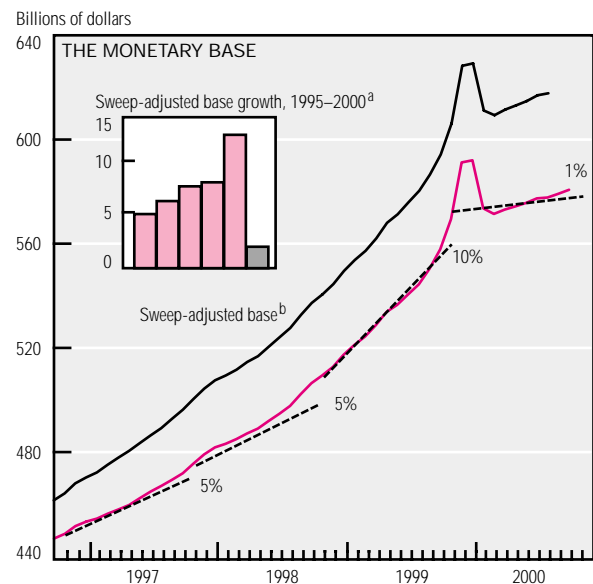
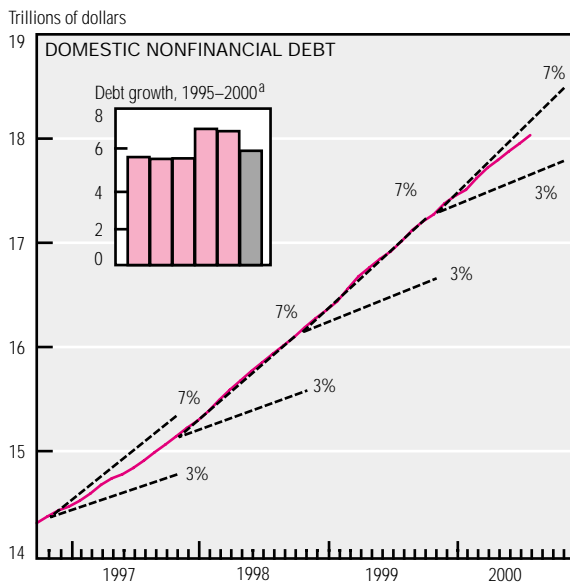
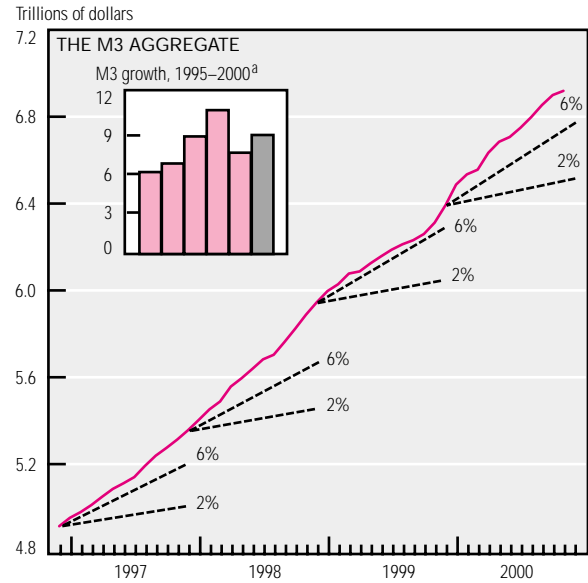
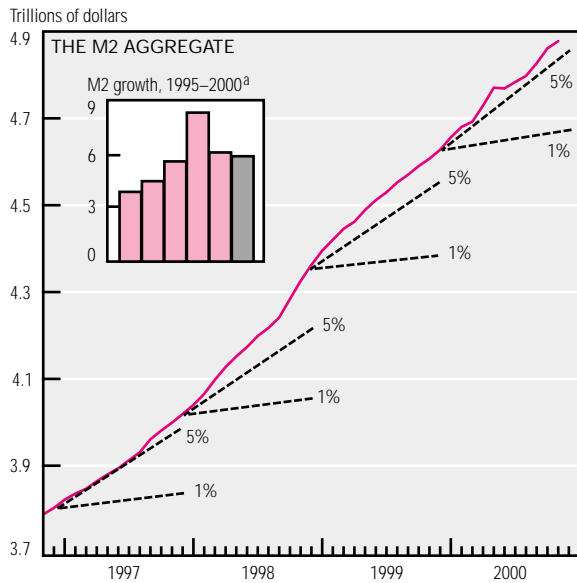


Monetary Policy



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. The 2000 growth rates for M2 and M3 are calculated on an estimated October over 1999:IVQ basis. The 2000 growth rates for debt and the sweep-adjusted base are calculated on an August over 1999:IVQ basis.

b. 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 M2, M3, and the monetary base are estimated for October 2000. Last plots for debt and the sweep-adjusted base are August 2000. Dotted lines for M2, M3, and debt are FOMC-determined provisional ranges. All other dotted lines represent growth rates and are for reference only.

SOURCE: Board of Governors of the Federal Reserve System.

Until recently, the Federal Open Market Committee (FOMC) established growth ranges for the broad monetary aggregates (M2 and M3) and domestic nonfinancial debt. For some time, these ranges have not been meaningful indicators in terms of defining specific rates consistent with the goal of price stability. Federal Reserve Chairman Alan Greenspan noted in his October 19 remarks at the Cato Institute, “We have difficulty defining those (money growth) limits

with precision, and within any such limits, there remains significant scope for discretion in setting policy.”

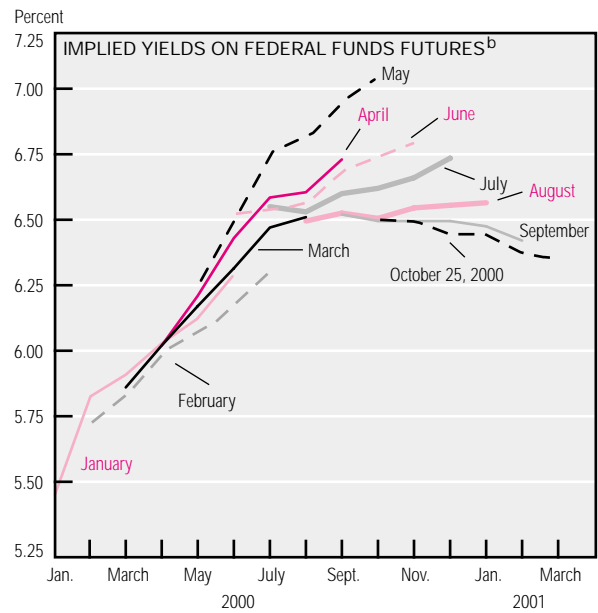
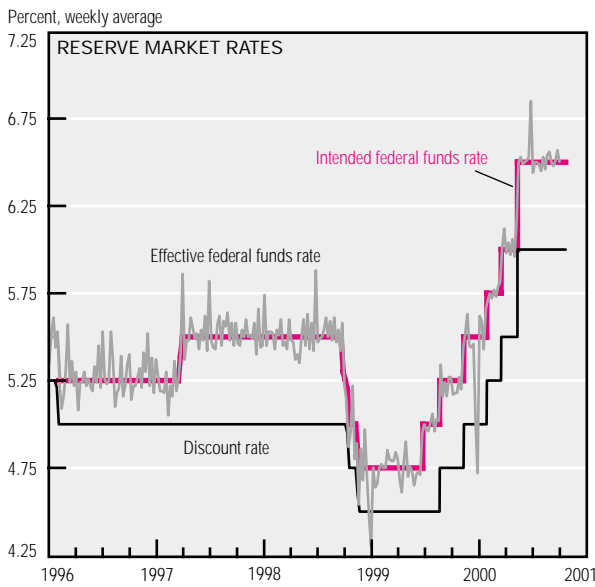
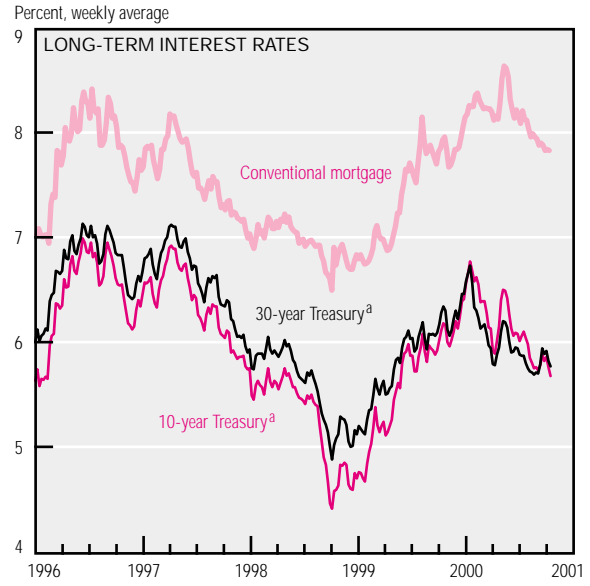
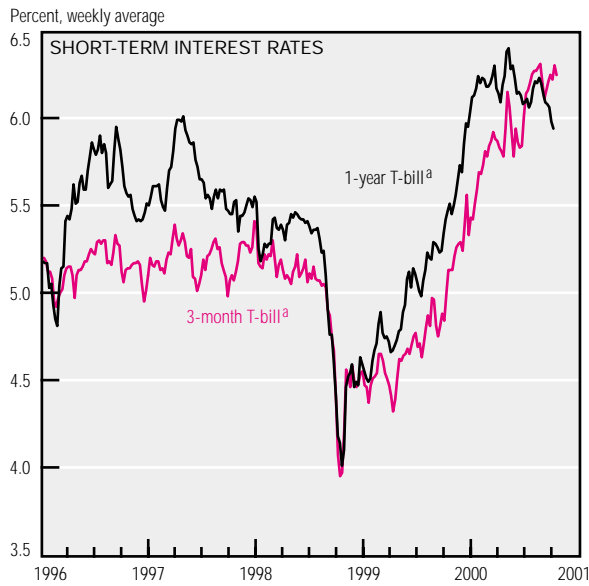
A casual inspection of the aggregates illustrates the difficulty: For almost four years, the growth rates of M2 and M3 have consistently met or exceeded the upper limit of the FOMC-determined ranges—yet economic expansion has continued with relatively modest inflation. This is not to say that money growth is irrelevant: Inflation is still believed to

result from excessive money growth. However, “excessive” is difficult to define over the short term. M2 growth of roughly 6% is not generally associated with price stability, but with real output growth averaging a remarkable 5%, the resulting inflation has been modest.

Through October, year-to-date growth rates of M2, M3, and debt are estimated to be 6.0%, 9.0%, and 5.8%, respectively. In keeping with the pattern established early this year,

(continued on next page)

Monetary Policy (cont.)



a. Constant maturity.
 b. Last active trading day of the month unless otherwise noted.
 SOURCES: Board of Governors of the Federal Reserve System; and Chicago Board of Trade.

growth in the narrower measures of money is much less robust. Year-to-date growth in the sweep-adjusted base was only 1.8% through August (the most recent sweeps data available), partly reflecting an offset to rapid Y2K-related growth in 1999.

Looking at interest rates, the rapid and sustained increases in short-term Treasury yields of 1999 have not characterized the 1-year T-bill so far this year. Trading in a relatively narrow range, the 1-year yield was down 9 basis points (bp) since the beginning of the year to 5.94% as of October 20. In contrast, the 3-month

T-bill yield has continued to climb, reaching 6.3% (up 87 bp this year). As a result, the inversion at the short end of the yield curve, which first appeared in July, continues to deepen.

Long-term Treasury yields peaked simultaneously early in the year and have largely moved together. Both the 10-year and 30-year Treasury bond yields are down (88 bp to 5.68% and 81 bp to 5.77%, respectively) through October 20. The spread between 30-year conventional mortgage rates and long-term Treasury yields has widened by around 50 bp over this period. While market

rates moved up sharply when the FOMC tightened by 75 bp in 1999, rates have not responded in similar fashion this year despite an additional percentage point increase.

Expectations of policy action, embodied in implied yields on federal funds futures, have changed significantly since May. The steeply sloped implied yield curves of the first two quarters have gradually flattened, culminating in the current inversion of 15 bp between the October 2000 and March 2001 contracts.