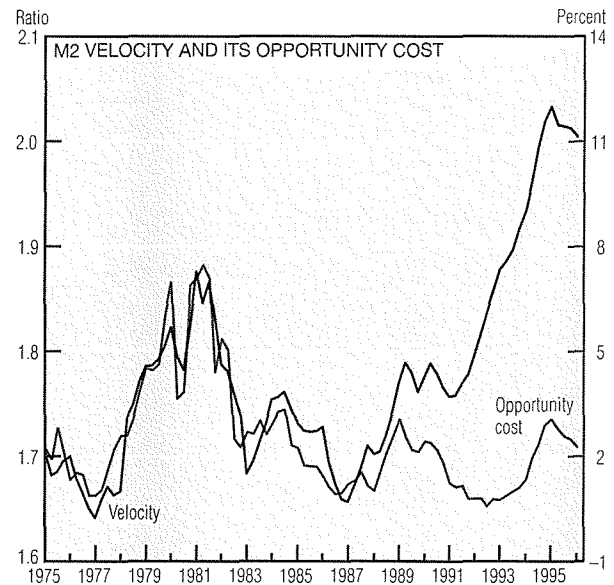
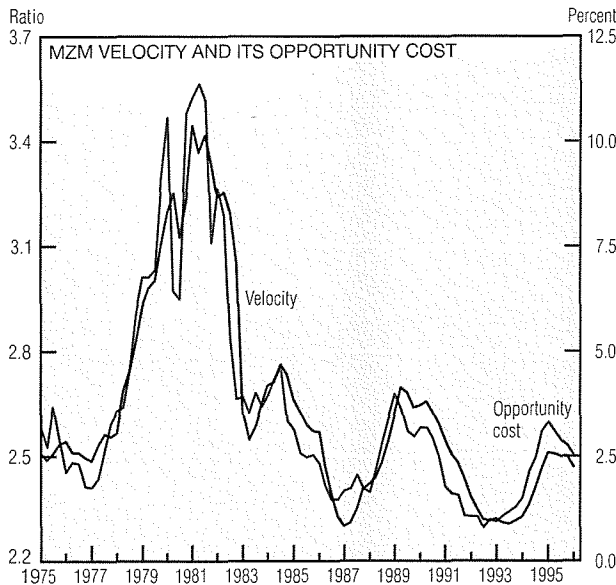
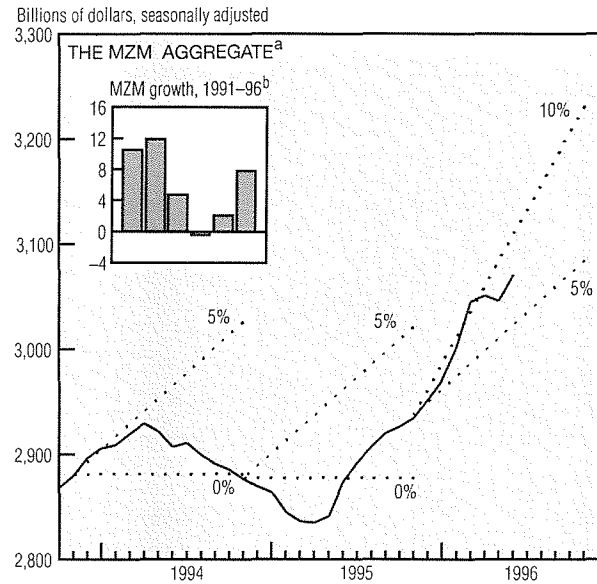


An Alternative Measure of Money

Measures of Money	
M1	= Currency
	+ Demand deposits
	+ Other checkable deposits
	+ Traveler's checks
M2	= M1
	+ Savings deposits
	+ Small time deposits
	+ Retail MMMFs
MZM	= M2
	+ Institutional MMMFs
	- Small time deposits



a. Last plot is estimated for June 1996. Dotted lines represent growth ranges and are for reference only.
 b. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1996 is calculated on an estimated June over 1995:IVQ basis.
 SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

In recent years, deregulation and financial innovation have wreaked havoc on relationships between traditionally defined measures of money—M1 and M2—and economic activity and interest rates. When these relationships break down, analysts often propose new monetary aggregates. One such measure, MZM, comprises all monetary instruments that have zero maturity and hence are redeemable at par on demand. Included are M1, savings deposits, and all money market mutual funds (MMMFs).

MZM's immunity to recent deregulation and financial innovation is evident in the relationship between MZM velocity (the ratio of nominal GDP to MZM) and its opportunity cost (defined here as the difference between the 3-month Treasury yield and the share-weighted average of yields paid on MZM components). While essentially trendless since 1974, MZM velocity varies systematically with its opportunity cost. It is estimated that a one-percentage-point increase in its opportunity cost eventually lowers the level of MZM demanded by more

than four percentage points.

In contrast, the relationship between M2 velocity and its opportunity cost broke down in the 1990s, when M2 velocity persistently rose in the face of falling opportunity cost. This distortion is believed to be a consequence of the proliferation of bond and equity mutual funds, which grew largely at the expense of small time deposits. Because MZM does not include small time deposits, it was not affected by the widespread substitution of bond and equity funds for bank deposits.