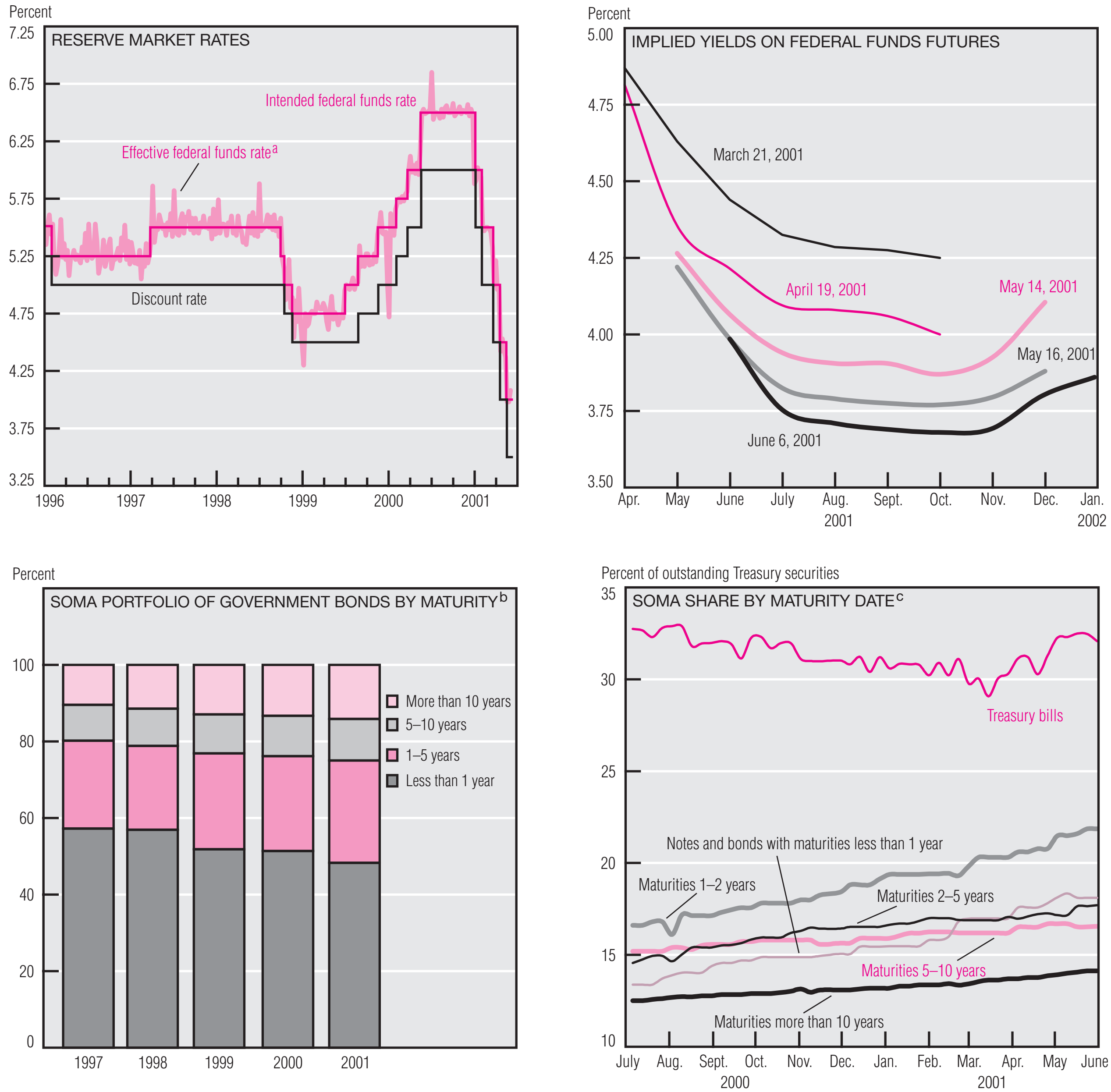
Monetary Policy



a. Weekly average.
b. Holdings for all years are as of the end of May.
c. Weighted average of the share of security issues held by SOMA.
SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; Federal Reserve Bank of New York; and Chicago Board of Trade.

The Federal Open Market Committee (FOMC) lowered the intended federal funds rate 50 basis points (bp) to 4% at its May 15 meeting. Its press release cited weakened business profitability as a factor in reduced spending on capital equipment. Separately, the Board of Governors approved Reserve Banks' requests to lower the discount rate 50 bp to 3.5%.

Implied yields on federal funds futures across various maturities have flattened since the year began, indicating reduced expectations of future rate cuts. As of June 6, the December contract traded at 3.8%.

In managing the System Open Market Account (SOMA), the FOMC attempts to maintain a relatively short, liquid portfolio. To minimize distortions in the yield curve, the Trading Desk has tended to spread its purchases evenly across the maturity spectrum of Treasury securities. However, because issuance of Treasury bills was reduced, the Desk curtailed operations in bills from December 1997 to April 2000, increasing the average maturity of SOMA's portfolio.

In July 2000, the New York Fed announced that instead of balancing purchases across maturities, it would make purchases consistent with shortening the portfolio's average maturity. It would limit holdings of each issue, ranging from 35% of outstanding bills and coupon securities with remaining maturities of less than one year to 15% of securities with maturities of more than 10 years. Since the cap for many Treasury bill issues currently is binding, shortening the portfolio's average maturity has meant buying coupon securities with maturities under two years.