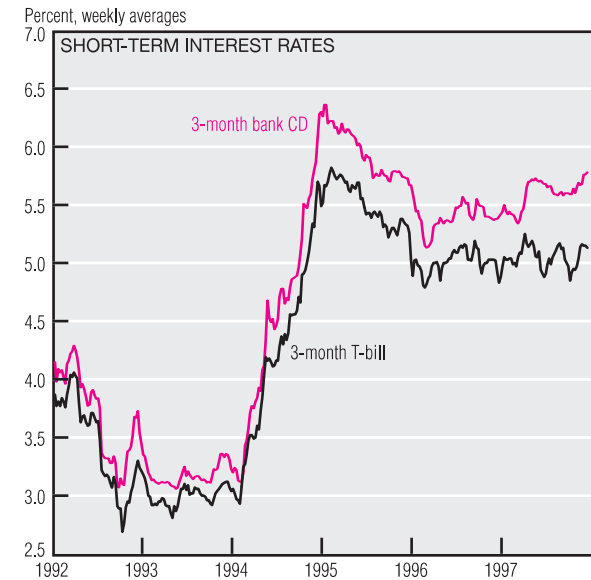
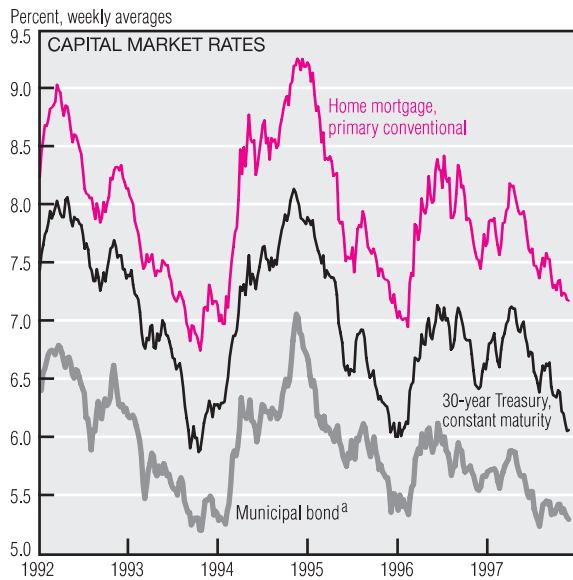
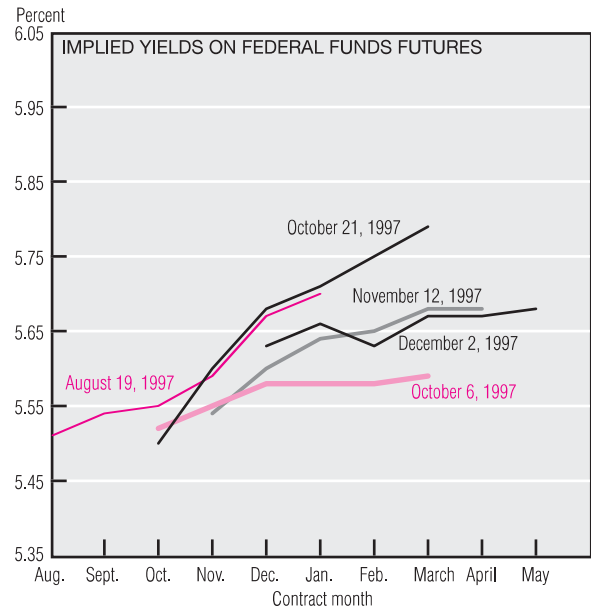
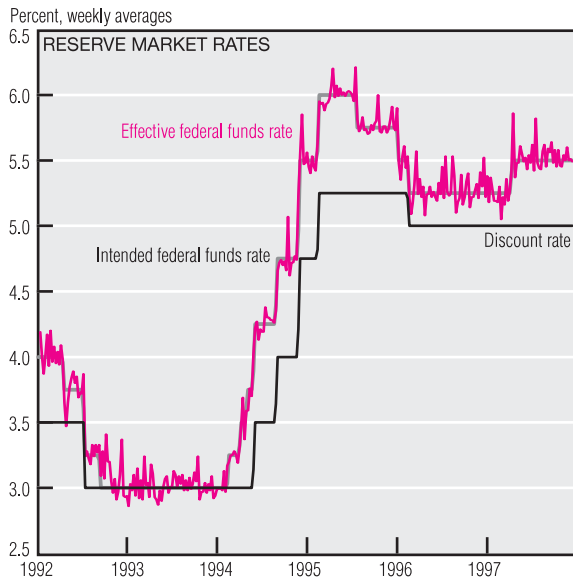


Monetary Policy



a. Bond Buyer Index, general obligation, 20 years to maturity, mixed quality.
SOURCES: Board of Governors of the Federal Reserve System; and the Chicago Board of Trade.

At its November 12 meeting, the Federal Open Market Committee (FOMC) left the federal funds rate target unchanged at 5.5%. The decision was widely anticipated by financial markets because of the sell-off in U.S. equity markets. The FOMC has maintained the 5.5% target at each of its last five meetings.

Implied yields on federal funds futures have been flattening over the last couple of months. The expectations of a rate increase that existed in mid-October have diminished substantially. One possible reason for this change is market participants'

belief that recent stock market events and economic turmoil abroad have made a rate increase less likely. The fact that the implied yields remain consistently above the current federal funds rate indicates that participants still believe that the rate is more likely to increase than to decrease.

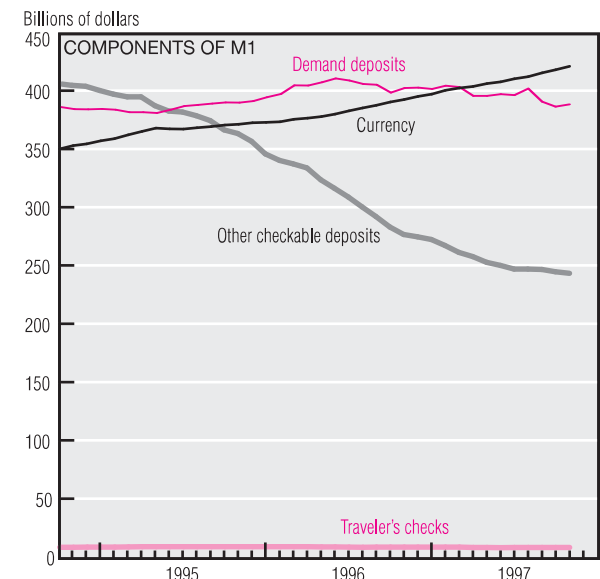
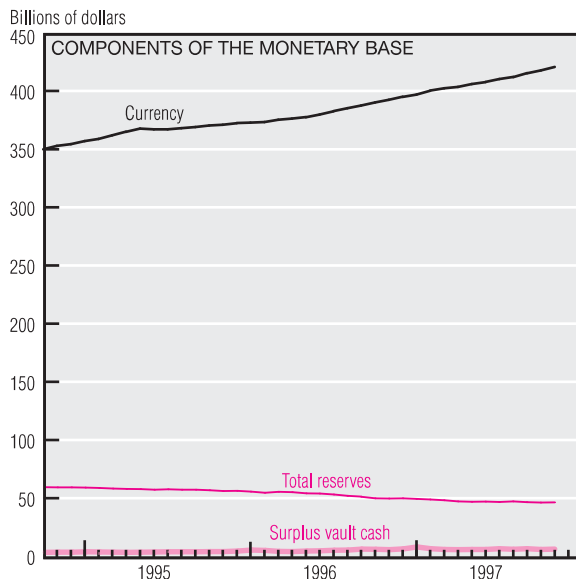
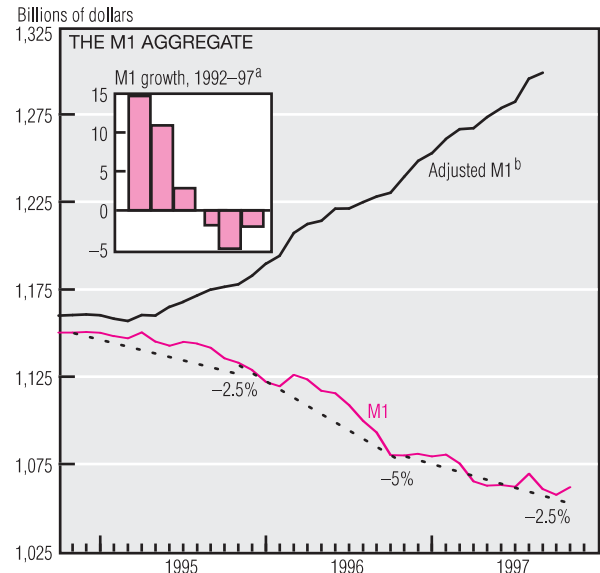
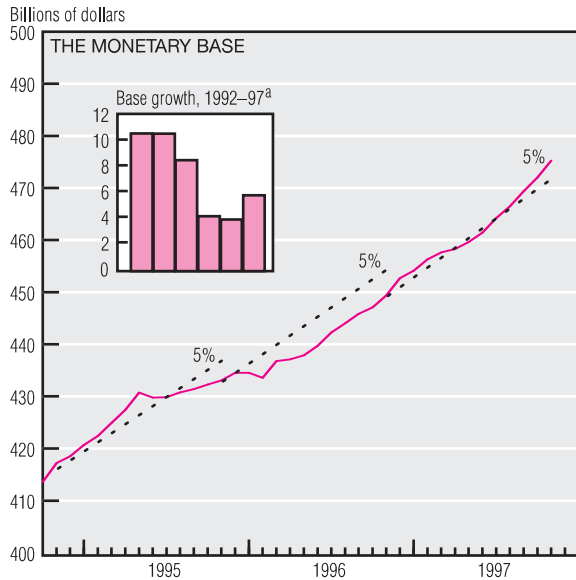
Long-term interest rates have been falling fairly steadily since April. Conventional home mortgage rates have dropped a full percentage point, reaching an average of 7.17% for the week ending November 28. Over the same period, the 30-year Treasury yield fell 106 basis points

to 6.06%, and municipal bond yields dropped 59 basis points to 5.29%.

In contrast, short-term interest rates have increased slightly since late September. As of the week ending November 28, the three-month T-bill rate had risen 28 basis points to 5.13%, and CD rates had risen 19 basis points to 5.78%.

The ultimate goal of monetary policy is to raise the standard of living for all U.S. citizens by maintaining a stable currency. To meet this goal, the Federal Reserve alters liquidity in financial markets, primarily
(continued on next page)

Monetary Policy (cont.)



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1997 is calculated on an estimated November over 1996:IVQ basis.
b. Adjusted for sweep accounts.
NOTE: All data are seasonally adjusted. Last plot is estimated for November 1997. Dotted lines represent growth rates and are for reference only.
SOURCE: Board of Governors of the Federal Reserve System.

through open-market sales or purchases of Treasury securities. Before taking any action, the Fed considers an array of economic and financial indicators, including the monetary aggregates, which provide a measure of the amount of liquidity in the economy and an insight into the current stance of policy.

Unfortunately, no one definition of money can completely characterize either liquidity or policy, so the Fed tracks several alternative definitions, which differ in the types of assets they include.

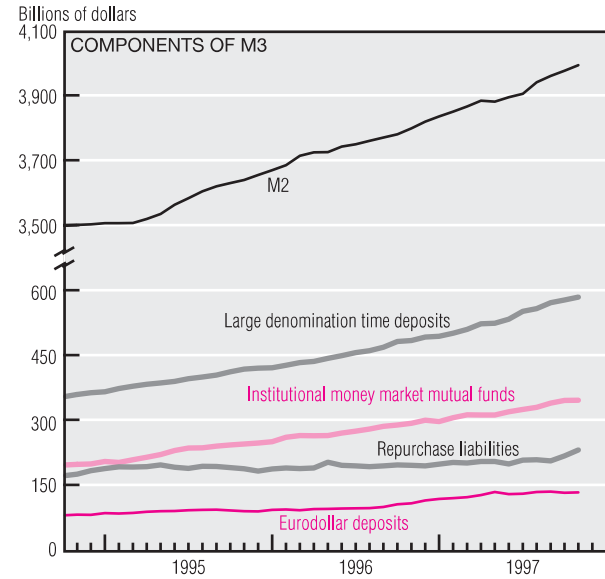
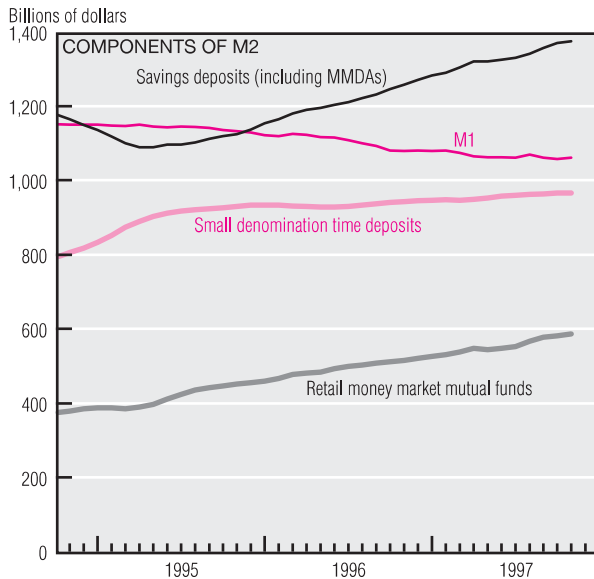
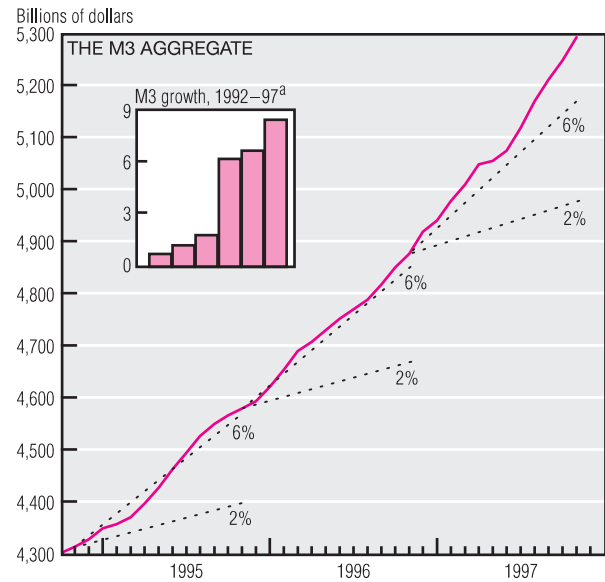
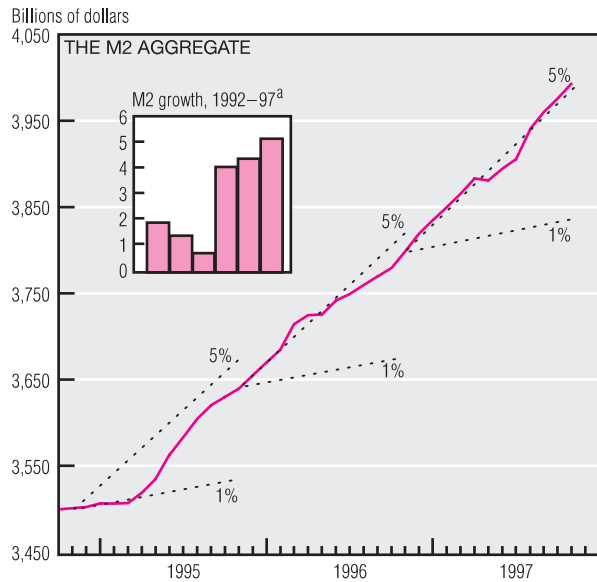
The monetary base, a narrow measure of money, consists of currency in the hands of the public, total reserves, and vault cash not used to satisfy reserve requirements. Growth in the monetary base has been about 5.7% year to date. The currency component, which now makes up almost 90% of the total, has accounted for expansions in base money over this period and for the past several years. However, since as much as two-thirds of the U.S. currency in circulation is held

abroad, this growth may not reflect an increase in the currency available to the domestic financial system.

A decline in total reserves in recent years has partly offset the increase in currency. The drop-off may be traced to the proliferation of sweep accounts, which allow banks to economize on reserves by "sweeping" funds from accounts that are reservable into money market deposit accounts (MMDAs), which are not.

(continued on next page)

Monetary Policy (cont.)



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1997 is calculated on an estimated November over 1996:IVQ basis.
NOTE: All data are seasonally adjusted. Last plot is estimated for November 1997. Dotted lines are FOMC-determined provisional ranges.
SOURCE: Board of Governors of the Federal Reserve System.

The M1 aggregate, a slightly broader definition of money, includes currency, demand deposits, other checkable deposits (OCDs), and traveler's checks. Since 1996:IVQ, M1 has fallen at a 1.7% annual rate. The drop-off largely reflects the continued dramatic decline in OCDs, which consist of negotiable order of withdrawal (NOW) accounts, automatic transfer service accounts, credit union share draft accounts, and demand deposits at thrift institutions. Demand deposits have also fallen somewhat over this period. Like the shrinkage in total reserves, the de-

cline in OCDs and demand deposits is commonly attributed to the use of sweep accounts. As of the end of October, M1 adjusted for sweep activity has grown roughly 5.8%.

The M2 aggregate expands upon the M1 definition of money by adding savings deposits (including MMDAs), small time deposits, and retail money market mutual funds. M2 is currently growing at about 5.1% year to date. Because M2 includes MMDAs, it is not prone to distortions from sweep account activity. Growth in savings deposits and retail money funds have ac-

counted for most of the growth in M2 over the last few years.

The M3 aggregate, the broadest measure of money discussed here, equals M2 plus several smaller components. M2 currently makes up roughly 75% of M3. Growth in M3 has been about 8.4% this year, substantially higher than the 5.1% pace of M2. The larger growth in M3 reflects relatively fast growth in the smaller (non-M2) components, notably large denomination time deposits and institutional money market mutual funds.