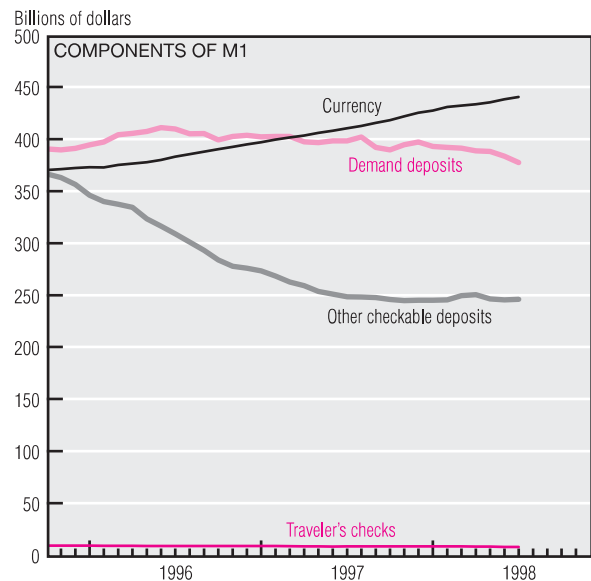
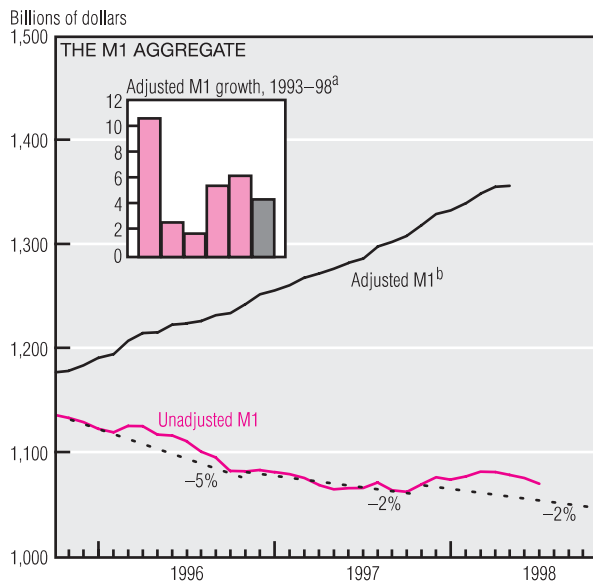
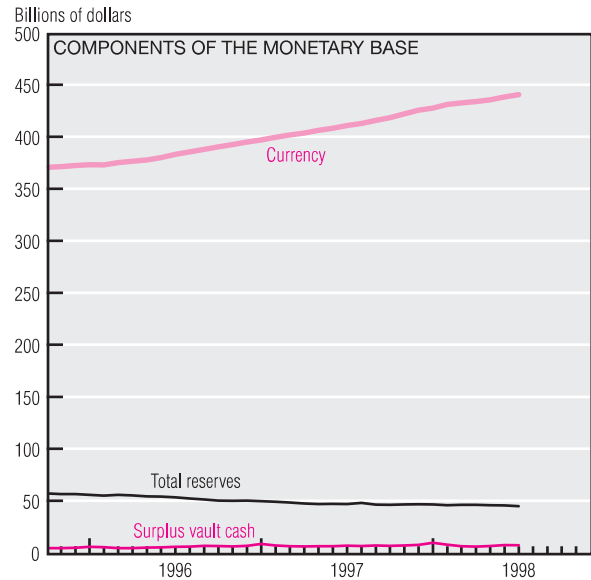
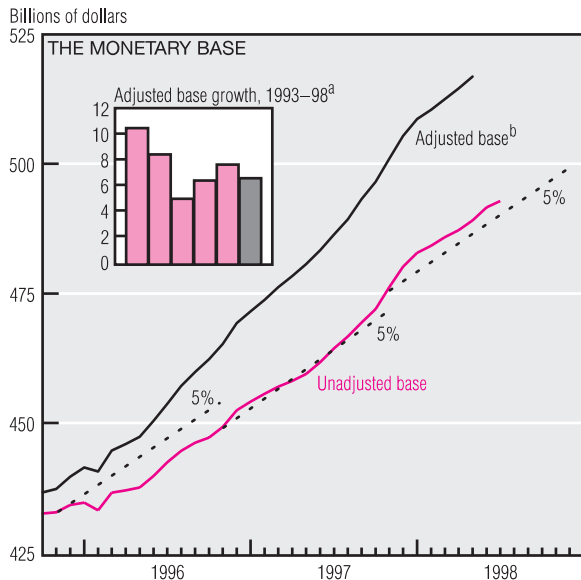


Monetary Policy



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1998 is calculated on an April over 1997:IVQ basis.

b. Adjusted for sweep accounts.

NOTE: Data are seasonally adjusted. Last plots for unadjusted base and M1 are estimated for July 1998. Dotted lines are FOMC-determined provisional growth levels.

SOURCE: Board of Governors of the Federal Reserve System.

The monetary base, including reserves and currency held by the public, grew at an annualized rate of about 4.3% in June and about 5.3% since the beginning of the year. The sweep-adjusted monetary base, however, went up 6.3% between April and May (the most recent data). All three of these increases can be attributed to currency, which has grown at a 6.6% annualized rate so far this year.

In June, M1 fell at an annualized rate of 3.7%. Its year-to-date growth, however, is slightly positive at just

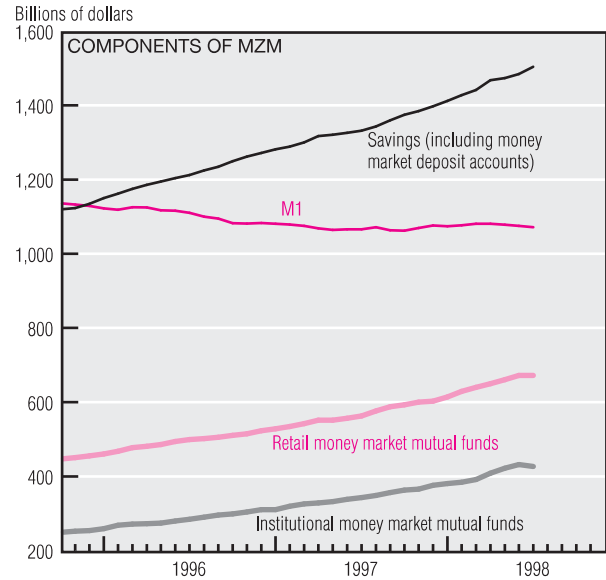
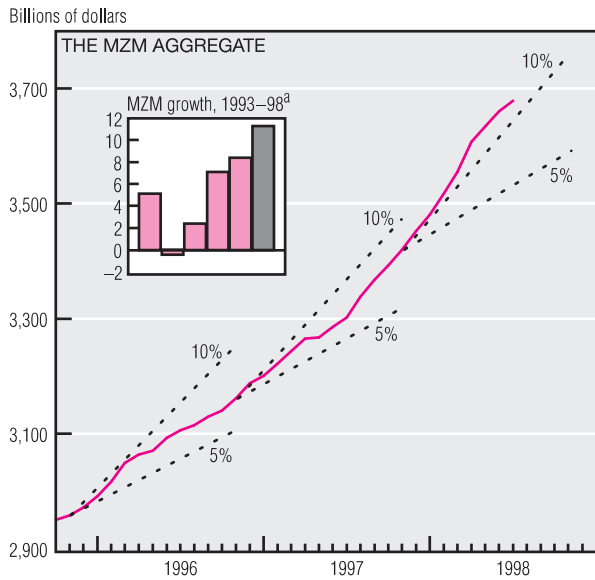
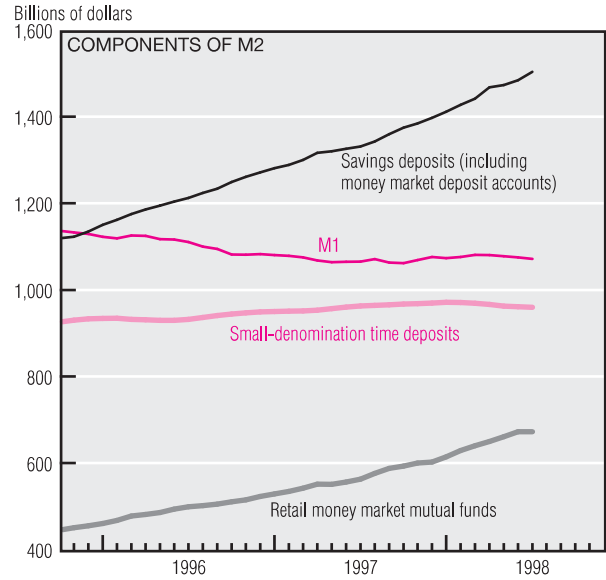
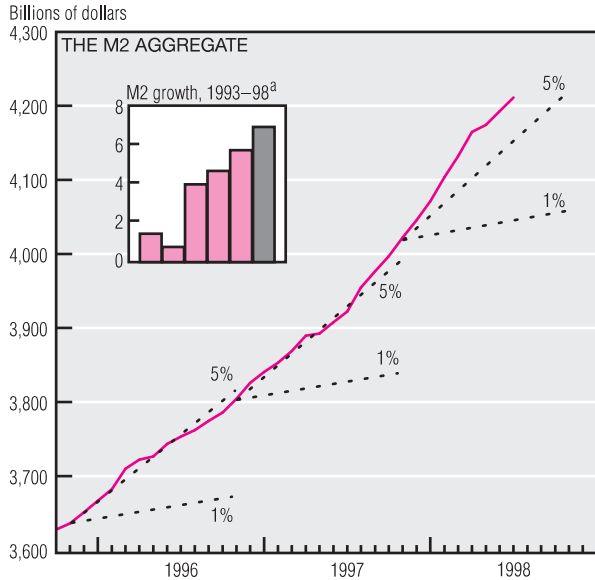
under 0.4%. The major factor mitigating M1 growth is demand deposits, which have fallen at a 6.2% annualized rate. Without demand deposits, M1 would have had an annualized growth rate of 4.2% since January. Adjusted for sweep accounts, its year-to-date annualized growth rate approached 5.7%.

For July, the annualized growth rate of M2 was nearly 4.4%. This may be welcome news to some, given M2's rapid advance of 6.9% since the beginning of the year. In the Humphrey-Hawkins report pre-

sented on July 21, however, Chairman Greenspan noted that "the rapid growth of M2 and M3 over the first half of the year...was consistent with the unexpectedly strong advance in aggregate demand." For example, the actual growth rate of GDP between 1996:IVQ and 1997:IVQ was 3.8%, which exceeded output growth estimates of 3% to 3.25% for 1997 and 2% to 2.5% for 1998.

In the report given last month, Chairman Greenspan expressed the Federal Open Market Committee's *(continued on next page)*

Monetary Policy (cont.)



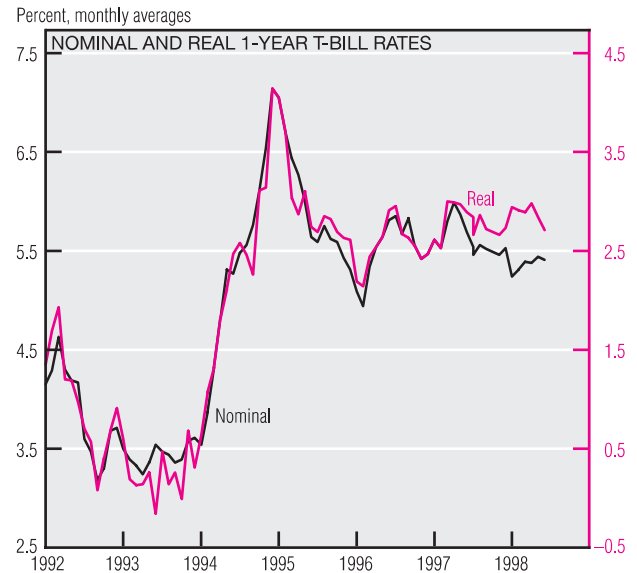
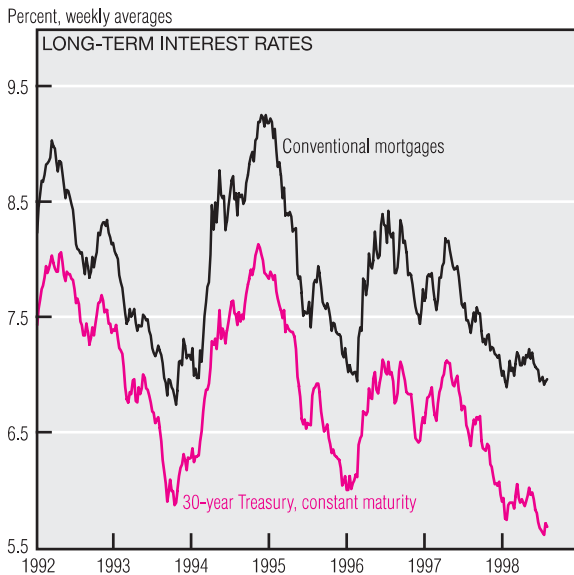
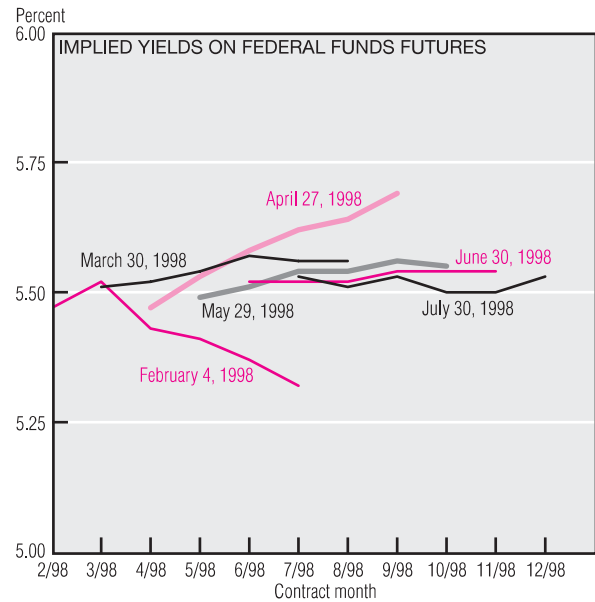
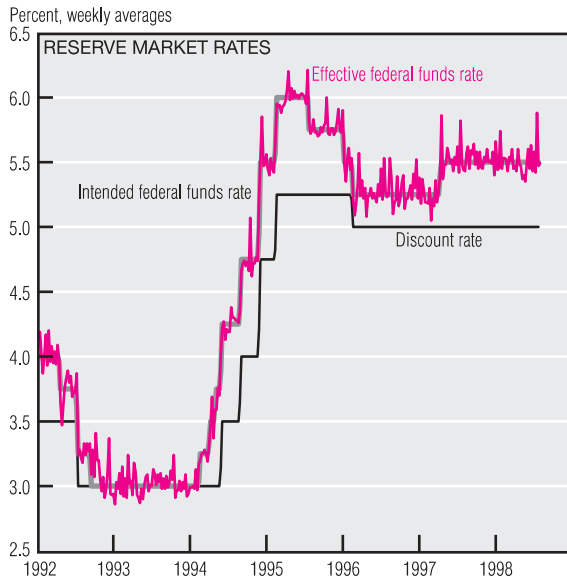
a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1998 is calculated on an estimated July over 1997:IVQ basis.
 NOTE: Data are seasonally adjusted. Last plots for M2 and MZM are estimated for July 1998. Dotted lines for M2 are FOMC-determined provisional ranges. Dotted lines for MZM represent growth ranges and are for reference only.
 SOURCE: Board of Governors of the Federal Reserve System.

intention of continuing to watch the monetary aggregates as “benchmarks for the achievement of price stability under conditions of historically normal velocity behavior.” While velocity behavior has not been stable enough to allow the FOMC to tie policy directly to monetary aggregate growth, these measures were recognized as providing “some information about trends in the economy and inflation.” Rapid growth of monetary aggregates was also cited by some members as a reason for their dissents at the May 19 FOMC

meeting. The provisional ranges for monetary aggregates’ growth, however, were left unchanged in the most recent Humphrey–Hawkins testimony. MZM is another monetary measure designed to capture money’s transactions role. MZM, which consists of “money” stocks with zero maturity, grew at an annualized rate of slightly more than 5% in June; however, its year-to-date annualized growth rate has been a dramatic 11.1%. MZM’s closest cousin is M2. MZM equals M2 less small-denomination

time deposits plus institutional money market funds. The difference in the growth rates of the two measures clearly results from the growth of institutional money market mutual funds (which have contributed over 2.5 percentage points to MZM growth) relative to small-denomination time deposits (which have cut at least 1.5 percentage points from the annualized growth of M2) since January. The effective federal funds rate continues to oscillate around the 5.5% intended rate set by the FOMC. *(continued on next page)*

Monetary Policy (cont.)



SOURCES: Board of Governors of the Federal Reserve System; and University of Michigan Survey of Consumers.

Market participants' opinion, as measured by the federal funds futures market, seems to be that there will be no change in the target rate in the near future. This has been the case since April of this year, when participants expected a rate hike that failed to materialize.

Chairman Greenspan noted that low interest rates on mortgages were contributing to households' ability "to purchase homes and to refinance outstanding debt." It is clear that long-term interest rates have been on a reasonably steady

decline since early in 1997:IIQ. There was some increase early in 1998, but the decline resumed and has continued since then. In the week ending July 31, 1998, the interest rate on constant maturity 30-year Treasury bonds averaged 5.73%, more than 70 basis points lower than the same week in 1997, and the average conventional mortgage rate was 6.97%, 46 basis points lower than the same week in 1997.

Nominal interest rates on constant maturity 1-year Treasury bills have experienced small upticks in the

past few months, after dropping throughout 1997. Real interest rates declined from nearly 3% in April to approximately 2.7% in June because inflation expectations (as measured by the University of Michigan Survey of Consumers) have increased slightly since the beginning of the year, after falling in 1997. Many view a decline in real interest rates as an implicit easing of policy, accomplished through the FOMC's inaction (a steady nominal federal funds rate) combined with rising inflation expectations.