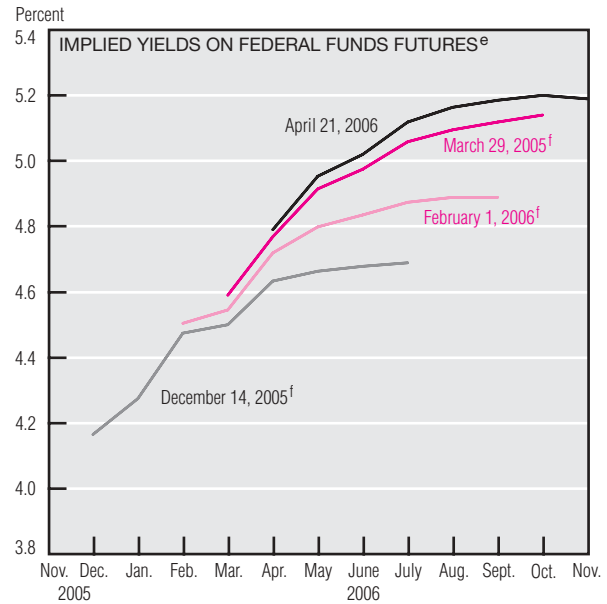
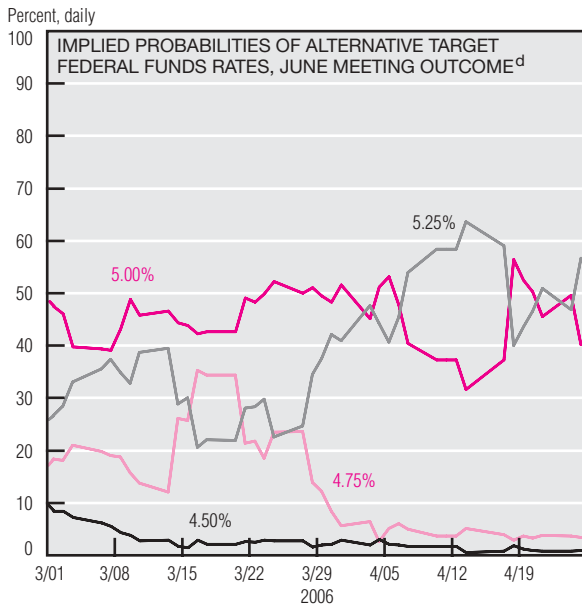
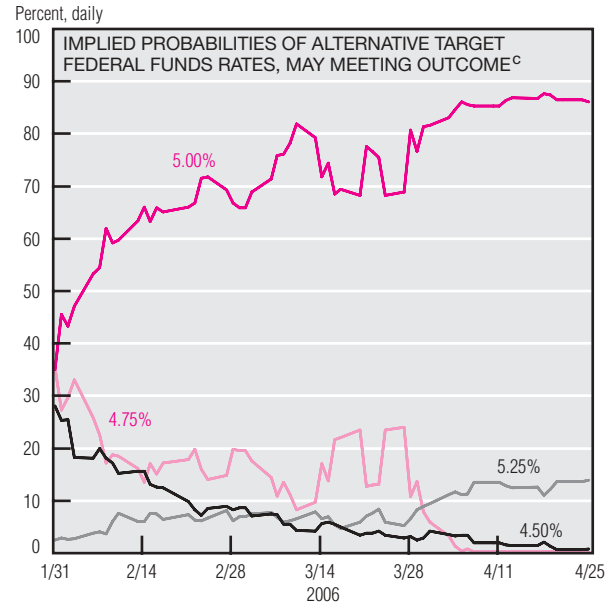
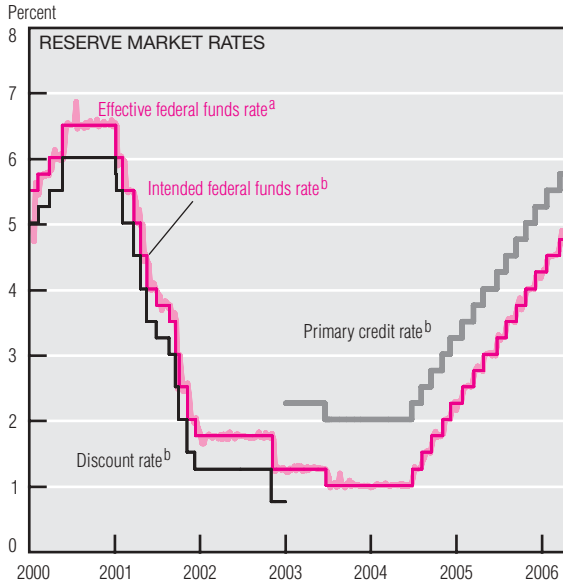


# Monetary Policy



a. Weekly average of daily figures.

b. Daily observations.

c. Probabilities are calculated using trading-day closing prices from options on May 2005 federal funds futures that trade on the Chicago Board of Trade.

d. Probabilities are calculated using trading-day closing prices from options on June 2005 federal funds futures that trade on the Chicago Board of Trade.

e. All yields are from constant-maturity series

f. One day after the FOMC meeting.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; Chicago Board of Trade; and Bloomberg Financial Information Services.

Since the Federal Open Market Committee (FOMC) increased the intended federal funds rate to 4.75% on March 28, 2006, market participants' views on the expected course of policy have shifted markedly in response to incoming economic reports and Federal Reserve officials' speeches.

In the days before the March meeting, participants in the federal funds options market placed about a 25% probability on a pause in policy tightening at the May and June meetings. But they quickly changed those views

in response to the March press release, which stated that growth appears to have "rebounded strongly" in the first quarter of 2006; it also made a reference to "inflation pressures." The statement preceded a marked reduction in probabilities of tightening.

Since March 28, the probability associated with a further funds rate increase of 25 basis points (bp) at the May meeting has steadily risen and is currently near 90%. However, views on the likelihood of a pause at the June meeting have bounced around considerably.

On April 18, the release of the FOMC's March meeting minutes and a speech by Federal Reserve Bank of San Francisco president Janet Yellen preceded a dive in the probability of a further rate increase in June. Both the minutes and President Yellen's speech indicated that further rate hikes might not be necessary, depending on upcoming data. But the next day brought news of an increase in core CPI inflation, beginning a reversal of the previous day's impact on expectations.