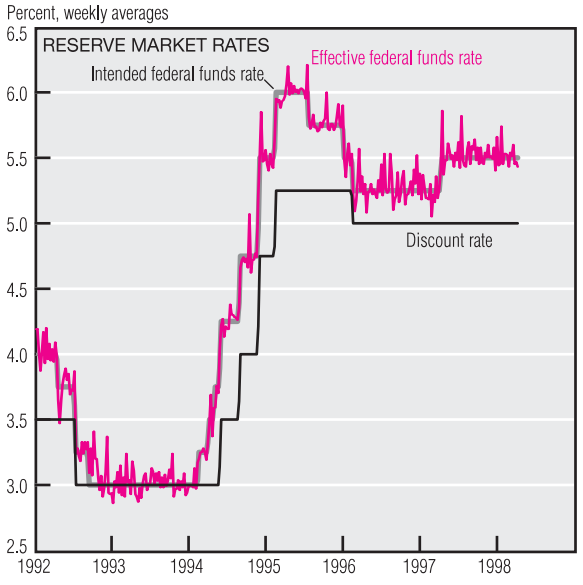
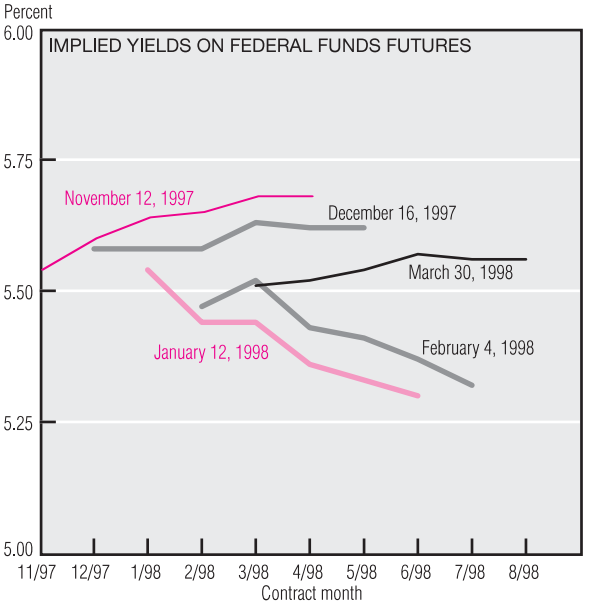
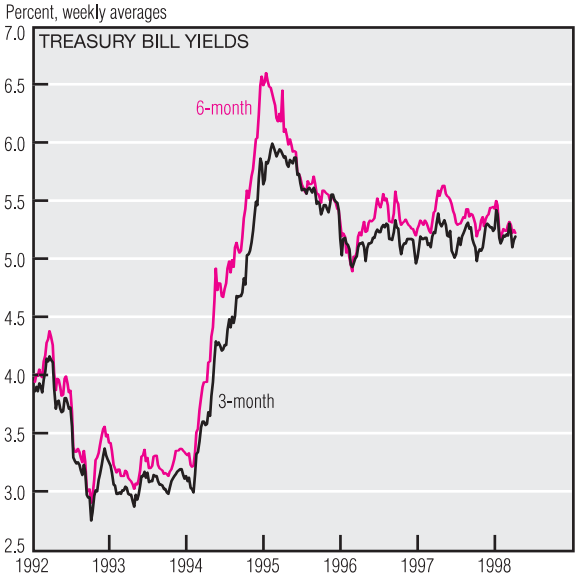
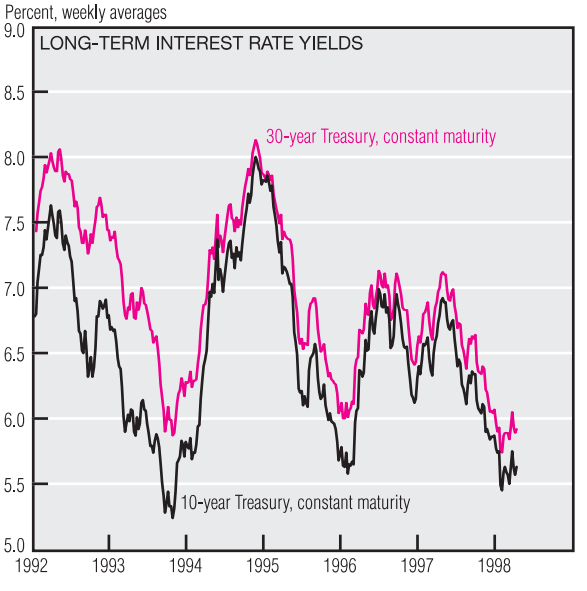
Monetary Policy









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

The past two years have been characterized by relatively stable interest rates. At its March 31 meeting, the Federal Open Market Committee (FOMC) left the federal funds rate target unchanged, a decision that was widely anticipated in financial markets. That meeting marked the one-year anniversary of the latest rate change, a 25-basis-point increase to 5.5% on March 25, 1997. The discount rate has stayed the same over an even longer period, its last move being a decrease of 25 basis points to 5% in February 1996. The FOMC will reconvene on May 19.

The implied yields on federal funds futures are fairly constant over the next several months, increasing only slightly. Fed funds futures allow market participants to hedge against or speculate on future changes in the federal funds rate. Implied yields show where market participants expect the federal funds rate to be in the coming months. The yields' downward slope in January and February signaled participants' belief that the rate was more likely to decrease than to increase. As of March 30, this expectation was replaced by a more symmetric belief that rates are about equally likely to increase or decrease, with an increase slightly more probable.

Short-term interest rates have fluctuated within a fairly narrow range since the beginning of 1996. The weekly average yield on 3-month Treasury bills traded in the secondary market has fluctuated by only 50 basis points (between 4.93% and 5.42%) over this period, and stood at 5.19% for the week ended March 27. This differs starkly from the experience of 1994, when 3-month Treasury bill yields increased from 2.99% to 5.86% in just a year.

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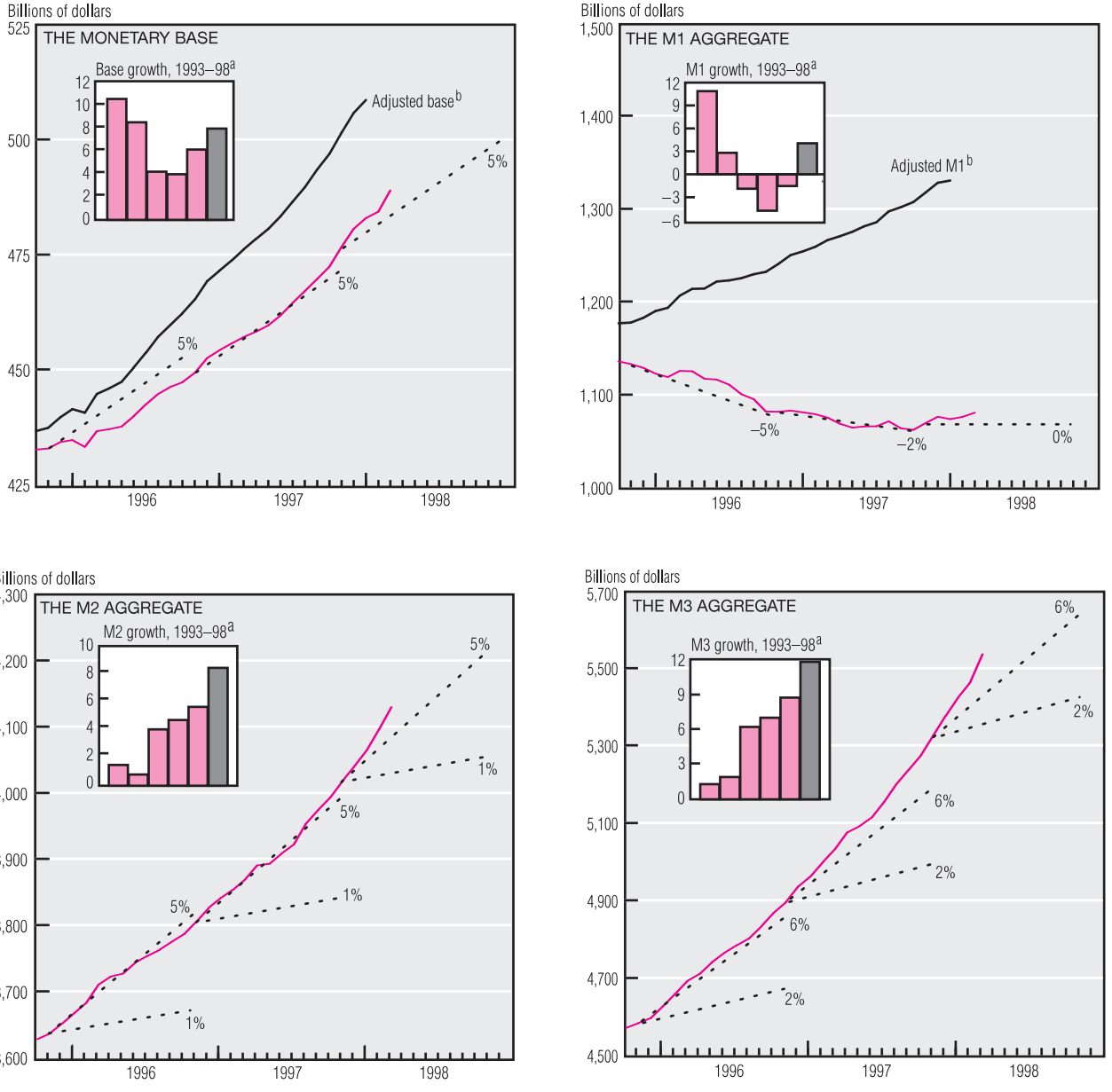
Monetary Policy (cont.)



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1998 is calculated on an estimated March over 1997:IVQ basis.
b. Adjusted for sweep accounts.
NOTE: All data are seasonally adjusted. Last plot is estimated for March 1998. For M2 and M3, dotted lines are FOMC-determined provisional ranges. For M1 and the monetary base, dotted lines represent growth rates and are for reference only.
SOURCE: Board of Governors of the Federal Reserve System.

Long-term interest rates have likewise varied over a relatively limited range. The weekly average yield on the 30-year Treasury constant-maturity rose from 6.00% at the beginning of 1996 to 7.13% in the middle of that year, but has since sunk back below 6.00%. As of the week ended March 27, the 30-year yield stood at 5.92%. In contrast, the 30-year yield increased from 6.24% to 8.13% in 1994, and fell again to 6.00% by the end of 1995.

The growth rates of the monetary aggregates accelerated in 1998:IQ, leaving M2 and M3 substantially above the provisional ranges set by the FOMC. These aggregates' relatively rapid growth has caught the attention of some policymakers, because sustained money growth may herald an inflation rate increase.

The monetary base rose an estimated 11.5% in March, and has expanded 7.8% since 1997:IVQ. Adjusted for sweep accounts, which banks use to "sweep" money from reservable to nonreservable accounts, the base increased 8.7% from 1997:IVQ through January (estimates of sweep activity are lagged one to two months). Growth through March in the adjusted base will be at least as large as in the nonadjusted base.

The M2 and M3 aggregates, which are unaffected by sweep activity, increased substantially in early 1998. M2 rose an estimated 9.8% in March, and about 8.4% from its 1997:IVQ level, while M3 increased roughly 16.0% in March and about 11.8% since 1997:IVQ. These growth rates are well above the ranges set by the FOMC.