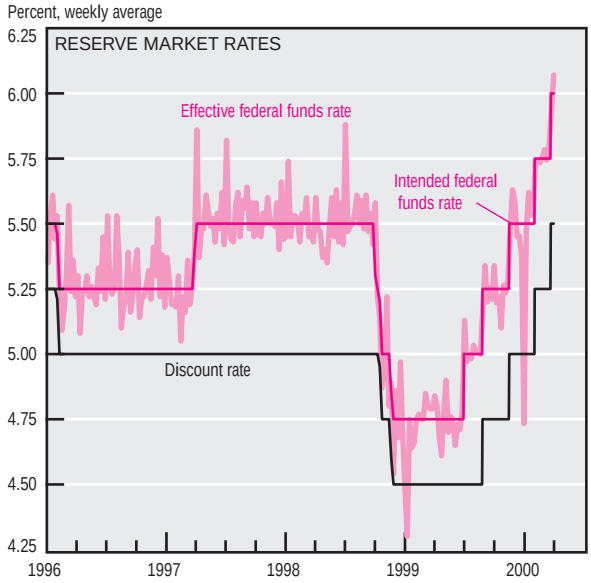
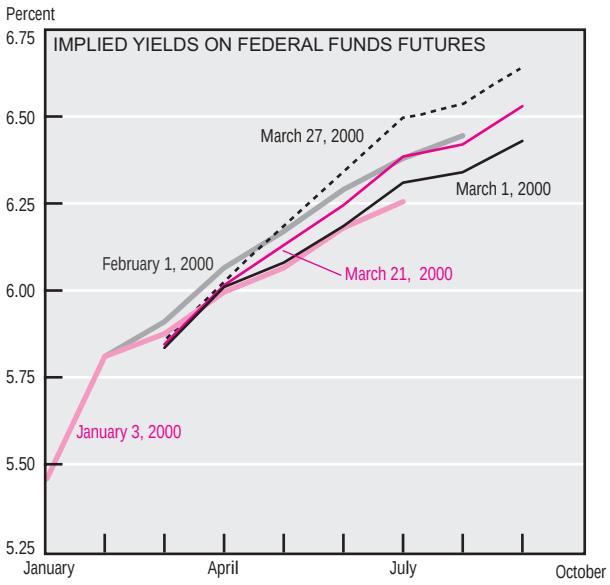
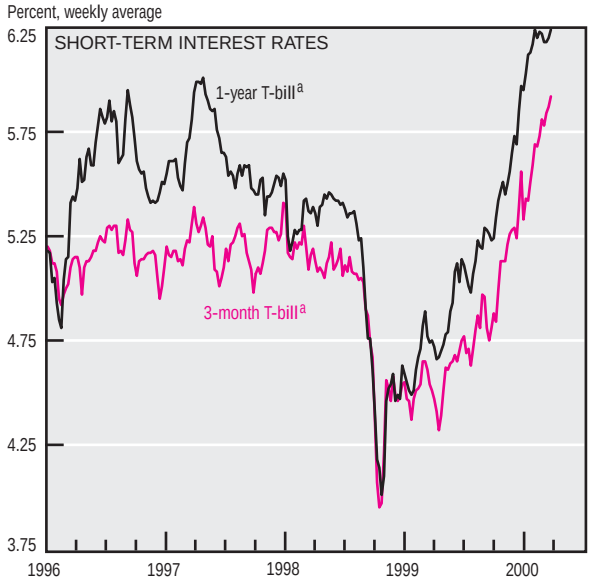
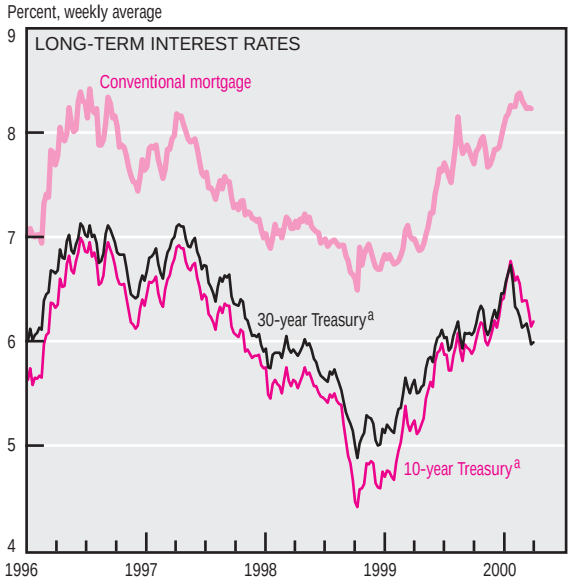
Monetary Policy









a. Constant maturity.
SOURCES: Board of Governors of the Federal Reserve System; and Chicago Board of Trade.

At its March 21 meeting, the Federal Open Market Committee raised the federal funds rate target 25 basis points (bp) to 6.0%. This was the second consecutive meeting to result in a 25 bp increase, and the fifth such increase since last June. The FOMC's press release described conditions as "essentially the same as when the Committee met in February," but it continued to stress that without further policy action, "increases in demand will continue to exceed the growth in potential supply, which could foster inflationary imbalances that would undermine the economy's record economic expansion." Separately, the Board of Governors approved recommendations by the Reserve Banks' boards of directors to raise the discount rate 25 bp.

Implied yields on federal funds futures, an oft-cited indicator of the expected future path of policy, continue to show that market participants assign a high probability to tightening at the May and June meetings. Under simplifying assumptions, if all market participants knew with certainty that the intended federal funds rate would increase 25 basis points at the May 16 meeting, then that contract would trade 12½ bp above the current intended rate. (The quoted implied yield is an average of contracts during the month; thus, 11 days at 6.0% and 11 days at 6.25% yields 6.13%.) Indeed, on March 21, the May contract traded at 6.13%. As of March 27, the May contract had risen to 6.19%, implying an expected increase of 37 bp or

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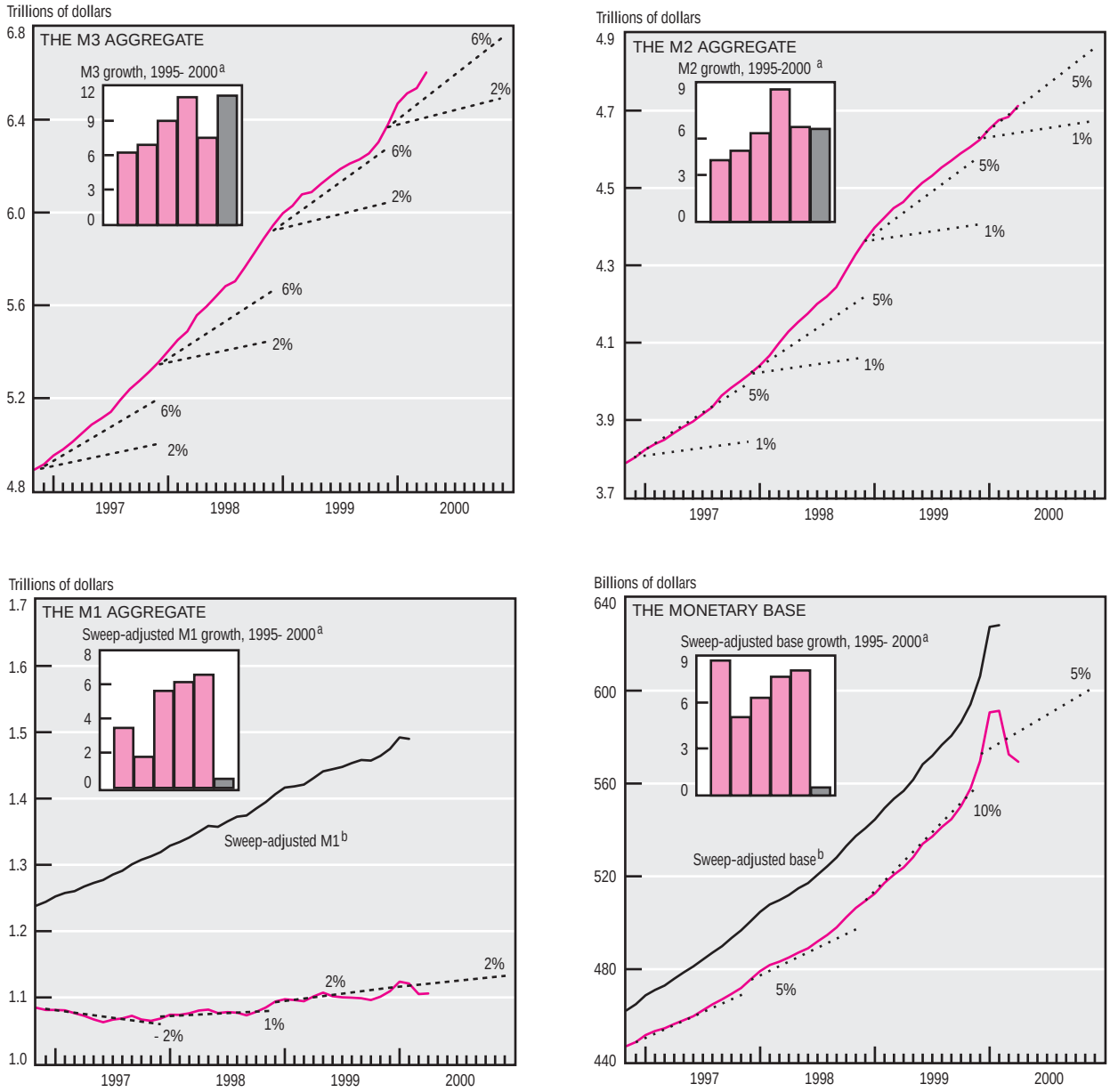
Monetary Policy (cont.)



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. The 1999 growth rates for M2 and M3 are calculated on an estimated March over 1999:IVQ basis. The 1999 growth rates for sweep-adjusted M1 and the monetary base are calculated on a February over 1999:IVQ basis.
b. Sweep-adjusted M1 contains an estimate of balances temporarily moved from M1 to non-M1 accounts. The sweep-adjusted base contains an estimate of required reserves saved when balances are shifted from reservable to nonreservable accounts.
NOTE: Data are seasonally adjusted. Last plots for M1, M2, M3, and the monetary base are estimated for March 2000. Last plot for sweep-adjusted M1 and base is February 1999. Dotted lines for M2 and M3 are FOMC-determined provisional ranges. All other lines represent growth in levels and are for reference only.
SOURCE: Board of Governors of the Federal Reserve System.

(perhaps more realistically) a roughly equal probability of either a 25 or a 50 bp increase.

Turning to interest rates, the 3-month Treasury bill continues its headlong climb, up 59 bp to 5.92% in the first three months of 2000. The 1-year Treasury bill rate posted a more modest gain, up 29 bp on the year to 6.24%. In stark contrast, long-term rates have reversed direction. The 30-year Treasury bond yield has fallen 47 bp to 5.99%, almost as much as the 3-month Treasury bill has risen. A similar relationship exists between the 10-year Treasury bond yield (which has dropped 22 bp to 6.19%) and the 1-year Treasury rate. These opposite movements in long- and short-term rates have led to an unusual situation, termed an inverted yield curve, in which long-term rates are lower than many short-term rates.

The M2 and M3 monetary aggregates continue to display strong growth relative to the provisional ranges established by the FOMC. Annualized M2 growth is slightly weaker (5.9%) than at the same time last year (6.9%), but it remains above the upper limit of the provisional range. Annualized M3 growth is considerably stronger than last year (11.1% versus 7.3%). It is difficult to assess the residual effects of Y2K preparations on the broader monetary aggregates, but narrow measures of money such as M1 and the monetary base continue to contract as excess liquidity drains from the system.