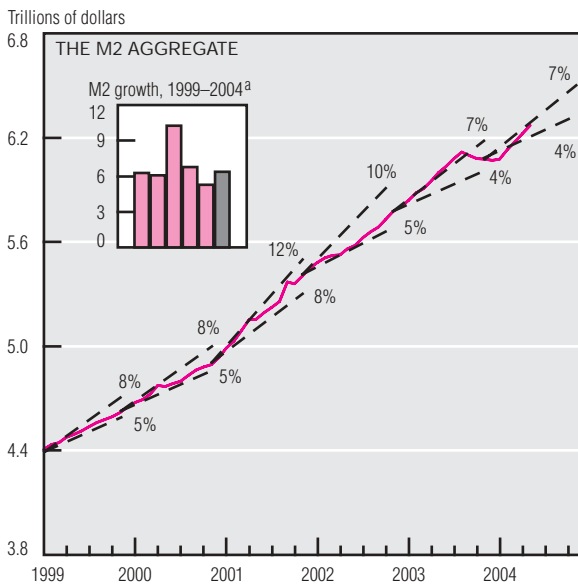
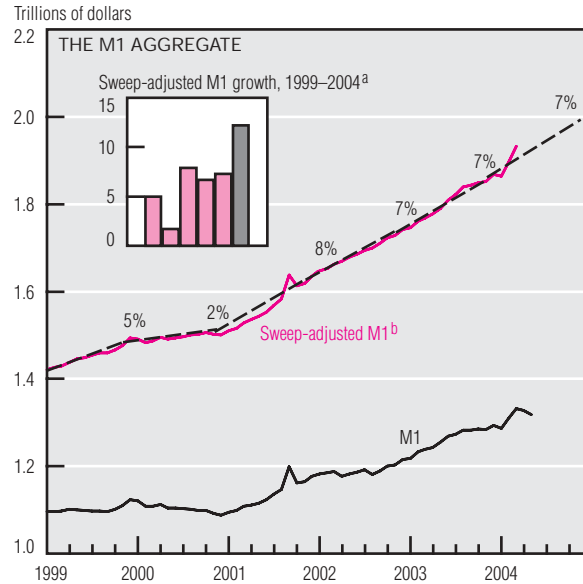
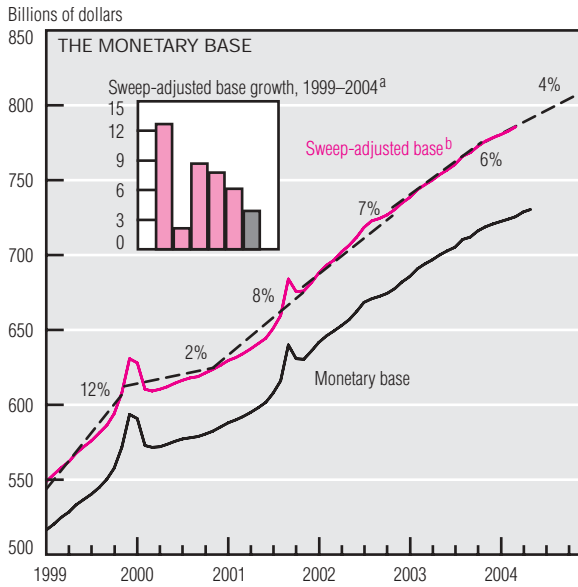


Monetary Policy



Growth Rates of Monetary Components (percent)

	Annual					Average,	
	1999	2000	2001	2002	2003	YTD 2004	1999–2003
Monetary base ^c	12.7	2.1	8.7	7.8	6.2	3.9	7.5
M1 ^d	5.0	1.7	7.9	6.7	7.3	12.2	5.7
M2	6.3	6.1	10.3	6.8	5.3	6.4	6.9
Currency	11.1	4.3	9.1	8.2	5.9	2.9	7.7
Total reserves	-7.2	-6.2	8.8	-6.7	8.3	11.3	-0.6
Check and demand ^e	-4.8	-6.8	4.9	-1.5	7.7	7.0	-0.1
Money market funds	13.7	11.3	8.4	-6.1	-11.6	-14.7	3.2
Small time deposits	-0.7	9.6	-4.9	-9.0	-9.5	-5.1	-2.9
Savings deposits	10.1	6.7	21.7	21.1	15.2	15.4	15.0

a. The far-right bar refers to the most recent data available. Growth rates are calculated on a fourth-quarter over fourth-quarter basis. The 2004 growth rates for the sweep-adjusted monetary base and sweep-adjusted M1 are calculated on a March over 2003:IVQ basis. The 2004 growth rate for M2 is calculated on a May over 2003:IVQ basis. Data are seasonally adjusted.

b. The sweep-adjusted base contains an estimate of required reserves saved when balances are shifted from reservable to nonreservable accounts. Sweep-adjusted M1 contains an estimate of balances temporarily moved from M1 to non-M1 accounts.

c. Refers to the sweep-adjusted base.

d. Refers to sweep-adjusted M1.

e. Refers to demand deposits and other checkable deposits.

SOURCE: Board of Governors of the Federal Reserve System, "Money Stock Measures," *Federal Reserve Statistical Releases*, H.6.

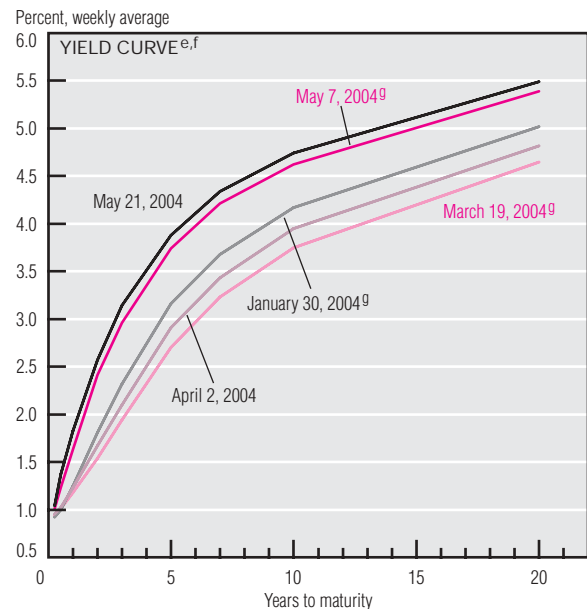
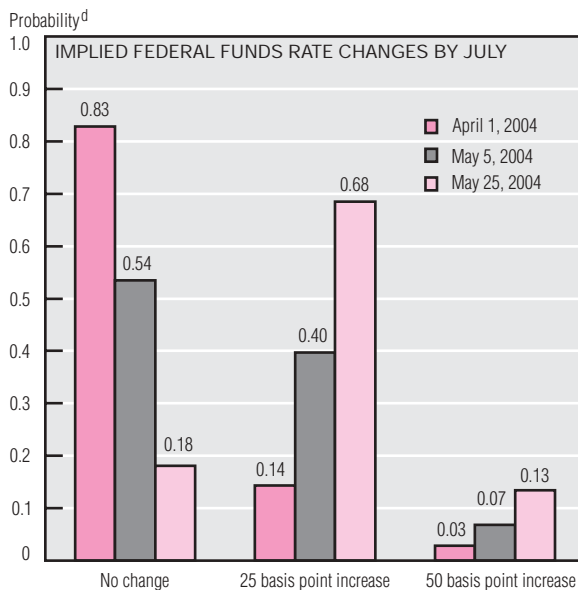
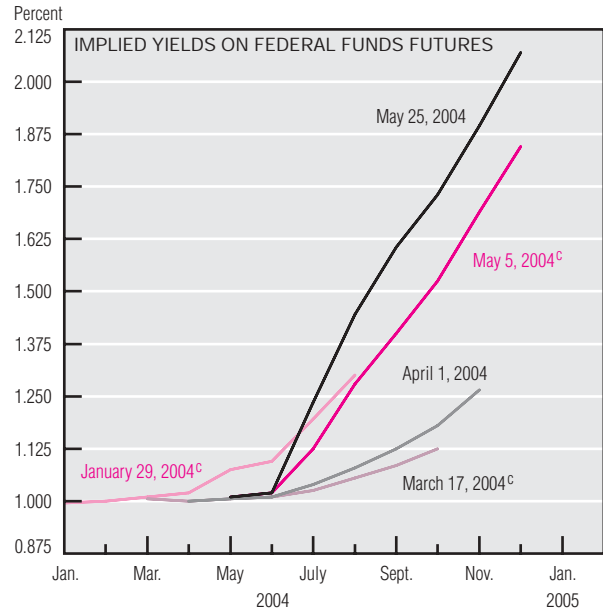
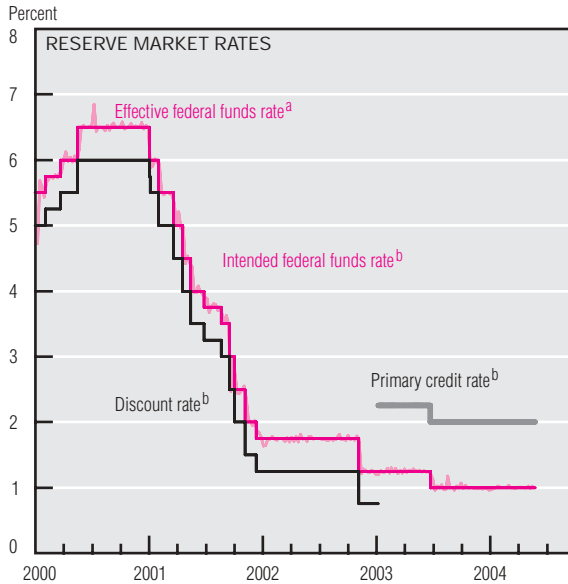
Growth in the sweep-adjusted monetary base (total currency in circulation plus total reserves plus vault cash of depository institutions not applied to reserve requirements) has moderated so far in 2004 to an annualized growth rate of 3.9%, in contrast with its five-year average of 7.5%. The decline in base growth results primarily from currency growth's drop of 4.8 percentage points from its five-year average of 7.7%. Given currency's larger share, its decline more than offset the 11.3% growth of total reserves in 2004.

M1, which consists of currency in the hands of the public plus demand and other checkable deposits, is a slightly broader monetary aggregate. So far in 2004, sweep-adjusted M1 has shown an annualized growth rate of 12.2%, roughly 6.5 percentage points above its five-year average. The acceleration in M1 growth is largely explained by the sharp increase in demand deposits and other checkable deposits, which comprise 49% of M1. Their year-to-date annualized growth rates in 2004 exceed their five-year averages by 7.1 percentage points.

Since 2003:IVQ, the broader monetary aggregate, M2, grew 6.4%, which is 0.5 percentage points less than its 1999–2003 average. Concerns about persistently slow M2 growth since mid-2003 were assuaged when the monetary aggregate began to rebound in January. Since then, M2 has grown at a 9.5% annualized rate, a surge that was associated with positive economic news such as employment reports.

At its May 4 meeting, the Federal Open Market Committee (FOMC) decided to keep the target federal funds *(continued on next page)*

Monetary Policy (cont.)



a. Weekly average of daily figures.

b. Daily observations.

c. One day after the FOMC meeting.

d. Probabilities are calculated using prices from options on July 2004 federal funds futures that trade on the Chicago Board of Trade.

e. All yields are from constant-maturity series.

f. Average for the week ending on the date shown.

g. The first weekly average available after the FOMC meeting.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; Chicago Board of Trade; and Bloomberg Financial Information Services.

rate at 1% and the primary credit rate at 2%. Despite a growing economy, the target has remained at 1% since June 2003. The FOMC reiterated its prior statement that "output is continuing to expand at a solid rate," but changed its assessment of hiring activity, noting that it now "appears to have picked up." The FOMC also stated that "policy accommodation can be removed at a pace that is likely to be measured" rather than with the "patience" mentioned in the prior statement.

The horizon for the next expected change, as implied by federal funds futures, has been pushed far forward; it is now expected to occur by July. Since early spring, the Chicago Board of Trade has provided a market for options on federal funds futures. Prices on these options enable one to estimate the implied probabilities associated with implied federal funds rate changes. In response to strong employment reports and higher-than-expected inflation numbers, market participants raised their expectations

of a June rate increase (there is no July meeting). In early April, they saw only a 17% chance of an increase, versus 81% in late May.

Reflecting strong economic news as well as the likelihood of funds rate hikes in the near future, the yield curve has shifted significantly since the March meeting (up 36 bp for the six-month rate and almost 100 bp for the 10-year rate). For the past three weeks, 90-day Treasury bill rates have remained at 1.04%, slightly above the intended federal funds rate.