Monetary Trends

January 2008

Can You Hear Me Now?

On November 14, 2007, the Federal Open Market Committee (FOMC) announced several changes designed to "improve the accountability and public understanding of monetary policy making."[1] These changes included increasing the frequency of the economic projections of the FOMC participants (governors and Reserve Bank presidents) from two to four times per year; extending the maximum projection horizon from two to three years; and quantifying, to the extent possible, the degree of uncertainty policymakers attach to their economic projections.

Increased transparency is one way to reduce the uncertainty that households, firms, and financial markets have about the current stance of monetary policy and its implications for future economic outcomes. In his remarks describing these changes, Chairman Bernanke said that increased transparency benefits society and the economy in two important ways.[2] First, "good communications are a prerequisite if central banks are to maintain the democratic legitimacy and independence that are essential to sound monetary policy making." Second, "central bank transparency increases the effectiveness of monetary policy and enhances economic and financial performance."

When the FOMC released its new economic projections on November 20, 2007, economic and financial market participants tended to focus first on the revisions to the 2007-08 projections that were published July 18, 2007, in the *Monetary Policy Report to the Congress*. The new projections indicated that FOMC policymakers had become modestly less optimistic about real GDP growth in 2008 compared with three months earlier (the mid-point of the central tendency was reduced from 2.5 percent to 2.15 percent), but their expectation for core PCE inflation in 2008 was virtually unchanged from three months earlier (the mid-point of the central tendency is 1.8 percent).[3] In view of the recent turbulence associated with developments in the housing and mortgage finance sector, the market's focus on the revisions to the near-term outlook is consistent with the FOMC's risk management strategy. If, for example, the risk of weaker economic growth exceeds the risk of higher inflation (asymmetric risk), "the appropriate policy gives more weight to a very damaging outcome that has a low probability than to a less damaging outcome with a greater probability."[4]

Analysts then focused on the FOMC's projections for overall and core PCE inflation in 2010. According to the central tendency, inflation—whether measured by the PCE or core PCE—is expected to be between 1.6 percent and 1.9 percent for the four quarters ending in 2010:Q4. From 2007 to 2009, though, overall inflation is projected to slightly exceed, on average, core inflation. Extending the projection horizon by one year is potentially an important innovation in the monetary policy communication process. For one thing, it reinforces the fact that monetary policy is the main determinant of inflation over longer horizons. Second, it also reinforces the fact that, over time, the overall inflation rate—which households and firms care most about—should be no different from the core inflation rate, which the FOMC uses as a measure of the underlying inflation rate. This is because food and energy price shocks tend to be temporary.

Some economic analysts appear to have interpreted the mid-point of the 2010 central tendency as the Committee's long-term inflation preference—despite no explicit policy statement to that effect. Nevertheless, if this interpretation persists, and if expectations are crucial for ensuring good macroeconomic outcomes, then the FOMC's longer-term inflation projection must be viewed as credible. One way to achieve credibility is by ensuring that the three-year-ahead projection errors are zero, on average. Attaining this outcome may be made more difficult because (i) the composition of the FOMC may change over time and (ii) each member may have a different view of what an "appropriate" policy stance is.

—Kevin L. Kliesen

[1] See www.federalreserve.gov/newsevents/press/monetary/20071114a.htm.

[2] See "Federal Reserve Communications," at www.federalreserve.gov/newsevents/speech/bernanke20071114a.htm.

[3] The central tendency removes the three highest and lowest projections.

[4] See Alan Greenspan, "Risk and Uncertainty in Monetary Policy," at www.federalreserve.gov/boarddocs/speeches/2004/20040103/default.htm.

Contents

Conventions used in this publication:

1. Unless otherwise indicated, data are monthly.
2. Shaded areas indicate recessions, as determined by the National Bureau of Economic Research.
3. *Percent change at an annual rate* is the simple, not compounded, monthly percent change multiplied by 12. For example, using consecutive months, the percent change at an annual rate in x between month $t-1$ and the current month t is: $[(x_t/x_{t-1})-1]\times 1200$. Note that this differs from *National Economic Trends.* In that publication, monthly percent changes are compounded and expressed as annual growth rates.
4. The *percent change from year ago* refers to the percent change from the same period in the previous year. For example, the percent change from year ago in x between month $t-12$ and the current month t is: $[(x_t/x_{t-12})-1]\times 100$.

We welcome your comments addressed to:

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On March 23, 2006, the Board of Governors of the Federal Reserve System ceased the publication of the M3 monetary aggregate. It also ceased publishing the following components: large-denomination time deposits, RPs, and eurodollars.

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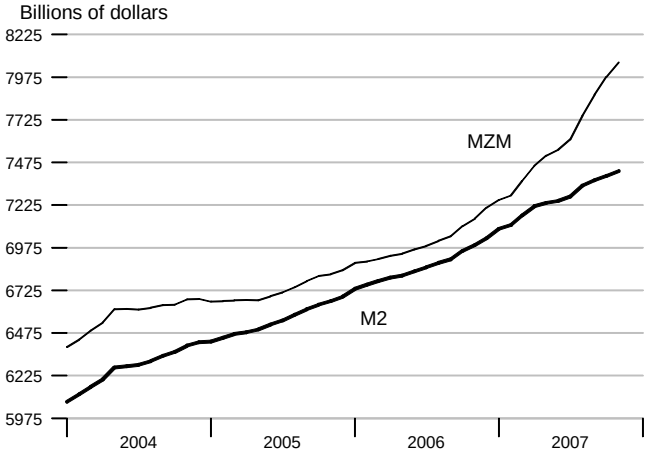
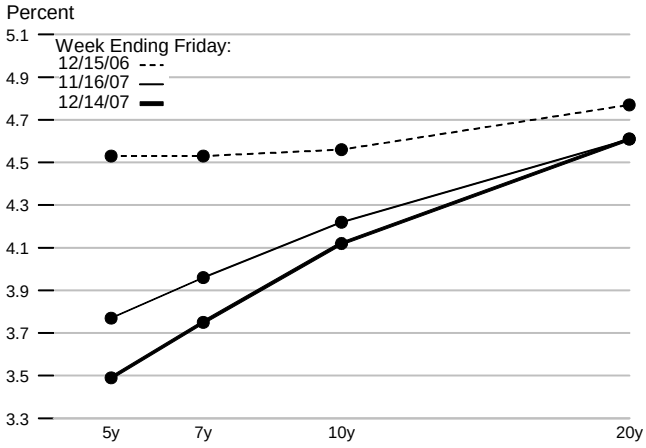
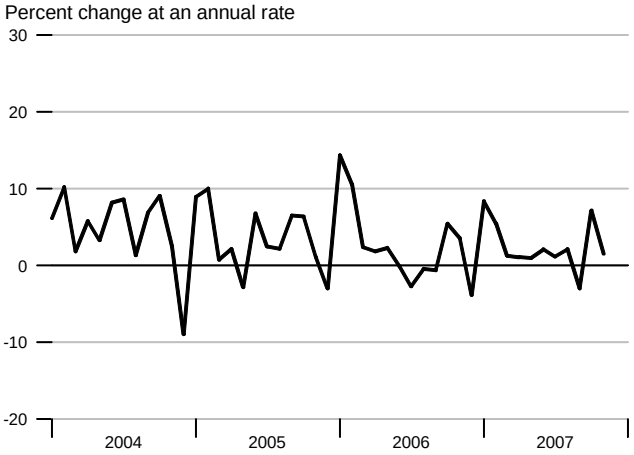
M2 and MZM



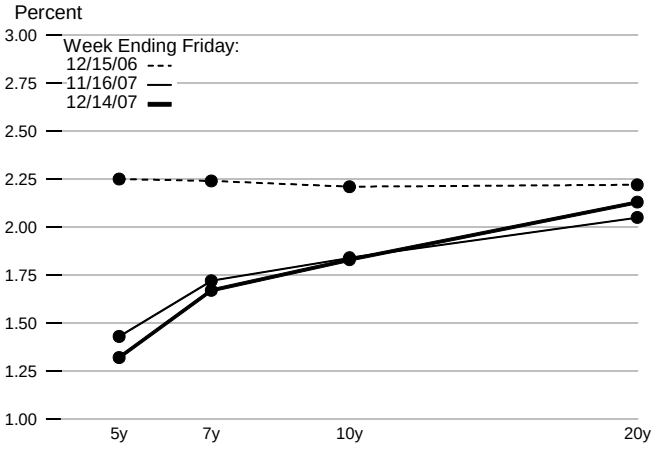
Treasury Yield Curve



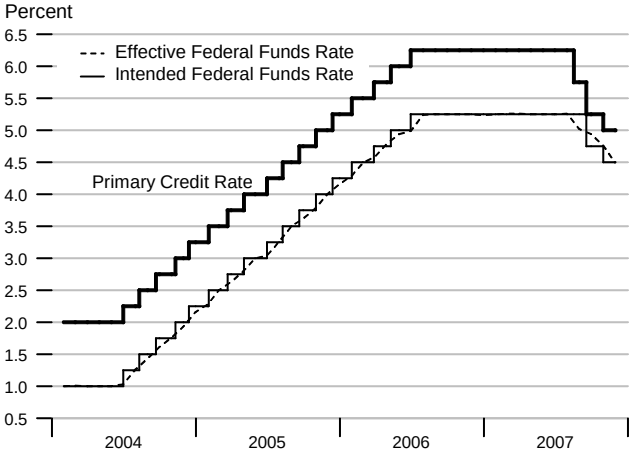
Adjusted Monetary Base



Real Treasury Yield Curve

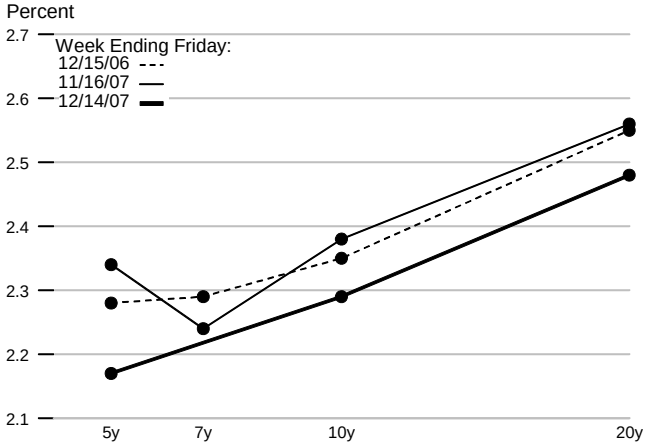


Reserve Market Rates



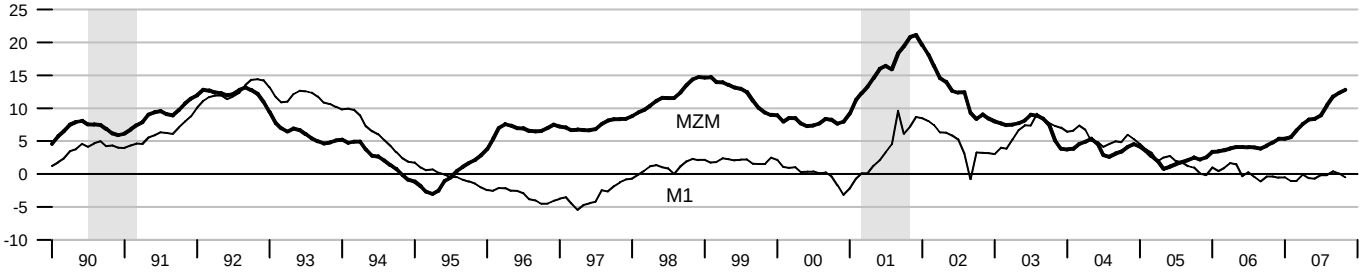
Data available as of November 2007.

Inflation-Indexed Treasury Yield Spreads



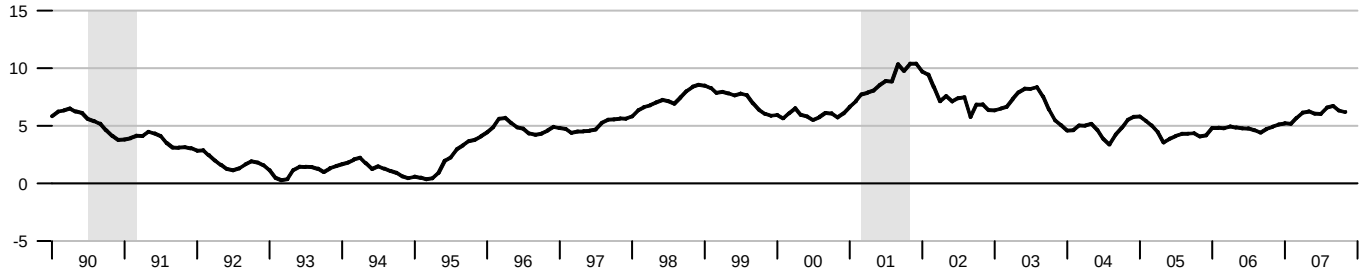
MZM and M1

Percent change from year ago



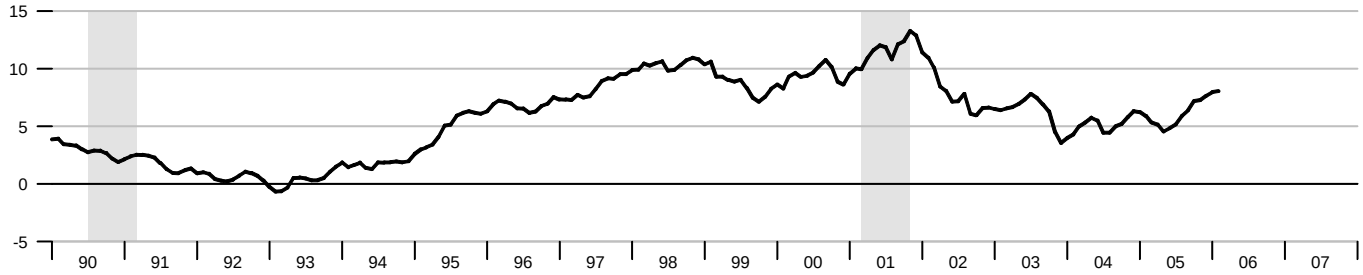
M2

Percent change from year ago



M3*

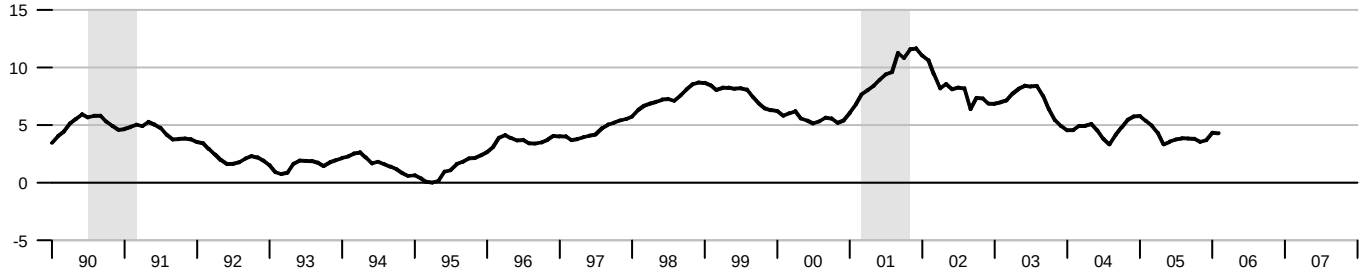
Percent change from year ago



*See table of contents for changes to the series.

Monetary Services Index - M2**

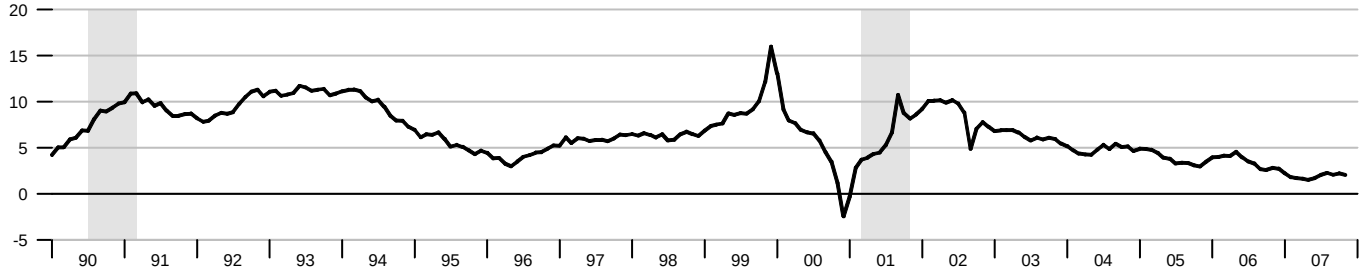
Percent change from year ago



**We will not update the MSI series until we revise the code to accomodate the discontinuation of M3.

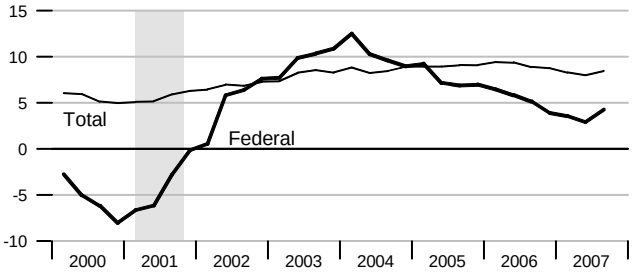
Adjusted Monetary Base

Percent change from year ago



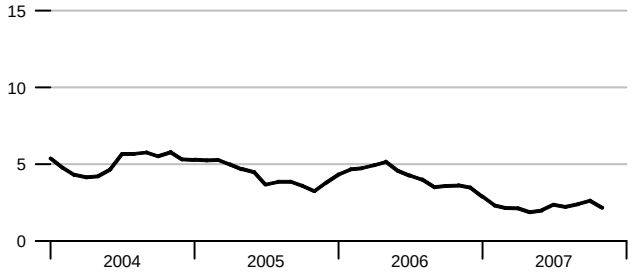
Domestic Nonfinancial Debt

Percent change from year ago



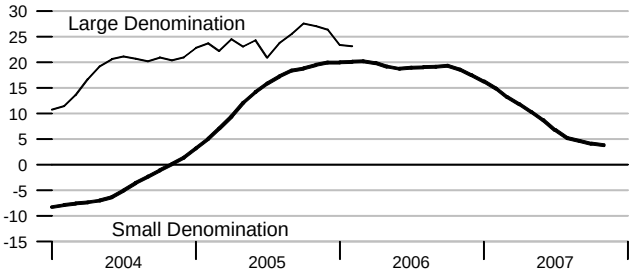
Currency Held by the Nonbank Public

Percent change from year ago



Time Deposits*

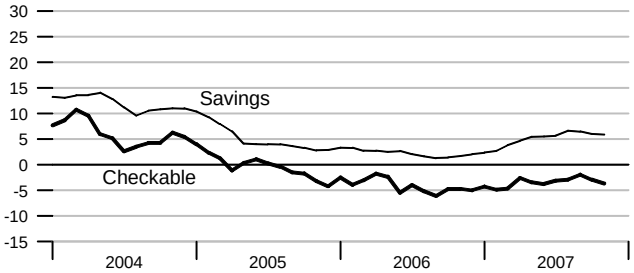
Percent change from year ago



*See table of contents for changes to the series.

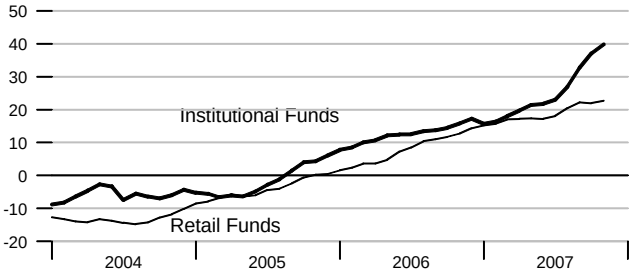
Checkable and Savings Deposits

Percent change from year ago



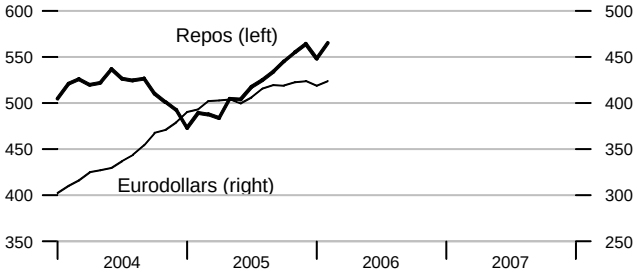
Money Market Mutual Fund Shares

Percent change from year ago



Repurchase Agreements and Eurodollars*

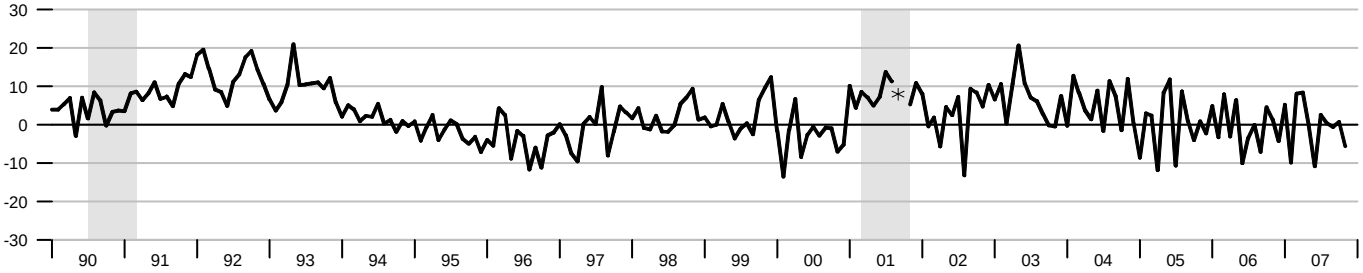
Billions of dollars Billions of dollars



*See table of contents for changes to these series.

M1

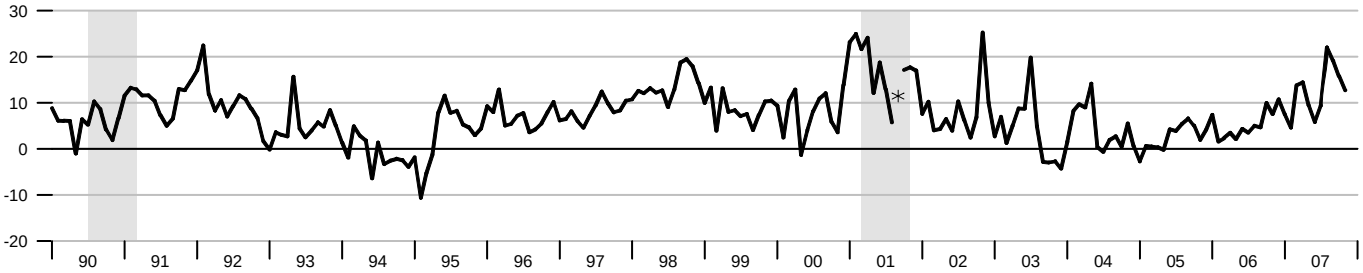
Percent change at an annual rate



*Actual values for September and October 2001 are 55.87 and -38.35 percent rate, respectively.

MZM

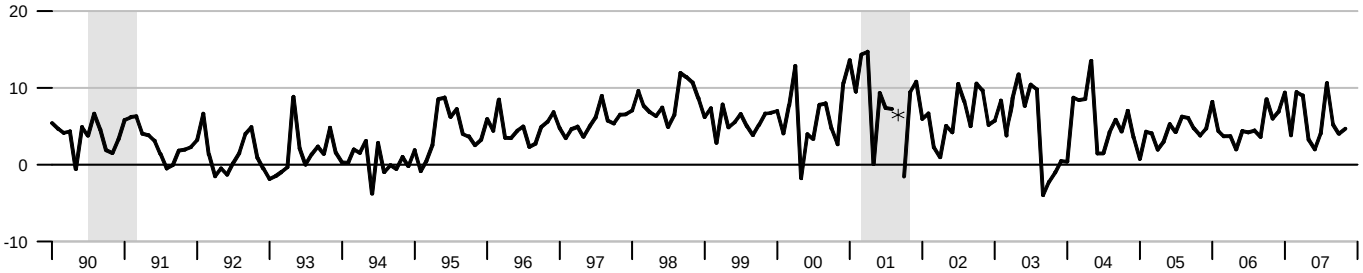
Percent change at an annual rate



*Actual value for September 2001 is 39.41 percent rate.

M2

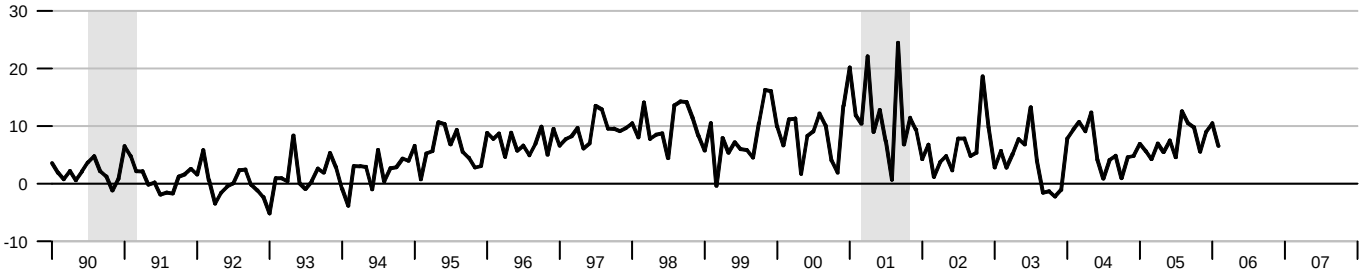
Percent change at an annual rate



*Actual value for September 2001 is 24.90 percent rate.

M3*

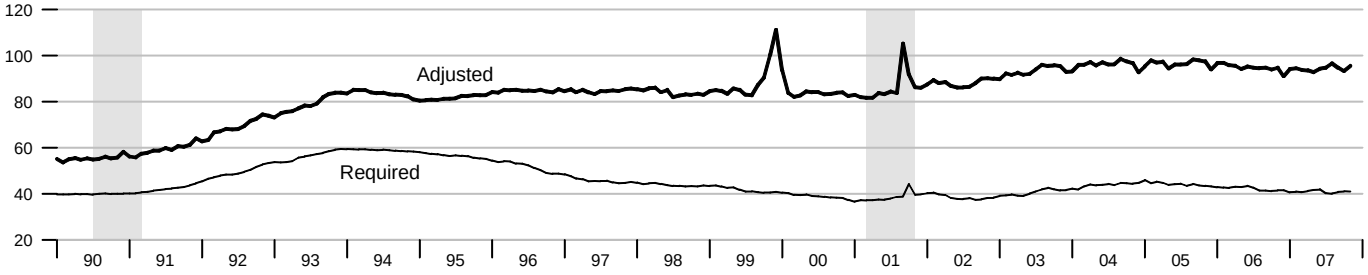
Percent change at an annual rate



*See table of contents for changes to the series.

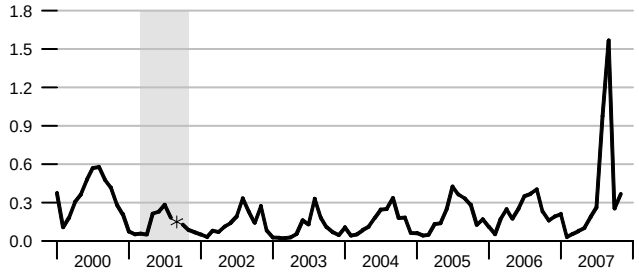
Adjusted and Required Reserves

Billions of dollars



Total Borrowings, nsa

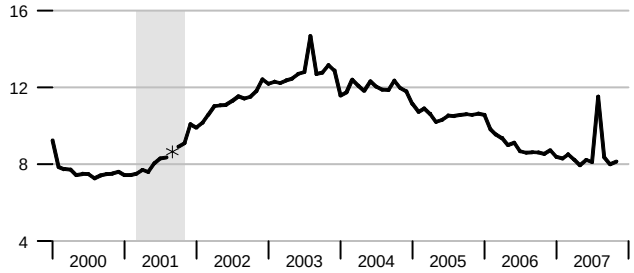
Billions of dollars



*Actual value for September 2001 is $3.4 billion.

Excess Reserves plus RCB Contracts

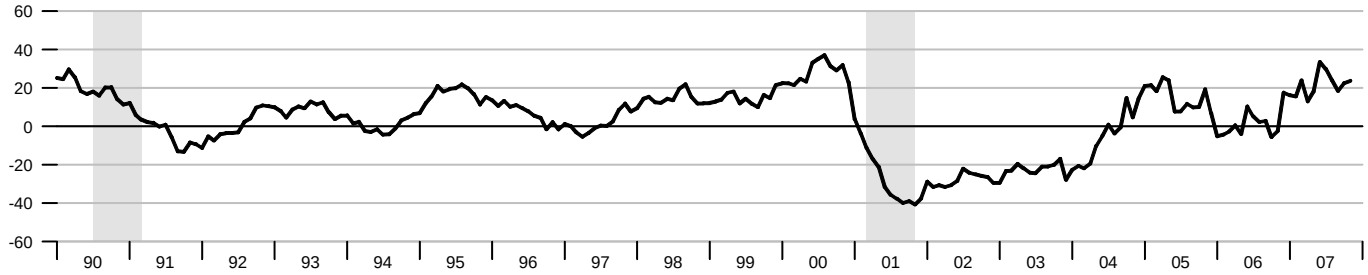
Billions of dollars



*Actual value for September 2001 is $26.43 billion.

Nonfinancial Commercial Paper

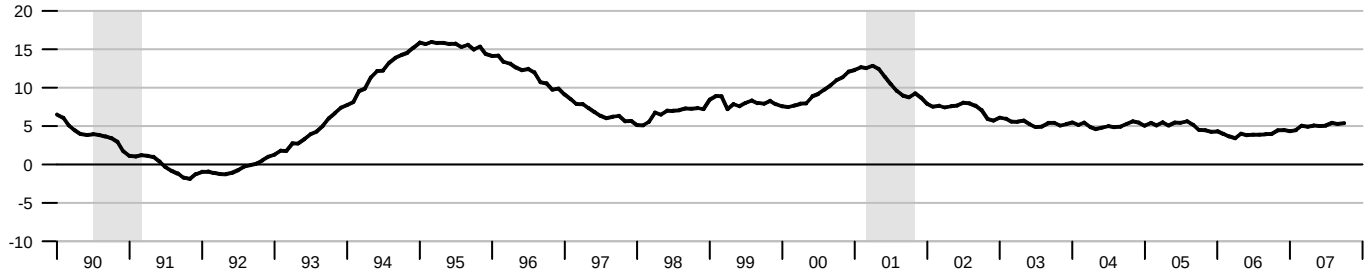
Percent change from year ago



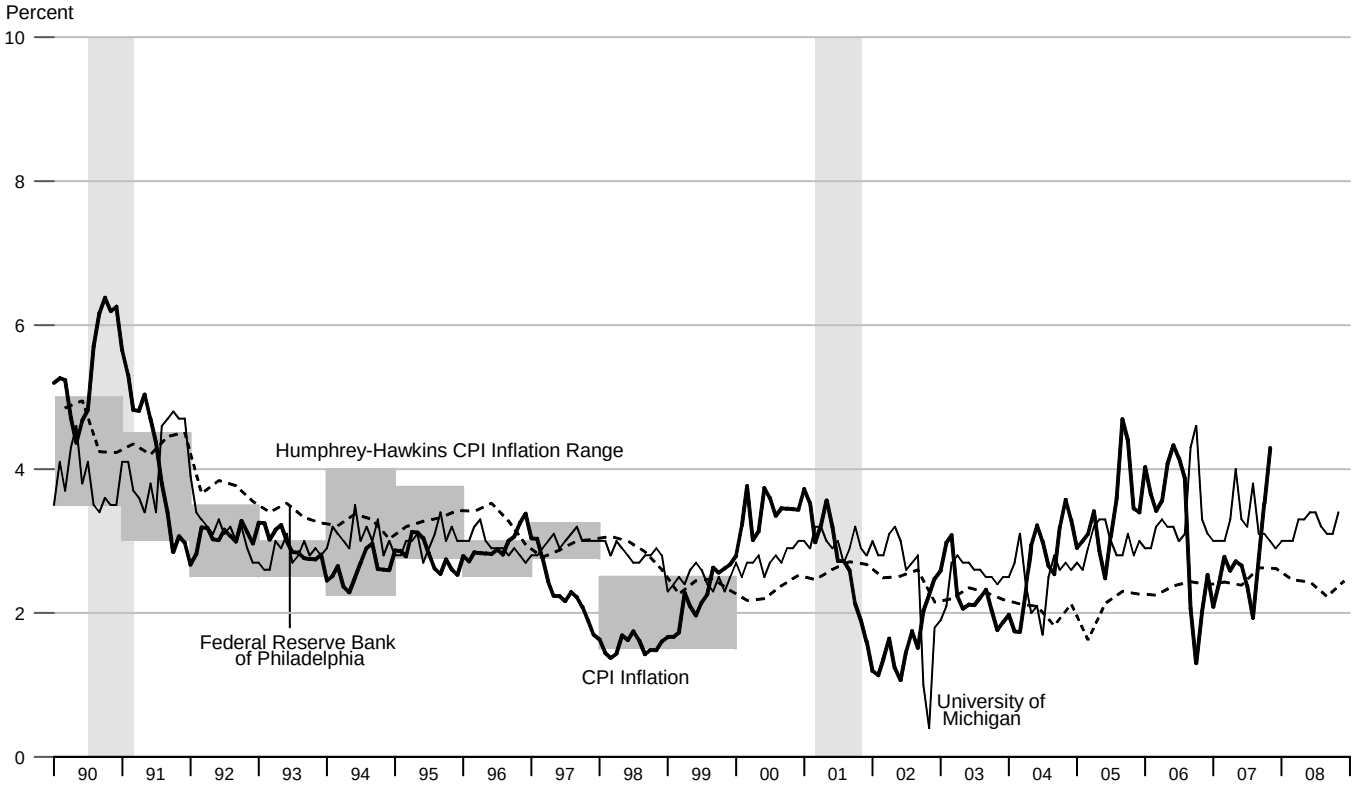
As of April 10, 2006, the Federal Reserve Board made major changes to its commercial paper calculations.
For more information, please refer to http://www.federalreserve.gov/releases/cp/about.htm.

Consumer Credit

Percent change from year ago

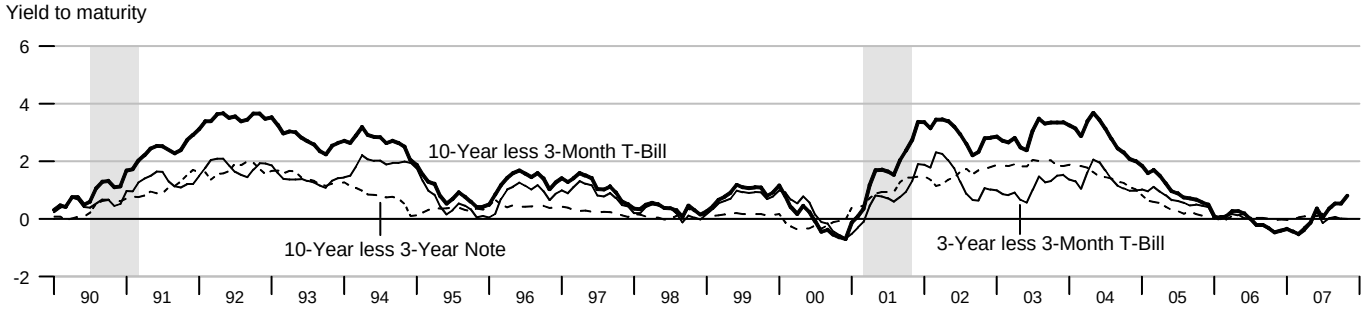


Inflation and 1-Year-Ahead Inflation Expectations



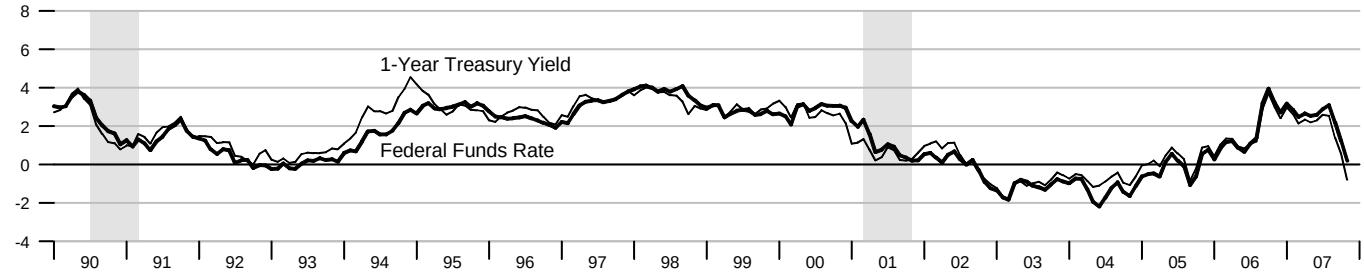
The shaded region shows the Humphrey-Hawkins CPI inflation range. Beginning in January 2000, the Humphrey-Hawkins inflation range was reported using the PCE price index and therefore is not shown on this graph. See notes on page 19.

Treasury Security Yield Spreads

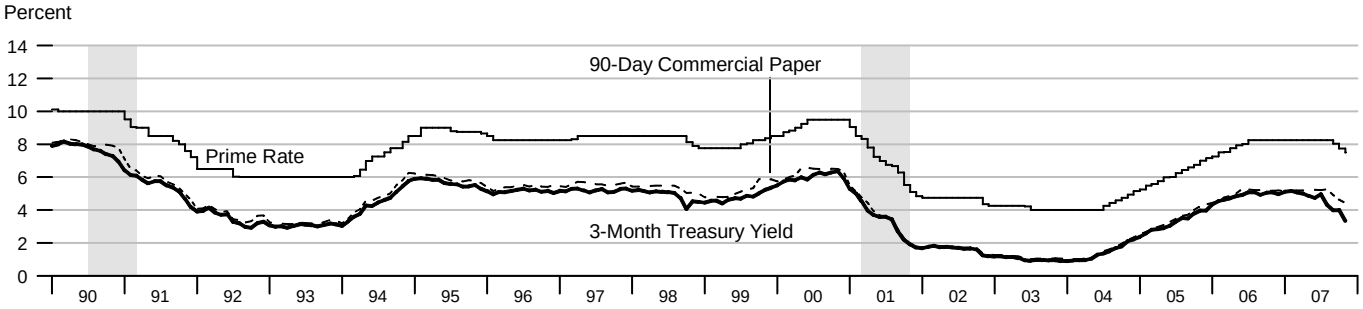


Real Interest Rates

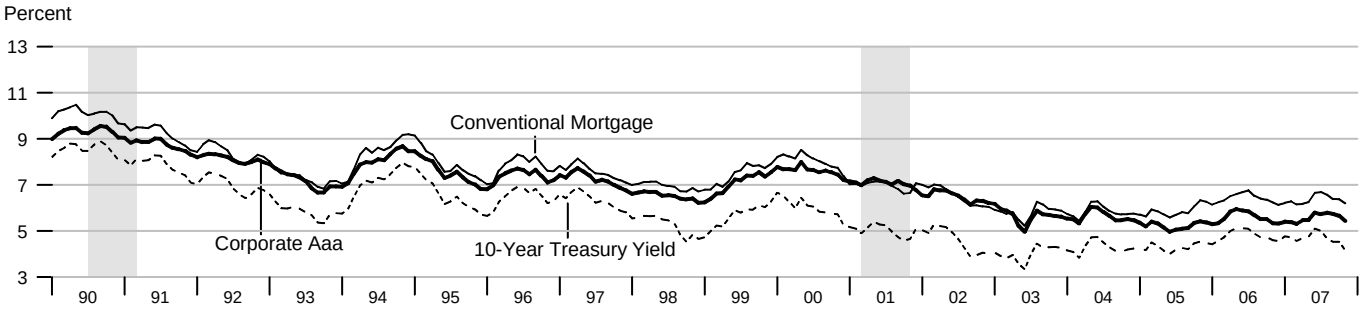
Percent, Real rate = Nominal rate less year-over-year CPI inflation



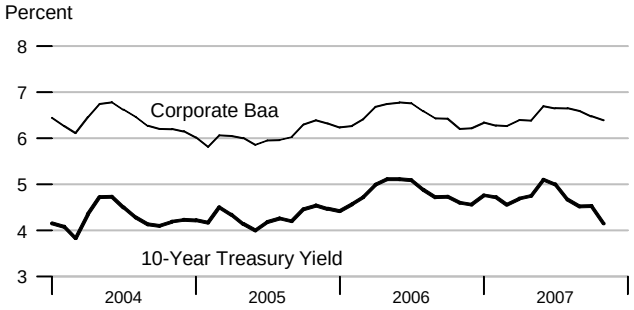
Short-Term Interest Rates



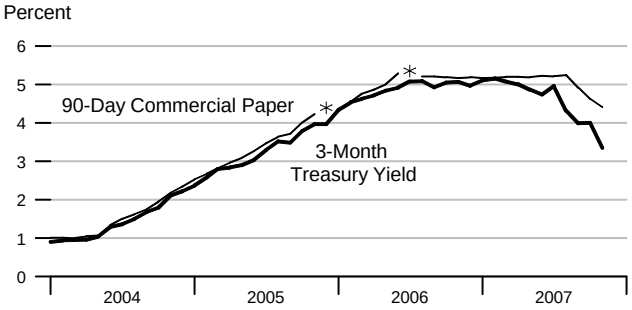
Long-Term Interest Rates



Long-Term Interest Rates

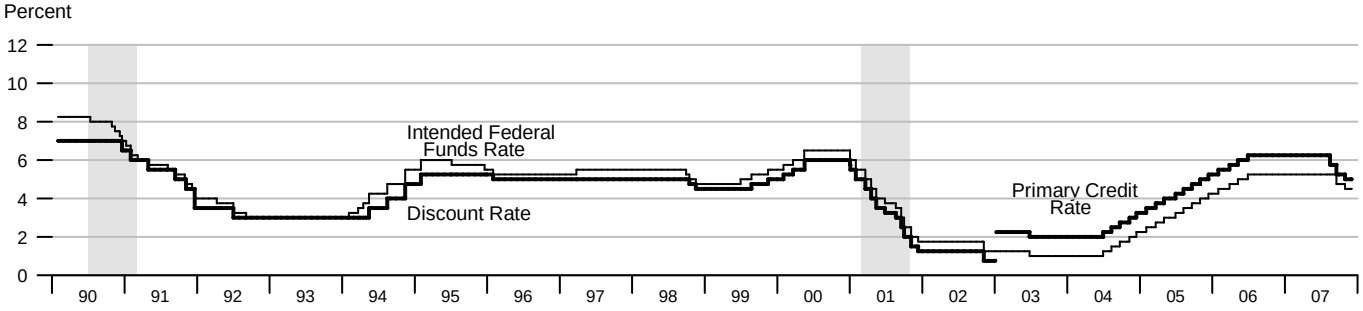


Short-Term Interest Rates



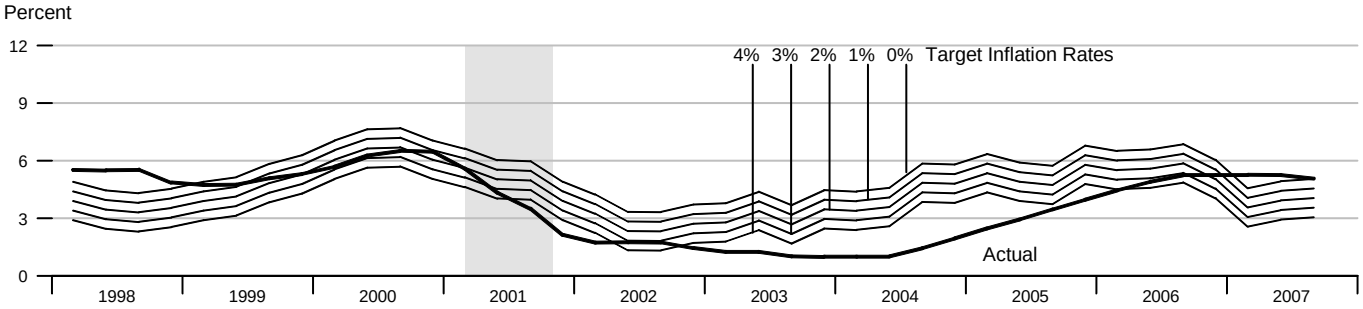
*90-Day Commercial Paper data are not available for December 2005, January 2006, and July 2006.

FOMC Intended Federal Funds Rate, Discount Rate, and Primary Credit Rate



Data available as of October 2007.

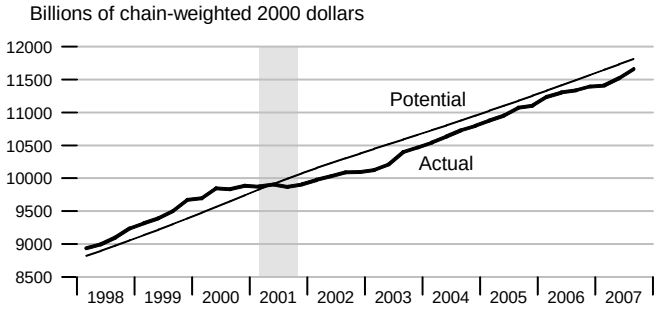
Federal Funds Rate and Inflation Targets



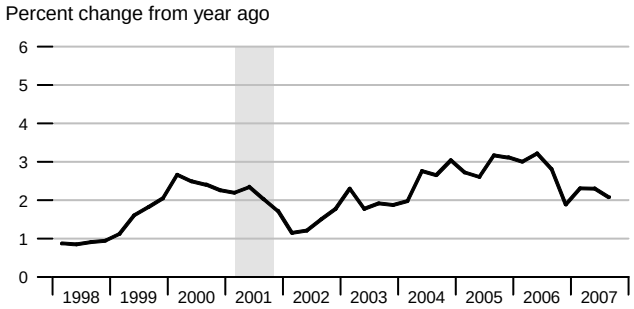
Calculated federal funds rate is based on Taylor's rule. See notes on page 19.

Components of Taylor's Rule

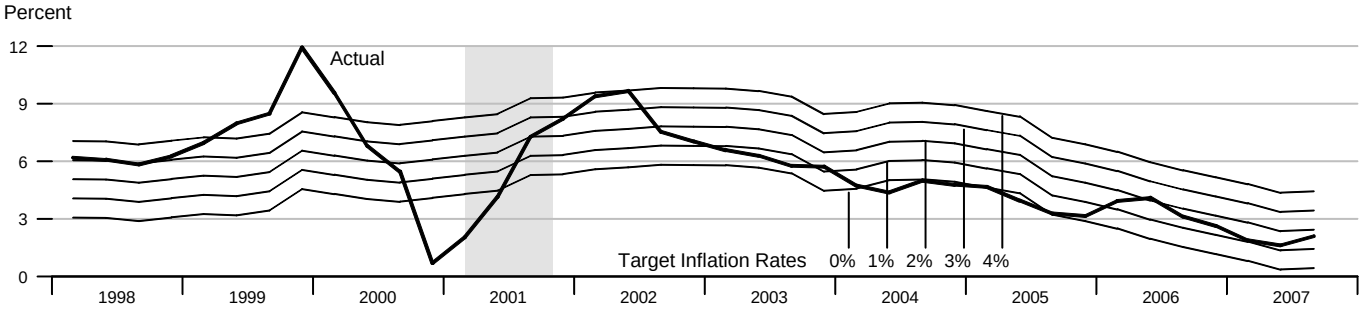
Actual and Potential Real GDP



PCE Inflation



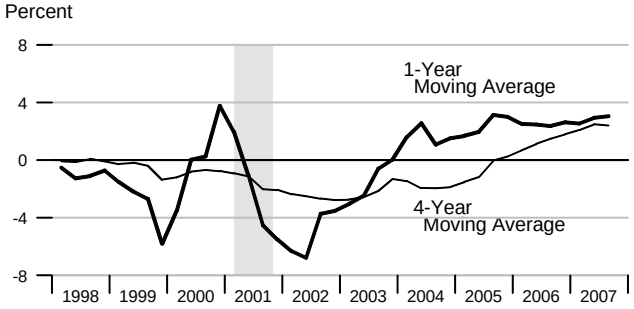
Monetary Base Growth* and Inflation Targets



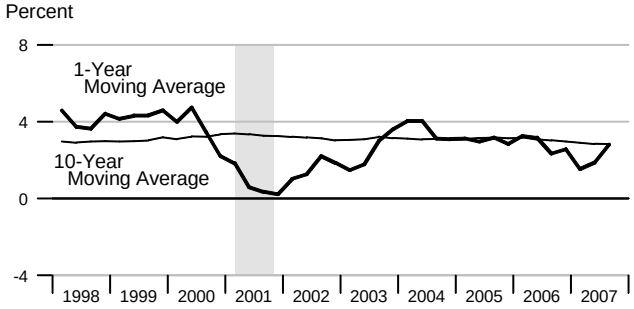
*Modified for the effects of sweeps programs on reserve demand.
Calculated base growth is based on McCallum's rule. Actual base growth is percent change from year ago. See notes on page 19.

Components of McCallum's Rule

Monetary Base Velocity Growth

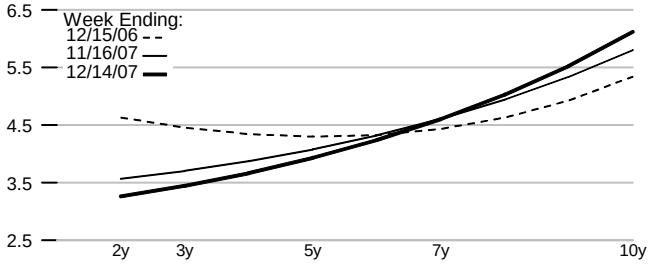


Real Output Growth



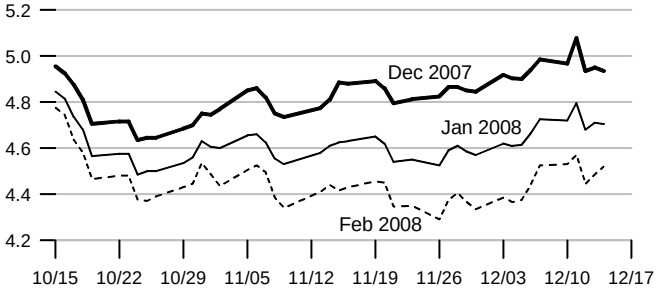
Implied One-Year Forward Rates

Percent



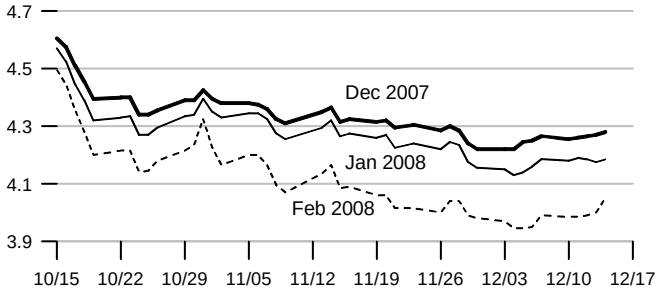
Rates on 3-Month Eurodollar Futures

Percent, daily data



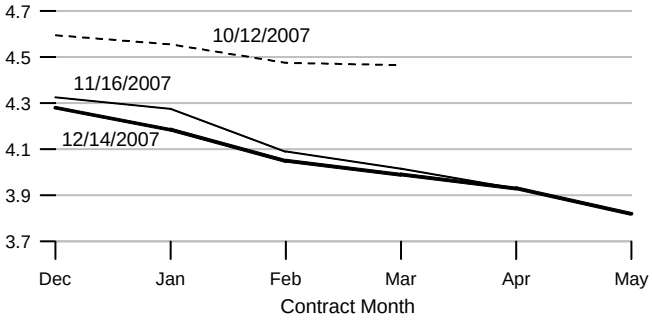
Rates on Selected Federal Funds Futures Contracts

Percent, daily data



Rates on Federal Funds Futures on Selected Dates

Percent



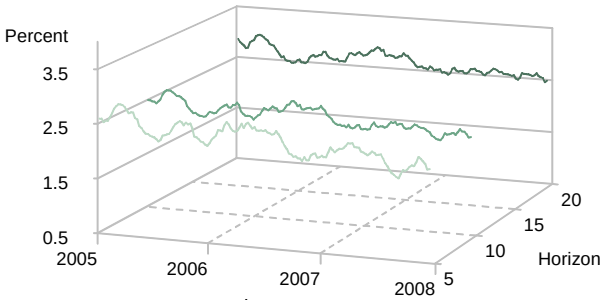
Inflation-Indexed Treasury Securities

Weekly data

Note: Yields are inflation-indexed constant maturity U.S. Treasury securities

Inflation-Indexed Treasury Yield Spreads

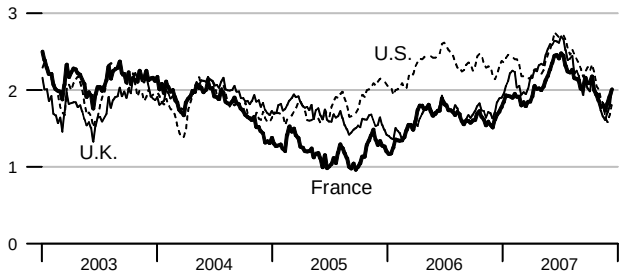
Weekly data



Note: Yield spread is between nominal and inflation-indexed constant maturity U.S. Treasury securities.

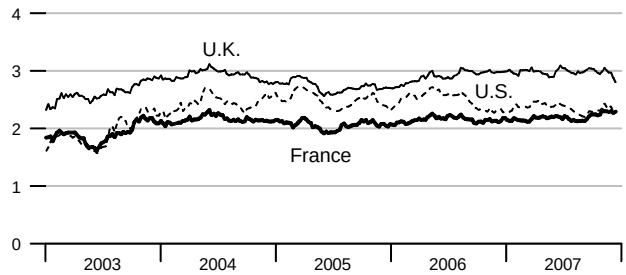
Inflation-Indexed 10-Year Government Notes

Percent, weekly data



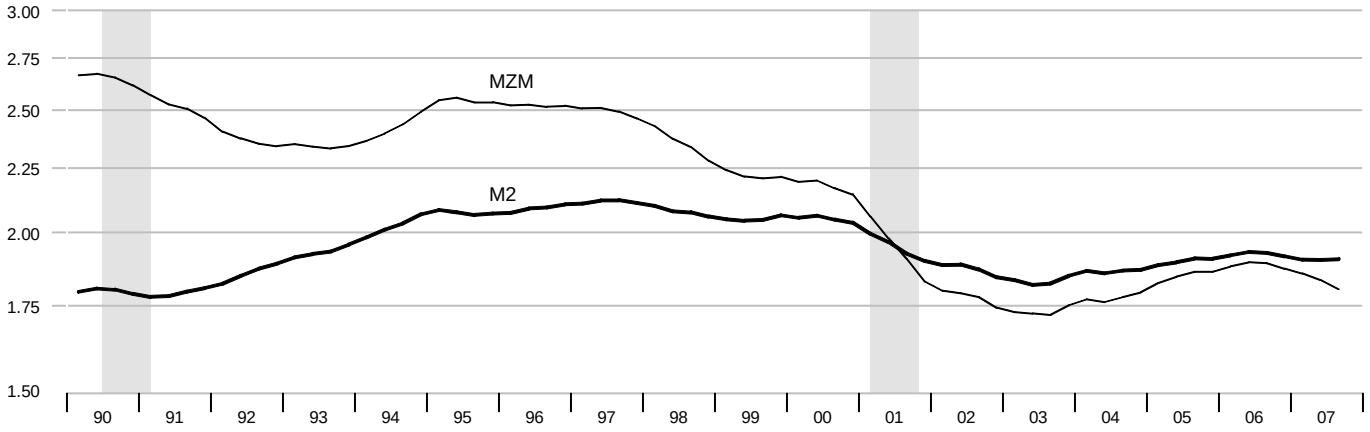
Inflation-Indexed 10-Year Government Yield Spreads

Percent, weekly data



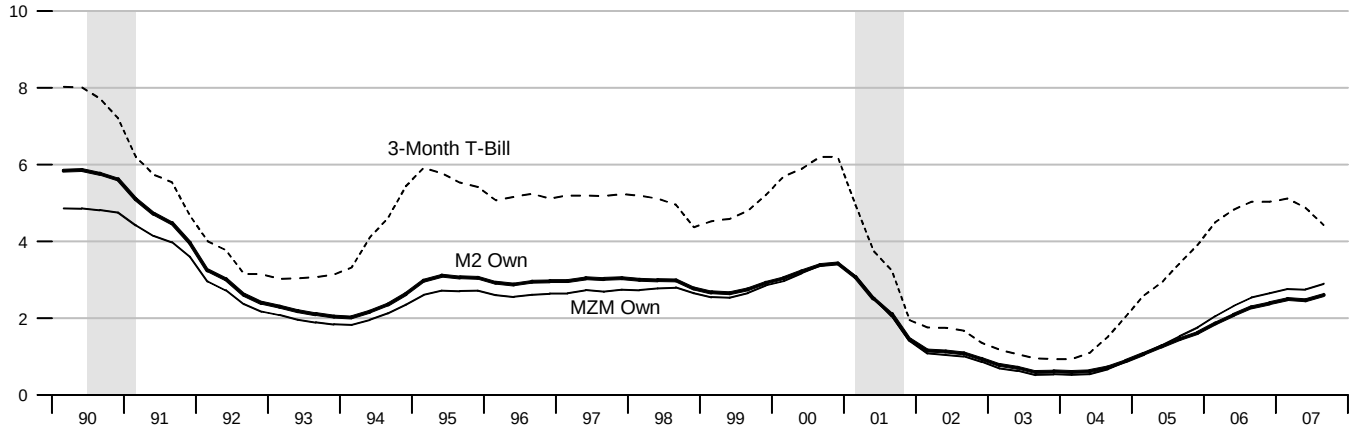
Velocity

Nominal GDP/MZM, Nominal GDP/M2 (Ratio Scale)



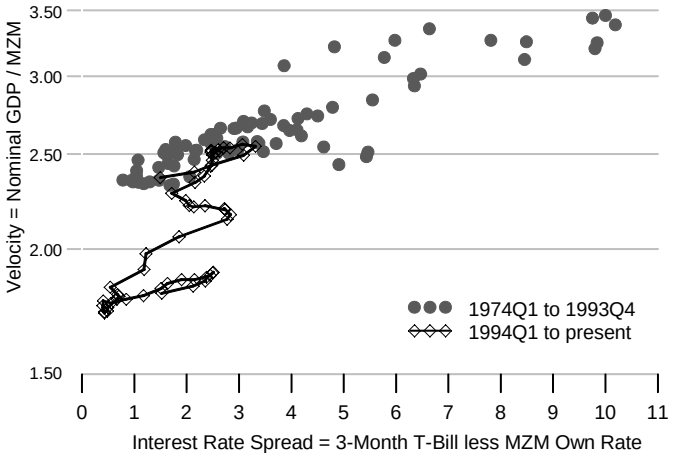
Interest Rates

Percent



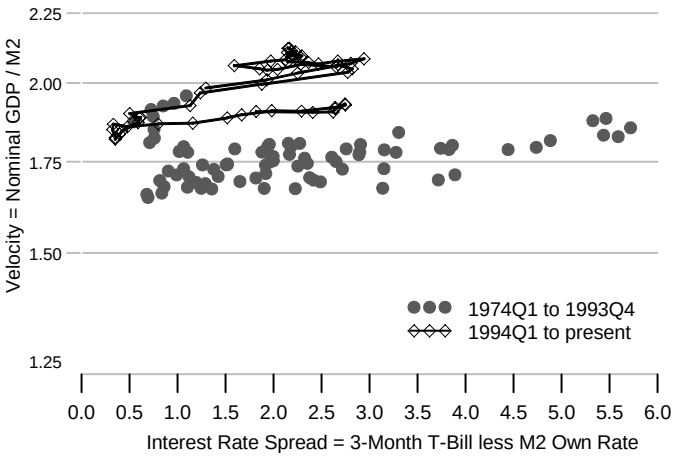
MZM Velocity and Interest Rate Spread

Ratio Scale



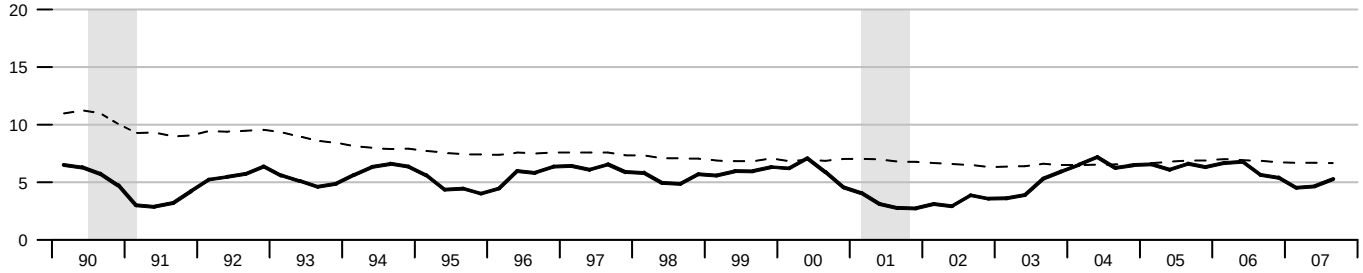
M2 Velocity and Interest Rate Spread

Ratio Scale



Gross Domestic Product

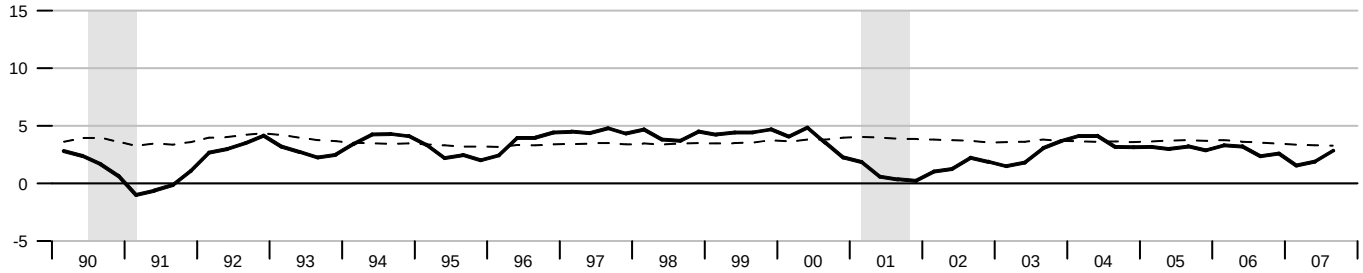
Percent change from year ago



Dashed lines indicate 10-year moving averages.

Real Gross Domestic Product

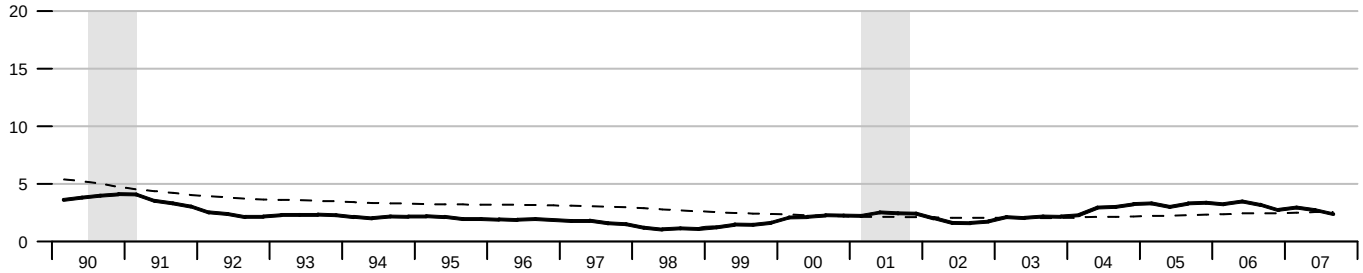
Percent change from year ago



Dashed lines indicate 10-year moving averages.

Gross Domestic Product Price Index

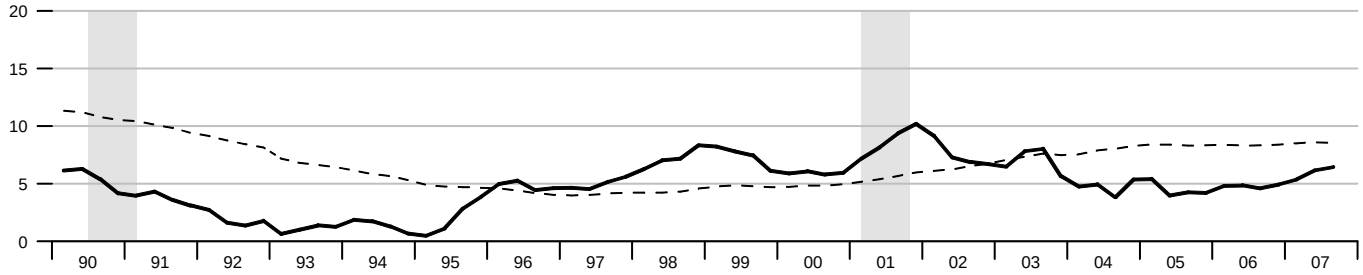
Percent change from year ago



Dashed lines indicate 10-year moving averages.

M2

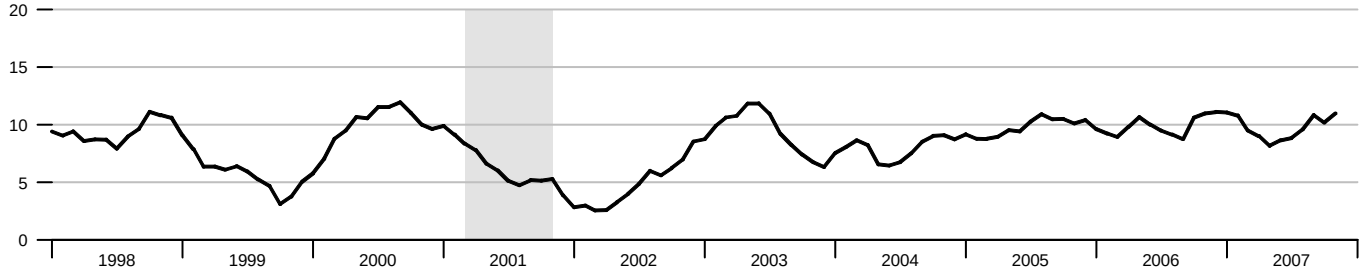
Percent change from year ago



Dashed lines indicate 10-year moving averages.

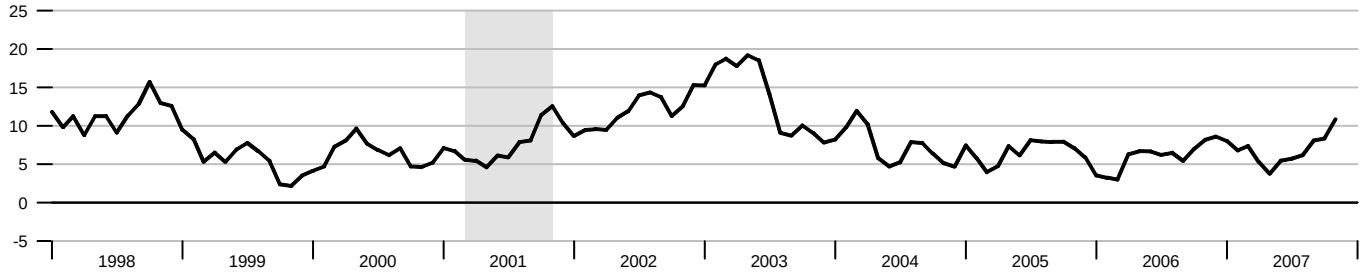
Bank Credit

Percent change from year ago



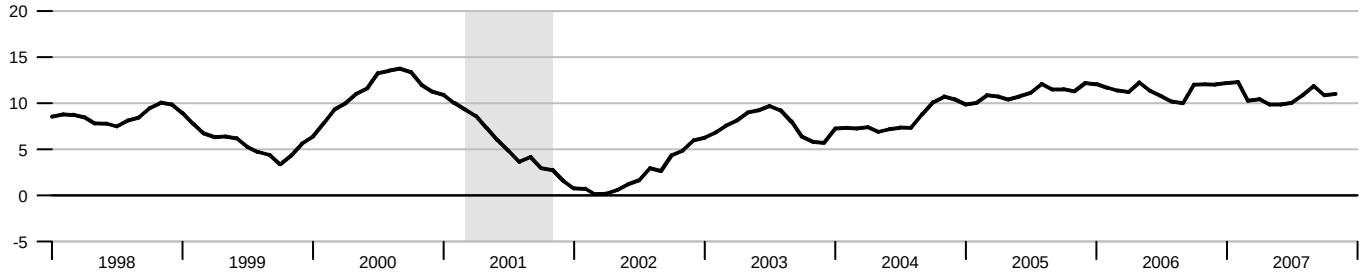
Investment Securities in Bank Credit at Commercial Banks

Percent change from year ago



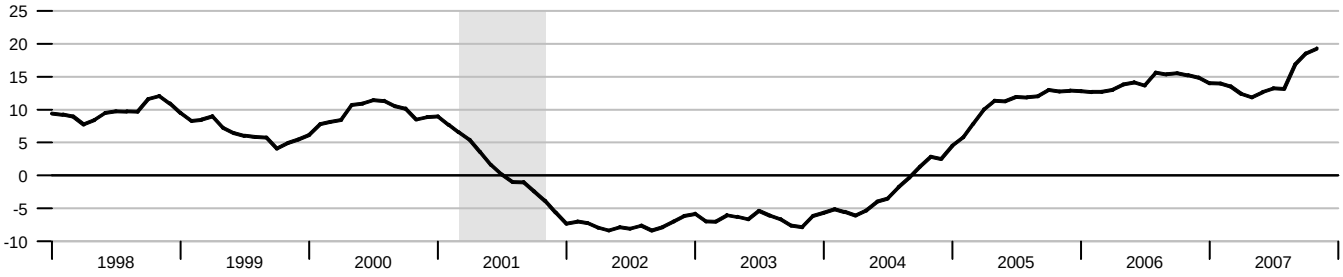
Total Loans and Leases in Bank Credit at Commercial Banks

Percent change from year ago

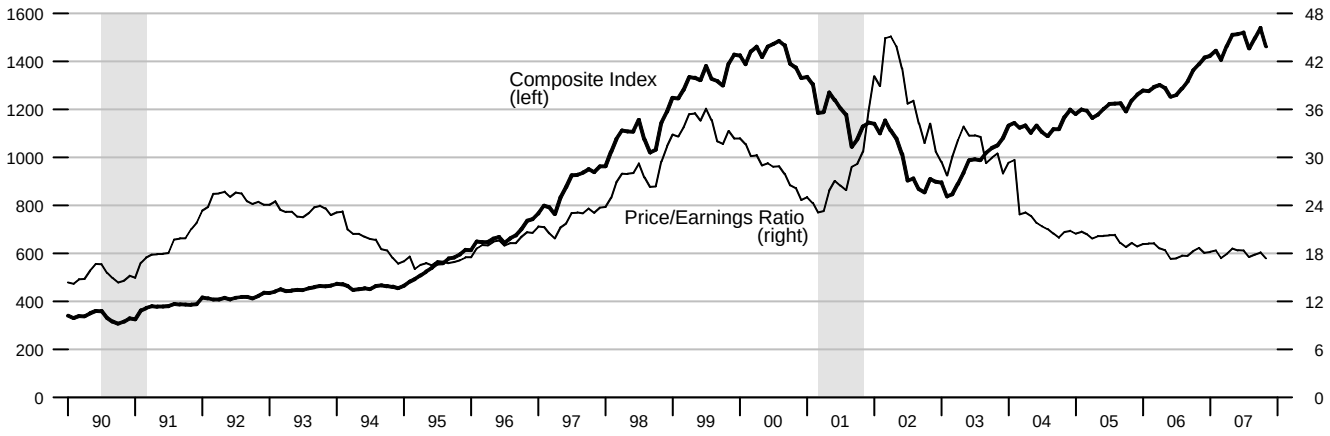


Commercial and Industrial Loans at Commercial Banks

Percent change from year ago



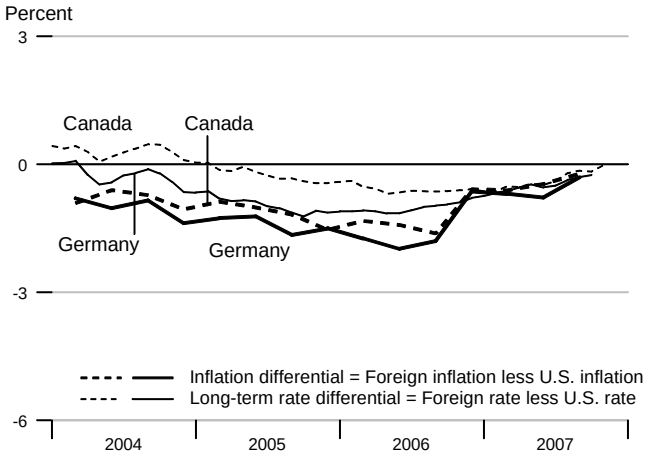
Standard & Poor's 500

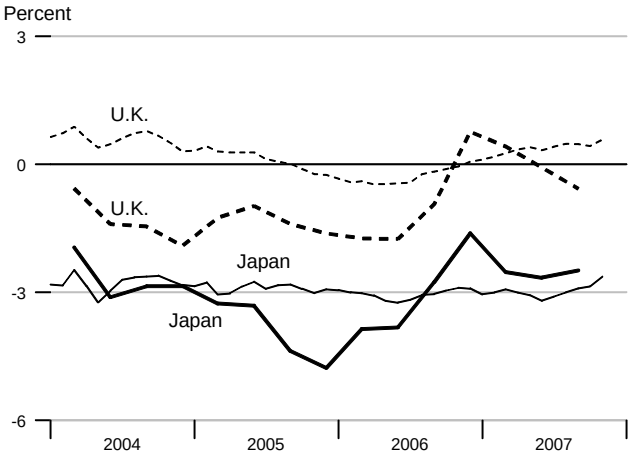


Recent Inflation and Long-Term Interest Rates

	Consumer Price Inflation Rates				Long-Term Government Bond Rates			
	Percent change from year ago				Percent			
	2006Q4	2007Q1	2007Q2	2007Q3	Aug07	Sep07	Oct07	Nov07
United States	1.95	2.43	2.66	2.35	4.67	4.52	4.53	4.15
Canada	1.37	1.81	2.19	2.13	4.46	4.37	4.36	4.13
France	1.34	1.16	1.18	1.27	4.39	4.36	4.40	.
Germany	1.31	1.74	1.88	2.05	4.30	4.22	4.28	.
Italy	1.82	1.73	1.59	1.64	4.58	4.57	4.59	4.45
Japan	0.33	-0.10	0.00	-0.13	1.67	1.61	1.67	1.52
United Kingdom	2.71	2.84	2.58	1.78	5.15	4.99	4.96	4.73

Inflation and Long-Term Interest Rate Differentials





		Money Stock				Bank	Adjusted		
		M1	MZM	M2	M3*	Credit	Monetary Base	Reserves	MSI M2**
2002		1196.216	5890.222	5595.630	8259.055	5595.853	697.075	88.132	294.080
2003		1273.521	6327.435	5986.754	8787.321	6118.739	740.938	93.325	315.192
2004		1344.426	6579.108	6269.195	9234.718	6603.671	776.768	96.129	329.873
2005		1371.784	6726.913	6548.158	9786.477	7249.693	806.627	96.558	343.539
2006		1374.729	7001.821	6862.496	10270.74	7965.422	835.013	94.886	
2005	1	1368.481	6663.276	6446.910	9528.052	7000.674	798.379	96.773	339.356
	2	1368.666	6675.454	6500.139	9670.405	7166.776	802.566	95.998	341.280
	3	1375.430	6745.070	6581.597	9859.294	7363.058	809.023	96.938	344.766
	4	1374.558	6823.850	6663.987	10088.16	7468.266	816.538	96.525	348.753
2006	1	1379.219	6895.933	6757.218		7649.056	830.533	96.494	
	2	1381.509	6944.603	6816.066		7894.833	836.330	95.026	
	3	1369.521	7014.604	6884.346		8035.489	834.533	94.751	
	4	1368.666	7152.143	6992.353		8282.310	838.655	93.275	
2007	1	1367.362	7301.329	7119.525		8448.013	846.370	94.186	
	2	1375.134	7506.459	7235.376		8574.463	849.949	93.585	
	3	1369.812	7743.628	7328.044		8820.074	852.273	95.369	
2005	Nov	1375.747	6819.656	6662.301	10078.49	7455.014	817.464	97.558	348.603
	Dec	1373.181	6843.357	6688.408	10154.03	7514.035	815.427	94.026	350.067
2006	Jan	1378.697	6885.406	6733.958	10242.79	7569.569	825.163	96.789	353.032
	Feb	1374.954	6894.486	6758.444	10298.68	7652.717	832.401	96.867	353.943
	Mar	1384.006	6907.906	6779.251		7724.883	834.035	95.826	
	Apr	1380.482	6927.943	6800.245		7815.744	835.307	95.578	
	May	1387.828	6940.391	6811.549		7929.129	836.887	94.200	
	Jun	1376.216	6965.474	6836.404		7939.626	836.797	95.299	
	Jul	1372.260	6986.018	6860.449		7986.899	834.900	94.811	
	Aug	1372.186	7015.213	6885.884		8048.412	834.570	94.647	
	Sep	1364.116	7042.582	6906.704		8071.157	834.130	94.795	
	Oct	1369.266	7100.943	6955.724		8224.572	837.900	93.970	
	Nov	1370.788	7145.767	6990.552		8273.926	840.382	94.764	
	Dec	1365.944	7209.718	7030.783		8348.433	837.684	91.090	
2007	Jan	1371.817	7254.817	7085.739		8406.875	843.515	94.207	
	Feb	1360.561	7282.739	7108.410		8479.114	847.351	94.520	
	Mar	1369.709	7366.432	7164.426		8458.051	848.245	93.832	
	Apr	1379.253	7455.083	7218.321		8520.245	849.000	93.641	
	May	1379.281	7513.858	7237.847		8576.758	849.686	92.841	
	Jun	1366.867	7550.437	7249.960		8626.385	851.162	94.272	
	Jul	1369.752	7609.383	7274.480		8694.014	851.984	94.700	
	Aug	1370.171	7748.942	7338.846		8820.249	853.482	96.632	
	Sep	1369.512	7872.560	7370.806		8945.960	851.353	94.776	
	Oct	1370.303	7976.218	7395.569		9062.640	856.418	93.354	
	Nov	1363.946	8060.822	7424.452		9181.907	857.503	95.553	

Note: All values are given in billions of dollars. *See table of contents for changes to the series.

**We will not update the MSI series until we revise the code to accommodate the discontinuation of M3.

		Federal Funds	Primary Credit Rate	Prime Rate	3-mo CDs	Treasury Yields 3-mo	3-yr	10-yr	Corporate Aaa Bonds	Municipal Aaa Bonds	Conventional Mortgage
2002		1.67		4.68	1.73	1.63	3.10	4.61	6.49	4.87	6.54
2003		1.13	2.11	4.12	1.15	1.03	2.11	4.02	5.67	4.52	5.82
2004		1.35	2.34	4.34	1.56	1.40	2.78	4.27	5.63	4.50	5.84
2005		3.21	4.19	6.19	3.51	3.21	3.93	4.29	5.23	4.28	5.86
2006		4.96	5.96	7.96	5.15	4.85	4.77	4.79	5.59	4.15	6.41
2005	1	2.47	3.44	5.44	2.78	2.58	3.61	4.30	5.32	4.23	5.76
	2	2.94	3.91	5.91	3.23	2.93	3.73	4.16	5.15	4.15	5.72
	3	3.46	4.43	6.43	3.74	3.43	3.98	4.21	5.09	4.28	5.76
	4	3.98	4.97	6.97	4.30	3.91	4.37	4.49	5.38	4.45	6.22
2006	1	4.46	5.43	7.43	4.72	4.50	4.58	4.57	5.39	4.29	6.24
	2	4.91	5.90	7.90	5.18	4.83	4.98	5.07	5.89	4.36	6.60
	3	5.25	6.25	8.25	5.39	5.03	4.87	4.90	5.68	4.13	6.56
	4	5.25	6.25	8.25	5.32	5.03	4.65	4.63	5.39	3.82	6.24
2007	1	5.26	6.25	8.25	5.31	5.12	4.68	4.68	5.36	3.91	6.22
	2	5.25	6.25	8.25	5.32	4.87	4.76	4.85	5.58	4.13	6.37
	3	5.07	5.93	8.18	5.42	4.42	4.41	4.73	5.75	4.27	6.55
2005	Nov	4.00	5.00	7.00	4.31	3.97	4.43	4.54	5.42	4.42	6.33
	Dec	4.16	5.15	7.15	4.45	3.97	4.39	4.47	5.37	4.46	6.27
2006	Jan	4.29	5.26	7.26	4.56	4.34	4.35	4.42	5.29	4.27	6.15
	Feb	4.49	5.50	7.50	4.72	4.54	4.64	4.57	5.35	4.33	6.25
	Mar	4.59	5.53	7.53	4.88	4.63	4.74	4.72	5.53	4.29	6.32
	Apr	4.79	5.75	7.75	5.03	4.72	4.89	4.99	5.84	4.36	6.51
	May	4.94	5.93	7.93	5.15	4.84	4.97	5.11	5.95	4.38	6.60
	Jun	4.99	6.02	8.02	5.35	4.92	5.09	5.11	5.89	4.35	6.68
	Jul	5.24	6.25	8.25	5.46	5.08	5.07	5.09	5.85	4.41	6.76
	Aug	5.25	6.25	8.25	5.38	5.09	4.85	4.88	5.68	4.10	6.52
	Sep	5.25	6.25	8.25	5.34	4.93	4.69	4.72	5.51	3.87	6.40
	Oct	5.25	6.25	8.25	5.33	5.05	4.72	4.73	5.51	3.91	6.36
	Nov	5.25	6.25	8.25	5.32	5.07	4.64	4.60	5.33	3.81	6.24
	Dec	5.24	6.25	8.25	5.32	4.97	4.58	4.56	5.32	3.76	6.14
2007	Jan	5.25	6.25	8.25	5.32	5.11	4.79	4.76	5.40	3.89	6.22
	Feb	5.26	6.25	8.25	5.31	5.16	4.75	4.72	5.39	3.95	6.29
	Mar	5.26	6.25	8.25	5.30	5.08	4.51	4.56	5.30	3.88	6.16
	Apr	5.25	6.25	8.25	5.31	5.01	4.60	4.69	5.47	3.99	6.18
	May	5.25	6.25	8.25	5.31	4.87	4.69	4.75	5.47	4.04	6.26
	Jun	5.25	6.25	8.25	5.33	4.74	5.00	5.10	5.79	4.36	6.66
	Jul	5.26	6.25	8.25	5.32	4.96	4.82	5.00	5.73	4.24	6.70
	Aug	5.02	6.01	8.25	5.49	4.32	4.34	4.67	5.79	4.30	6.57
	Sep	4.94	5.53	8.03	5.46	3.99	4.06	4.52	5.74	4.26	6.38
	Oct	4.76	5.24	7.74	5.08	4.00	4.01	4.53	5.66	4.20	6.38
	Nov	4.49	5.00	7.50	4.97	3.35	3.35	4.15	5.44		6.21

Note: All values are given as a percent at an annual rate.

		M1	MZM	M2	M3*
Percent change at an annual rate					
	2002	4.91	12.77	7.48	7.98
	2003	6.46	7.42	6.99	6.40
	2004	5.57	3.98	4.72	5.09
	2005	2.03	2.25	4.45	5.97
	2006	0.21	4.09	4.80	4.95
2005	1	-0.58	0.03	3.23	5.63
	2	0.05	0.73	3.30	5.98
	3	1.98	4.17	5.01	7.81
	4	-0.25	4.67	5.01	9.29
2006	1	1.36	4.23	5.60	
	2	0.66	2.82	3.48	
	3	-3.47	4.03	4.01	
	4	-0.25	7.84	6.28	
2007	1	-0.38	8.34	7.27	
	2	2.27	11.24	6.51	
	3	-1.55	12.64	5.12	
2005	Nov	0.87	1.96	3.80	5.57
	Dec	-2.24	4.17	4.70	8.99
2006	Jan	4.82	7.37	8.17	10.49
	Feb	-3.26	1.58	4.36	6.55
	Mar	7.90	2.34	3.69	
	Apr	-3.06	3.48	3.72	
	May	6.39	2.16	1.99	
	Jun	-10.04	4.34	4.38	
	Jul	-3.45	3.54	4.22	
	Aug	-0.06	5.01	4.45	
	Sep	-7.06	4.68	3.63	
	Oct	4.53	9.94	8.52	
	Nov	1.33	7.57	6.01	
	Dec	-4.24	10.74	6.91	
2007	Jan	5.16	7.51	9.38	
	Feb	-9.85	4.62	3.84	
	Mar	8.07	13.79	9.46	
	Apr	8.36	14.44	9.03	
	May	0.02	9.46	3.25	
	Jun	-10.80	5.84	2.01	
	Jul	2.53	9.37	4.06	
	Aug	0.37	22.01	10.62	
	Sep	-0.58	19.14	5.23	
	Oct	0.69	15.80	4.03	
	Nov	-5.57	12.73	4.69	

*See table of contents for changes to the series.

Definitions

M1: The sum of currency held outside the vaults of depository institutions, Federal Reserve Banks, and the U.S. Treasury; travelers checks; and demand and other checkable deposits issued by financial institutions (except demand deposits due to the Treasury and depository institutions), minus cash items in process of collection and Federal Reserve float.

MZM (money, zero maturity): M2 minus small-denomination time deposits, plus institutional money market mutual funds (that is, those included in M3 but excluded from M2). The label MZM was coined by William Poole (1991); the aggregate itself was proposed earlier by Motley (1988).

M2: M1 plus savings deposits (including money market deposit accounts) and small-denomination (under $100,000) time deposits issued by financial institutions; and shares in retail money market mutual funds (funds with initial investments under $50,000), net of retirement accounts.

M3: M2 plus large-denomination ($100,000 or more) time deposits; repurchase agreements issued by depository institutions; Eurodollar deposits, specifically, dollar-denominated deposits due to nonbank U.S. addresses held at foreign offices of U.S. banks worldwide and all banking offices in Canada and the United Kingdom; and institutional money market mutual funds (funds with initial investments of $50,000 or more).

Bank Credit: All loans, leases, and securities held by commercial banks.

Domestic Nonfinancial Debt: Total credit market liabilities of the U.S. Treasury, federally sponsored agencies, state and local governments, households, and nonfinancial firms. End-of-period basis.

Adjusted Monetary Base: The sum of currency in circulation outside Federal Reserve Banks and the U.S. Treasury, deposits of depository financial institutions at Federal Reserve Banks, and an adjustment for the effects of changes in statutory reserve requirements on the quantity of base money held by depositories. This series is a spliced chain index; see Anderson and Rasche (1996a,b, 2001, 2003).

Adjusted Reserves: The sum of vault cash and Federal Reserve Bank deposits held by depository institutions and an adjustment for the effects of changes in statutory reserve requirements on the quantity of base money held by depositories. This spliced chain index is numerically larger than the Board of Governors' measure, which excludes vault cash not used to satisfy statutory reserve requirements and Federal Reserve Bank deposits used to satisfy required clearing balance contracts; see Anderson and Rasche (1996a, 2001, 2003).

Monetary Services Index: An index that measures the flow of monetary services received by households and firms from their holdings of liquid assets; see Anderson, Jones, and Nesmith (1997). Indexes are shown for the assets included in M2, with additional data at research.stlouisfed.org/msi/index.html.

Note: M1, M2, M3, Bank Credit, and Domestic Nonfinancial Debt are constructed and published by the Board of Governors of the Federal Reserve System. For details, see *Statistical Supplement to the Federal Reserve Bulletin*, tables 1.21 and 1.26. MZM, Adjusted Monetary Base, Adjusted Reserves, and Monetary Services Index are constructed and published by the Research Division of the Federal Reserve Bank of St. Louis.

Notes

Page 3: Readers are cautioned that, since early 1994, the level and growth of M1 have been depressed by retail sweep programs that reclassify transactions deposits (demand deposits and other checkable deposits) as savings deposits overnight, thereby reducing banks' required reserves; see Anderson and Rasche (2001) and research.stlouisfed.org/aggreg/swdata.html. **Primary Credit Rate**, **Discount Rate,** and **Intended Federal Funds Rate** shown in the chart **Reserve Market Rates** are plotted as of the date of the change, while the **Effective Federal Funds Rate** is plotted as of the end of the month. Interest rates in the table are monthly averages from the Board of Governors H.15 Statistical Release. The **Treasury Yield Curve** and **Real Treasury Yield Curve** show constant maturity yields calculated by the U.S. Treasury for securities 5, 7, 10, and 20 years to maturity. **Inflation-Indexed Treasury Yield Spreads** are a measure of inflation compensation at those horizons, and it is simply the nominal constant maturity yield less the real constant maturity yield. Daily data and descriptions are available at research.stlouisfed.org/fred2/. See also *Statistical Supplement to the Federal Reserve Bulletin*, table 1.35. The 30-year constant maturity series was discontinued by the Treasury as of February 18, 2002.

Page 5: **Checkable Deposits** is the sum of demand and other checkable deposits. **Savings Deposits** is the sum of money market deposit accounts and passbook and statement savings. **Time Deposits** have a minimum initial maturity of 7 days. **Large Time Deposits** are deposits of $100,000 or more. **Retail** and **Institutional Money Market Mutual Funds** are as included in M2 and the non-M2 component of M3, respectively.

Page 7: **Excess Reserves plus RCB (Required Clearing Balance) Contracts** equals the amount of deposits at Federal Reserve Banks held by depository institutions but not applied to satisfy statutory reserve requirements. (This measure excludes the vault cash held by depository institutions that is not applied to satisfy statutory reserve requirements.) **Consumer Credit** includes most short- and intermediate-term credit extended to individuals. See *Statistical Supplement to the Federal Reserve Bulletin*, table 1.55.

Page 8: **Inflation Expectations** measures include the quarterly Federal Reserve Bank of Philadelphia *Survey of Professional Forecasters*, the monthly University of Michigan Survey Research Center's *Surveys of Consumers*, and the annual Federal Open Market Committee (FOMC) range as reported to the Congress in the February testimony that accompanies the Monetary Policy Report to the Congress. Beginning February 2000, the FOMC began using the personal consumption expenditures (PCE) price index to report its inflation range; the FOMC then switched to the PCE chain-type price index excluding food and energy prices ("core") beginning July 2004. Accordingly, neither are shown on this graph. **CPI Inflation** is the percentage change from a year ago in the consumer price index for all urban consumers. **Real Interest Rates** are ex post measures, equal to nominal rates minus year-over-year CPI inflation.

Page 9: **FOMC Intended Federal Funds Rate** is the level (or midpoint of the range, if applicable) of the federal funds rate that the staff of the FOMC expected to be consistent with the desired degree of pressure on bank reserve positions. In recent years, the FOMC has set an explicit target for the federal funds rate.

Page 10: **Federal Funds Rate and Inflation Targets** shows the observed federal funds rate, quarterly, and the level of the funds rate implied by applying Taylor's (1993) equation

$$f_t^* = 2.5 + \pi_{t-1} + (\pi_{t-1} - \pi^*)/2 + 100 \times (y_{t-1} - y_{t-1}^P)/2$$

to five alternative target inflation rates, $\pi^* = 0, 1, 2, 3, 4$ percent, where f_t^* is the implied federal funds rate, π_{t-1} is the previous period's inflation rate (PCE) measured on a year-over-year basis, y_{t-1} is the log of the previous period's level of real gross domestic product (GDP), and y_{t-1}^P is the log of an estimate of the previous period's level of potential output. **Potential Real GDP** is as estimated by the Congressional Budget Office.

Monetary Base Growth and Inflation Targets shows the quarterly growth of the adjusted monetary base (modified to include an estimate of the effect of sweep programs) implied by applying McCallum's (1988, 1993) equation

$$\Delta MB_t^* = \pi^* + (\text{10-year moving average growth of real GDP}) - (\text{4-year moving average of base velocity growth})$$

to five alternative target inflation rates, $\pi^* = 0, 1, 2, 3, 4$ percent, where ΔMB_t^* is the implied growth rate of the adjusted monetary base. The 10-year moving average growth of real GDP for a quarter t is calculated as the average quarterly growth during the previous 40 quarters, at an annual rate, by the formula $((y_t - y_{t-40})/40) \times 400$, where y_t is the log of real GDP. The 4-year moving average of base velocity growth is calculated similarly. To adjust the monetary base for the effect of retail-deposit sweep programs, we add to the monetary base an amount equal to 10 percent of the total amount swept, as estimated by the Federal Reserve Board staff. These estimates are imprecise, at best. Sweep program data are found at research.stlouisfed.org/aggreg/swdata.html.

Page 11: **Implied One-Year Forward Rates** are calculated by this Bank from Treasury constant maturity yields. Yields to maturity, $R(m)$, for securities with $m = 1,\ldots, 10$ years to maturity are obtained by linear interpolation between reported yields. These yields are smoothed by fitting the regression suggested by Nelson and Siegel (1987),

$$R(m) = a_0 + (a_1 + a_2)(1 - e^{-m/50})/(m/50) - a_2 \times e^{-m/50},$$

and forward rates are calculated from these smoothed yields using equation (a) in table 13.1 of Shiller (1990),

$$f(m) = [D(m)R(m) - D(m-1)] / [D(m) - D(m-1)],$$

where duration is approximated as $D(m) = (1 - e^{-R(m) \times m})/R(m)$. These rates are linear approximations to the true instantaneous forward rates; see Shiller (1990). For a discussion of the use of forward rates as indicators of inflation expectations, see Sharpe (1997). **Rates on 3-Month Eurodollar Futures** and **Rates on Selected Federal Funds Futures Contracts** trace through time the yield on three specific contracts. **Rates on Federal Funds Futures on Selected Dates** displays a single day's snapshot of yields for contracts expiring in the months shown on the horizontal axis. **Inflation-Indexed Treasury Securities and Yield Spreads** are those plotted on page 3. **Inflation-Indexed 10-Year Government Notes** shows the yield of an inflation-indexed note that is scheduled to mature in approximately (but not greater than) 10 years. The current French note has a maturity date of 7/25/2015, the current U.K. note has a maturity date of 8/16/2013, and the current U.S. note has a maturity date of 7/15/2017. **Inflation-Indexed Treasury Yield Spreads** and **Inflation-Indexed 10-Year Government Yield Spreads** equal the difference between the yields on the most recently issued inflation-indexed securities and the unadjusted security yields of similar maturity.

Page 12: **Velocity** (for MZM and M2) equals the ratio of GDP, measured in current dollars, to the level of the monetary aggregate. **MZM** and **M2 Own Rates** are weighted averages of the rates received by households and firms on the assets included in the aggregates. Prior to 1982, the 3-month T-bill rates are secondary market yields. From 1982 forward, rates are 3-month constant maturity yields.

Page 13: **Real Gross Domestic Product** is GDP as measured in chained 2000 dollars. The **Gross Domestic Product Price Index** is the implicit price deflator for GDP, which is defined by the Bureau of Economic Analysis, U.S. Department of Commerce, as the ratio of GDP measured in current dollars to GDP measured in chained 2000 dollars.

Page 14: **Investment Securities** are all securities held by commercial banks in both investment and trading accounts.

Page 15: **Inflation Rate Differentials** are the differences between the foreign consumer price inflation rates and year-over-year changes in the U.S. all-items Consumer Price Index.

Page 17: **Treasury Yields** are Treasury constant maturities as reported in the Board of Governors of the Federal Reserve System's H.15 release.

Sources

Agence France Trésor: French note yields.

Bank of Canada: Canadian note yields.

Bank of England: U.K. note yields.

Board of Governors of the Federal Reserve System: Monetary aggregates and components: H.6 release. Bank credit and components: H.8 release. Consumer credit: G.19 release. Required reserves, excess reserves, clearing balance contracts, and discount window borrowing: H.4.1 and H.3 releases. Interest rates: H.15 release. Nonfinancial commercial paper: Board of Governors website. Nonfinancial debt: Z.1 release. M2 own rate.

Bureau of Economic Analysis: GDP.

Bureau of Labor Statistics: CPI.

Chicago Board of Trade: Federal funds futures contract.

Chicago Mercantile Exchange: Eurodollar futures.

Congressional Budget Office: Potential real GDP.

Federal Reserve Bank of Philadelphia: Survey of Professional Forecasters inflation expectations.

Federal Reserve Bank of St. Louis: Adjusted monetary base and adjusted reserves, monetary services index, MZM own rate, one-year forward rates.

Organization for Economic Cooperation and Development: International interest and inflation rates.

Standard & Poor's: Stock price-earnings ratio, stock price composite index.

University of Michigan Survey Research Center: Median expected price change.

U.S. Department of the Treasury: U.S. security yields.

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Note: *Available on the Internet at research.stlouisfed.org/publications/review/.