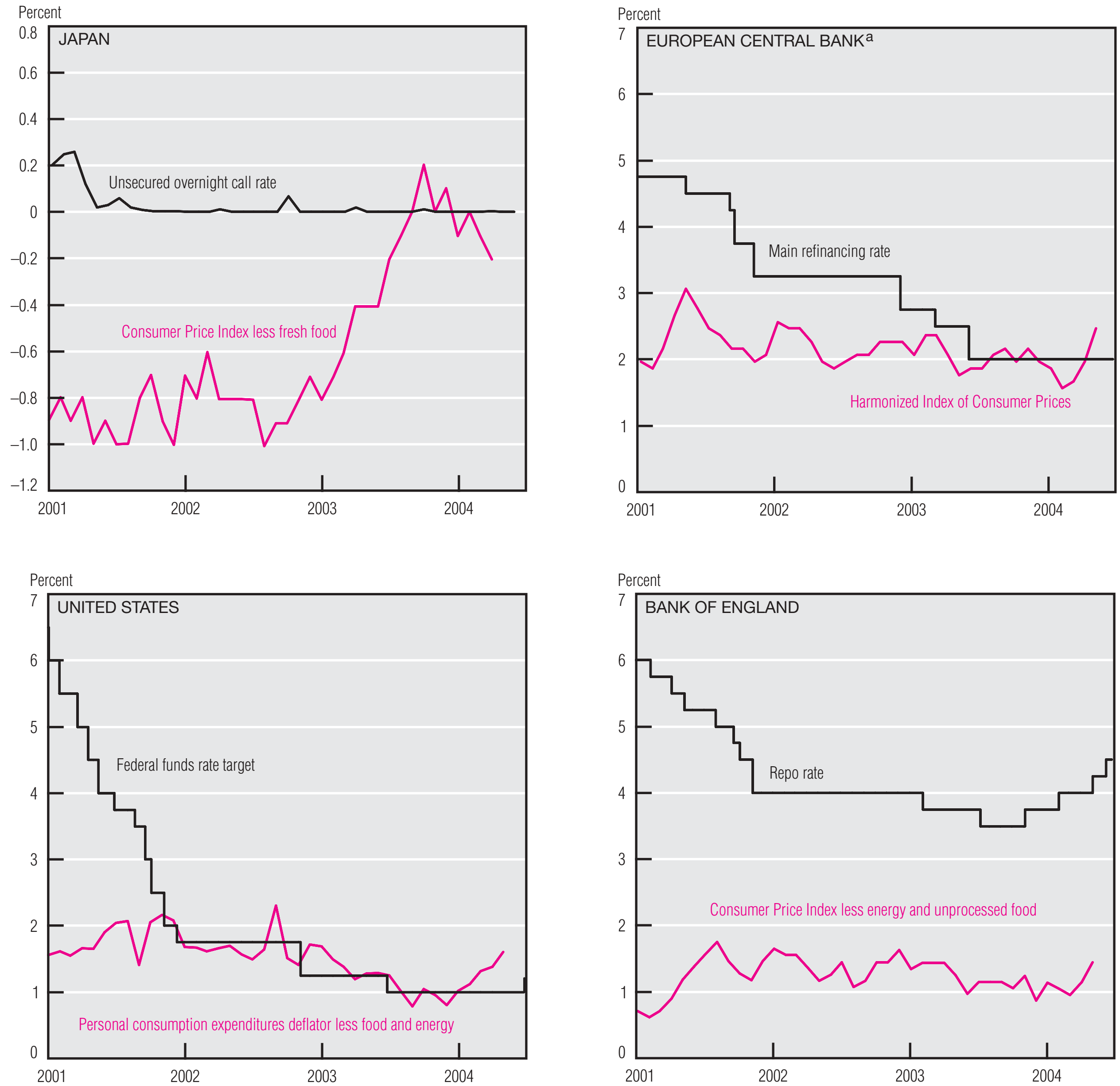
Foreign Central Banks



a. The ECB changed its main refinancing rate from a two-week to a one-week maturity, beginning March 9, 2004.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; Bank of Japan; European Central Bank; and Bank of England.

Central banks continue to be viewed in the context of a presumed global economic recovery—led partly by China's strong growth—and of upward price pressures, some created directly or indirectly by petroleum markets. Measured inflation rates faced by three of the four major central banks have moved up noticeably in recent months. Japan is the exception, although its deflation has become less severe since 2002. Coupled with strong output growth, this has turned public attention to the Bank of Japan's possible exit policy for removing the enormous volume of excess reserves created by quantitative easing with a zero interest rate. The actual deflation rate, however, is unchanged from July of last year and the Bank continues to expect mild deflation.

Analysts long thought it was only a matter of time before the European Central Bank (ECB) announced another cut in its policy rate. Increasingly, however, stronger growth plus rising inflation (traceable partly to higher petroleum prices because the ECB does not target a core measure of inflation) have brought more balanced expectations.

In the U.S., more assured real growth and a rapid increase in the FOMC's preferred core inflation measure created almost unanimous expectations of the 25 basis point increase in its federal funds rate target announced on June 30.

The Bank of England has raised its policy rate target as well—by a full percentage point since October of last year. Its Monetary Policy Committee called the 25 basis point increase announced at its June meeting a "response to [a] more robust outlook."