in the future. This expectation may be measured by forward rates, which are calculated from the yield curve on U.S. government bonds or by the yield on eurodollar futures. These measures are very similar, but rates based on eurodollar futures are higher than forward rates calculated from government bonds. The extra risk present in eurodollar futures suggests that implied forward rates are better at gauging future policy actions. Although this measure is likely to be an overestimate, it suggests that the funds rate may be hiked 100 basis points by the end of 2004 and perhaps 250 basis points by the end of 2005.