

Monetary Trends



Interpreting the Annual Ranges for Money Growth

The chairman of the Federal Reserve Board testifies before Congress each February and July on the objectives of the Federal Open Market Committee (FOMC) for monetary policy. The testimony sets annual ranges for the growth of monetary and credit aggregates in terms of ranges for growth rates from the fourth quarter of the prior year to the fourth quarter of the current year.

In July of this year, Chairman Alan Greenspan indicated that the FOMC has decided to leave the range for the growth of M2 unchanged; the range has been from 1 percent to 5 percent since 1993. M2, however, has grown at an annual rate of 7.1 percent from the fourth quarter of 1997 through July of this year. Does this deviation of M2 growth from the annual range indicate that the FOMC will make slower growth of M2 over the remainder of 1998 a high priority in conducting monetary policy? Past experience and the text of the testimony on monetary policy objectives suggest not.

The record of policy actions does not indicate a consistent pattern of easing policy when M2 growth has been below the FOMC's annual range nor of tightening policy when M2 growth has been above the range. Indeed, the Fed even has moved against its M2 growth ranges. For instance, M2 growth was below the FOMC's range during much of the period from early 1994 through early 1995 when the Fed raised its federal funds target rate.

According to the testimony on monetary policy objectives, the ranges for the growth of the aggregates do not necessarily reflect the expectations of FOMC

members for the actual growth of the aggregates. Rather, they are benchmarks for growth of the aggregates that would be consistent with price stability if the income velocity of the aggregates behaved as they have historically. M2 velocity growth, for example, historically has been approximately zero. During the period from early 1994 to early 1995, however, M2 velocity was rising rapidly, so lack of growth in M2 was not a constraint on growth in total spending in the economy, and the moves to tighten policy were not inconsistent with the Fed's long-term objectives. Thus, the record of policy actions and congressional testimony suggest that, because of uncertainty about the behavior of velocity, the FOMC will not set a high priority on bringing the growth of M2 to within the annual range over the remainder of 1998.

—R. Alton Gilbert

Federal Funds Target Rate

Shaded areas represent periods when M2 growth is outside the annual range set by the FOMC

