



## The Monetary Base and Bank Lending: You Can Lead a Horse to Water...

In its response to the worsening financial crisis during the fall of 2008, the Federal Reserve took actions that dramatically increased the size of the monetary base (the sum of currency in circulation and depository institution deposits with the Fed) (see chart). Subsequently, the Fed purchased some \$1.7 trillion of securities issued by the U.S. Treasury and federally sponsored housing agencies, which expanded the monetary base further. The base more than doubled in size between September 2008 and May 2010. Yet measures of the money stock, such as MZM, M1, and M2, increased far less. For example, M1 increased about 17 percent over these months; consequently, the ratio of M1 to the monetary base (measured by the St. Louis Adjusted Monetary Base), commonly referred to as the “M1 money multiplier,” fell from about 1.6 to 0.84.

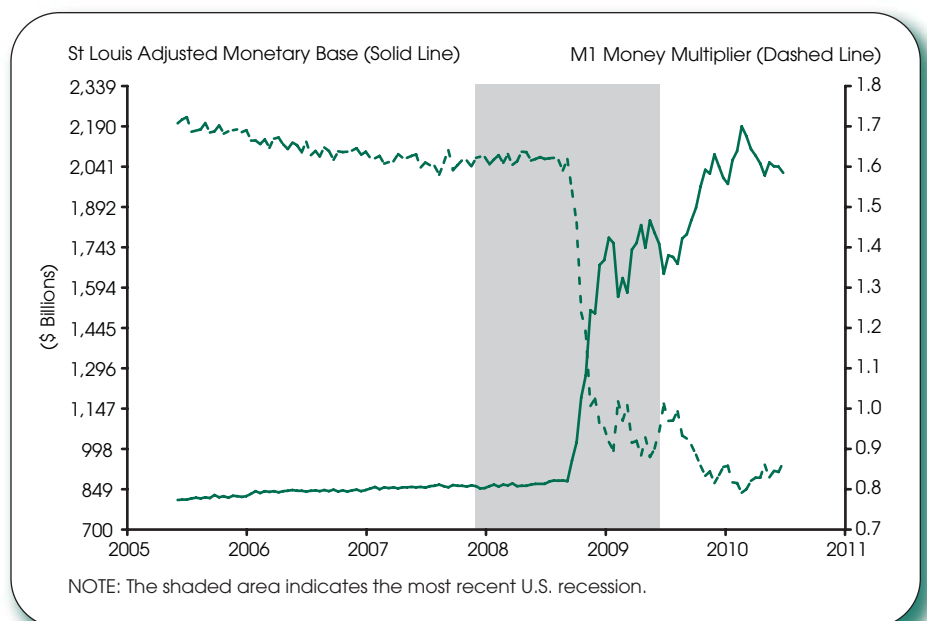
Why was the increase in the money stock so small when the increase in the monetary base was so large? The answer centers on the willingness of depository institutions (banks) to lend and the perceived creditworthiness of potential borrowers. A deposit is created when a bank makes a loan. Ordinarily, bank loans—and hence deposits—increase when the Fed adds reserves to the banking system. However, despite an increase in reserves of over \$1 trillion, total commercial bank loans were some \$200 billion lower in May 2010 than in September 2008. Banks added to their holdings of securities, which resulted in a modest increase in deposits and the money stock, but many banks were reluctant to make new loans. Partly this reflected weak loan demand, but it also indicated a diminished appetite for risk on the part of bankers. Further, a lack of equity capital (and a high cost of obtaining additional capital) constrained the lending of many banks (banks are subject to minimum capital requirements based on their outstanding loans and other assets).

Many economists worry that bank lending and monetary growth will eventually surge and, ultimately, cause higher inflation.

Minutes of Federal Open Market Committee meetings indicate that Fed officials have discussed possible measures to discourage excessive growth in lending and the money stock. One option is to sell securities outright or under repurchase agreements, which would shrink the monetary base. Recent experience illustrates, however, that large changes in the base may be necessary to effect the desired changes in bank lending. Another option is to raise the interest rate paid to banks on their reserve deposits, which would raise the opportunity cost of lending and thereby tend to exert upward pressure on market rates generally and slow the growth of loans and the money stock. However, because the Fed has little experience with paying interest on reserves, it is difficult to predict how much bank loans would change in response to an increase in the interest rate paid on reserve deposits.<sup>1</sup> Hence, the Fed may resort to both options if monetary growth threatens to become excessive.

—David C. Wheelock

<sup>1</sup> The Federal Reserve has paid interest on bank reserve deposits since October 2008 under authority granted by the Emergency Stabilization Act of 2008 (see Richard G. Anderson, “Paying Interest on Deposits at Federal Reserve Banks,” Federal Reserve Bank of St. Louis *Economic Synopses*, No. 30, 2008; <http://research.stlouisfed.org/publications/es/08/ES0830.pdf>).



Views expressed do not necessarily reflect official positions of the Federal Reserve System.

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## Conventions used in this publication:

1. Unless otherwise indicated, data are monthly.
2. Except where otherwise noted, solid shading indicates recessions, as determined by the National Bureau of Economic Research. The NBER has not yet determined the end of the recession that began in December 2007; however, the hatched shading shows that the recession ended in July 2009. We made this determination based on a statistical model for dating business cycle turning points developed by Marcelle Chauvet and Jeremy Piger (“A Comparison of the Real-Time Performance of Business Cycle Dating Methods,” *Journal of Business and Economic Statistics*, 2008, 26, 42-49). For more information, see [http://www.uoregon.edu/~jpiger/us\\_recession\\_probs.htm](http://www.uoregon.edu/~jpiger/us_recession_probs.htm).
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:

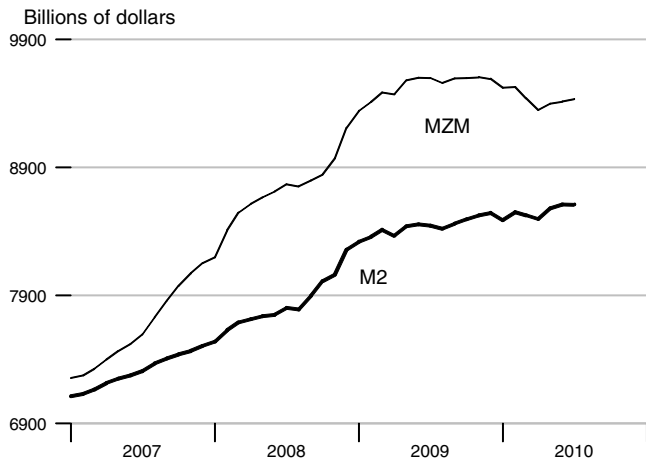
Editor, *Monetary Trends*  
Research Division  
Federal Reserve Bank of St. Louis  
P.O. Box 442  
St. Louis, MO 63166-0442

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.

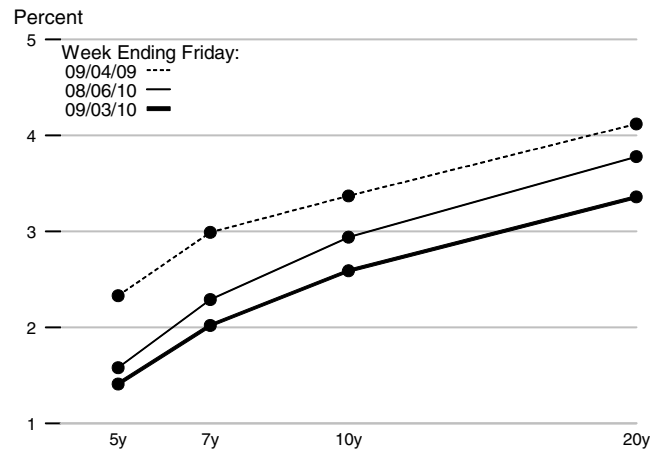
or to:

[stlsFRED@stls.frb.org](mailto:stlsFRED@stls.frb.org)

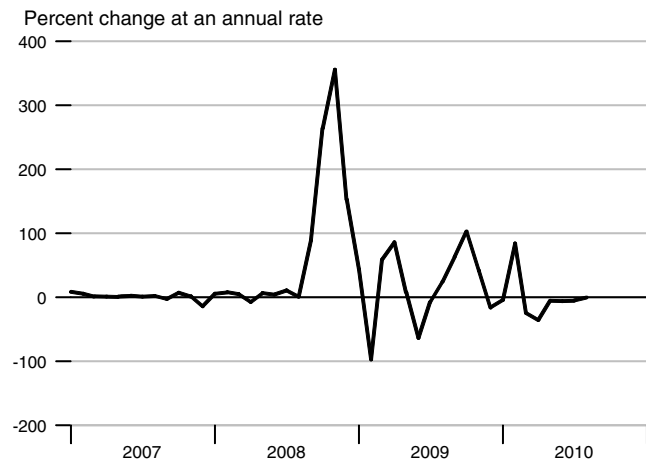
### M2 and MZM



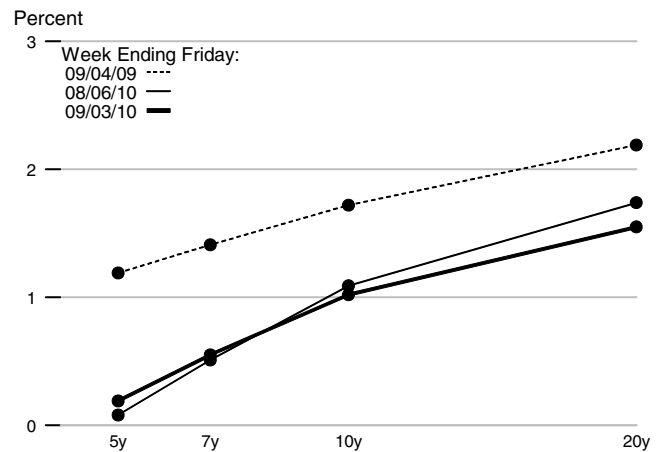
### Treasury Yield Curve



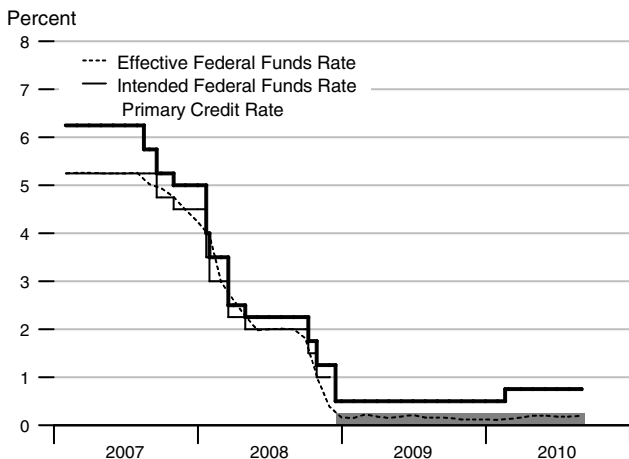
### Adjusted Monetary Base



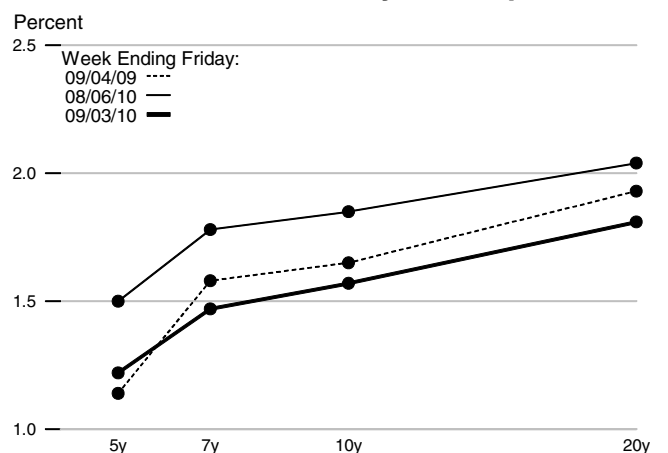
### Real Treasury Yield Curve



### Reserve Market Rates



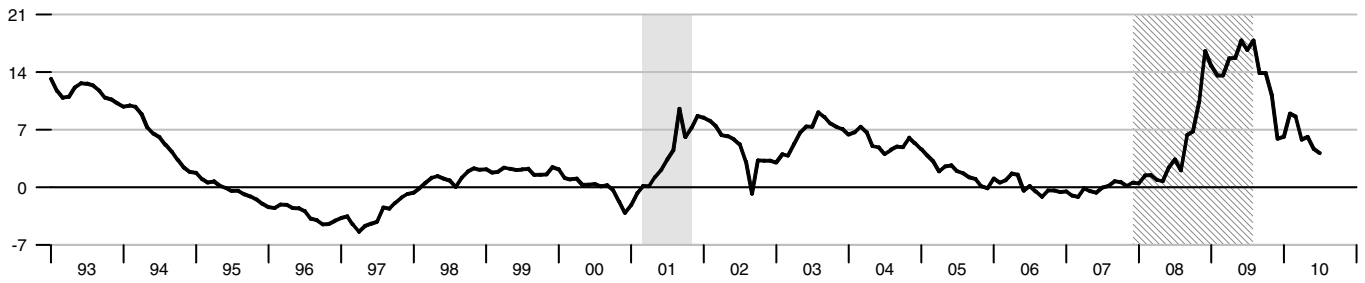
### Inflation-Indexed Treasury Yield Spreads



Note: Effective December 16, 2008, FOMC reports the intended Federal Funds Rate as a range.

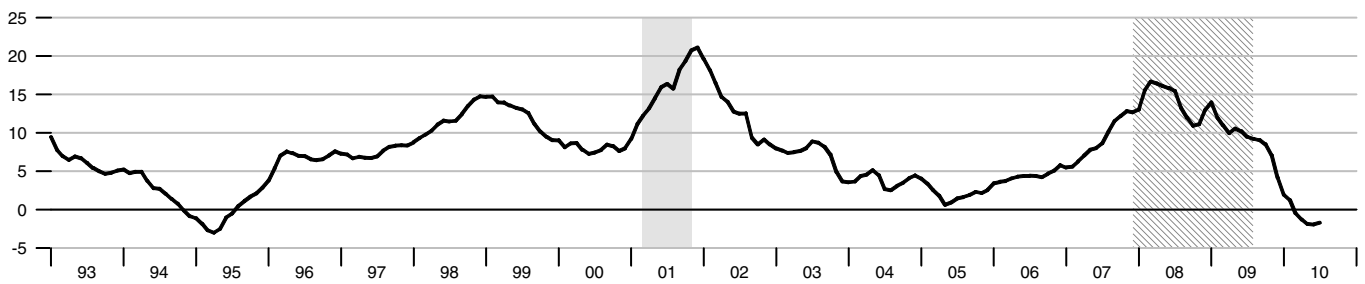
**M1**

Percent change from year ago



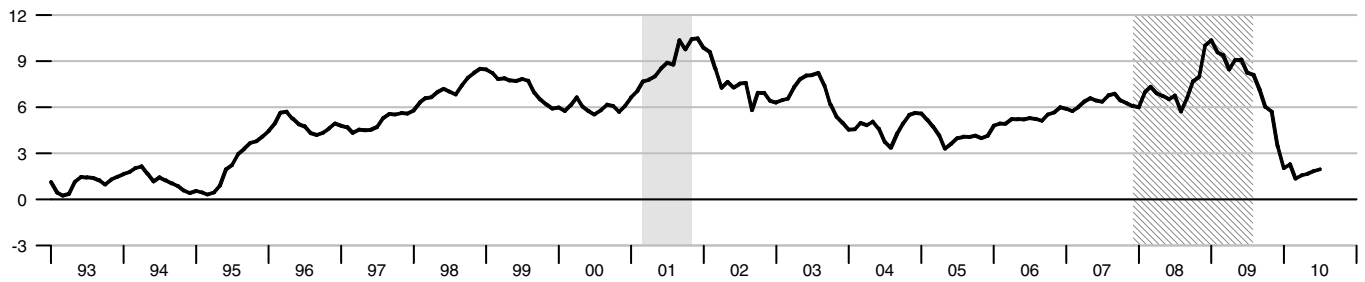
**M2M**

Percent change from year ago



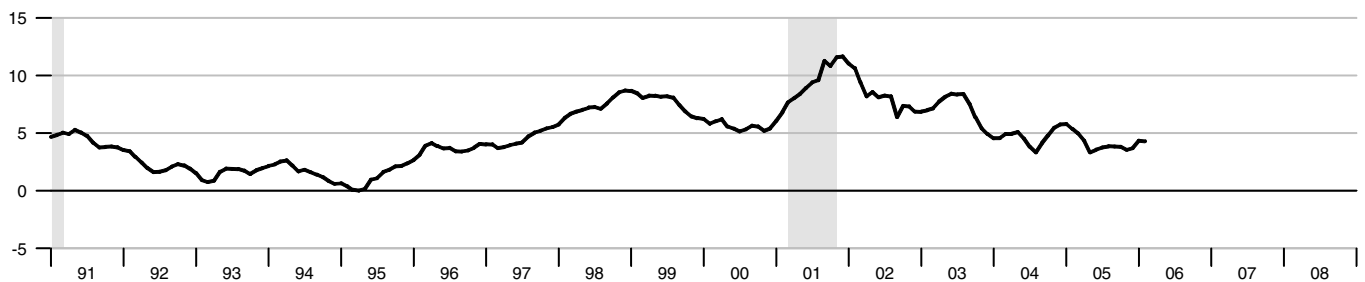
**M2**

Percent change from year ago



**Monetary Services Index - M2\*\***

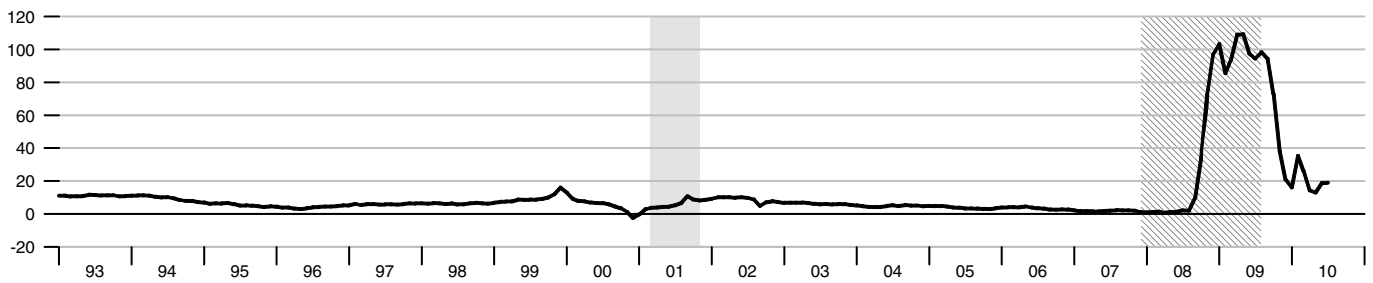
Percent change from year ago



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

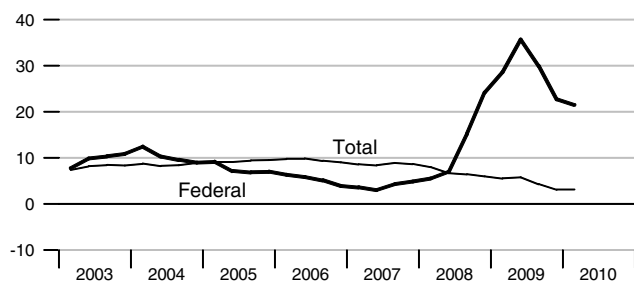
### Adjusted Monetary Base

Percent change from year ago



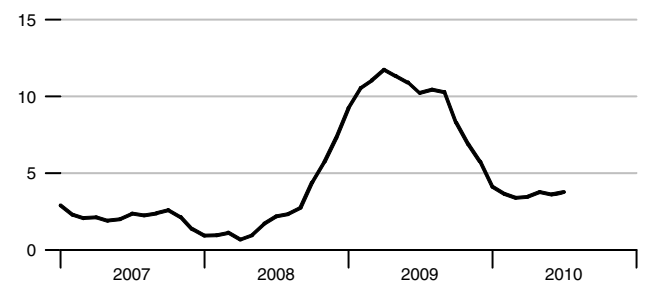
### Domestic Nonfinancial Debt

Percent change from year ago



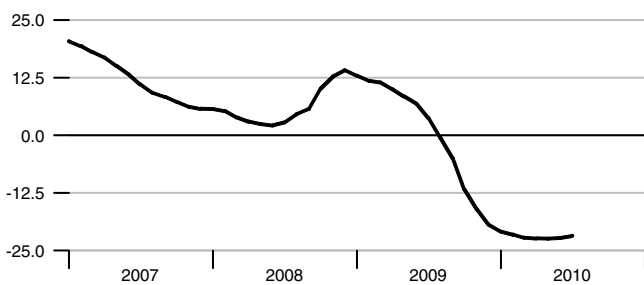
### Currency Held by the Nonbank Public

Percent change from year ago



### Small Denomination Time Deposits\*

Percent change from year ago



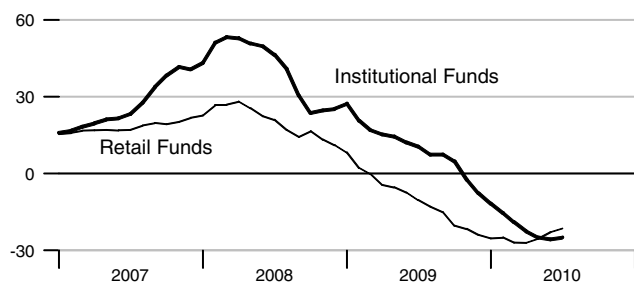
### Checkable Deposits

Percent change from year ago



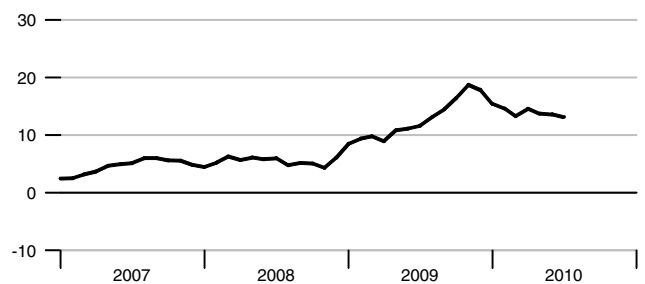
### Money Market Mutual Fund Shares

Percent change from year ago



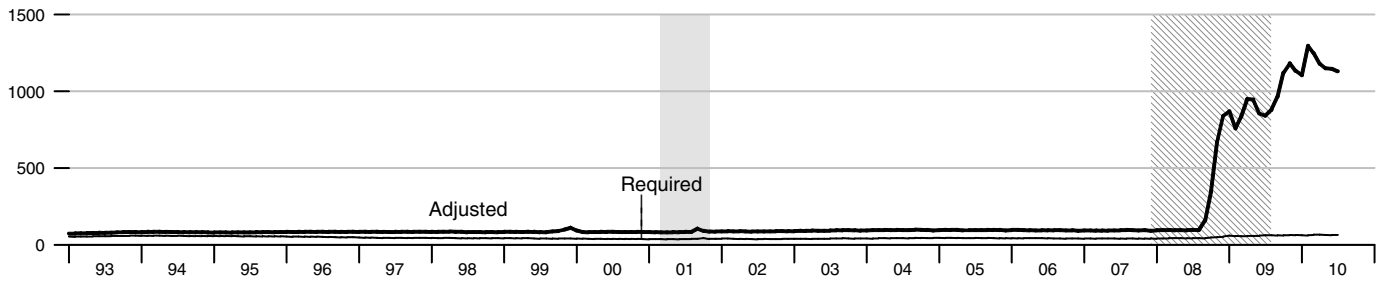
### Savings Deposits

Percent change from year ago



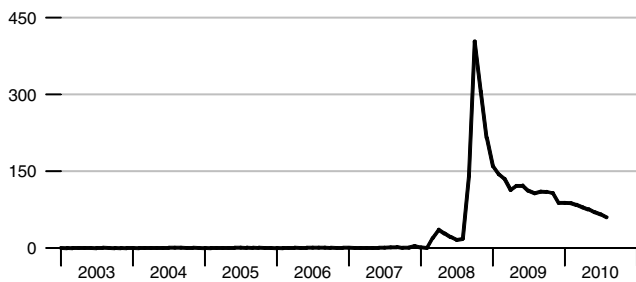
### Adjusted and Required Reserves

Billions of dollars



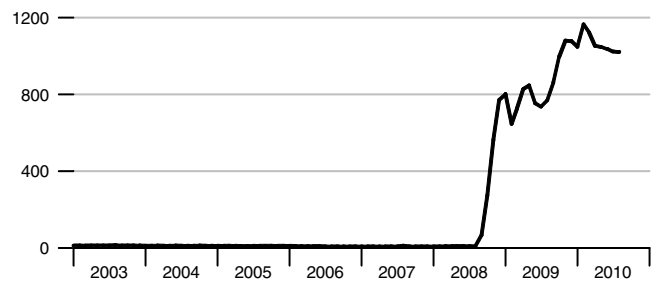
### Total Borrowings, nsa

Billions of dollars



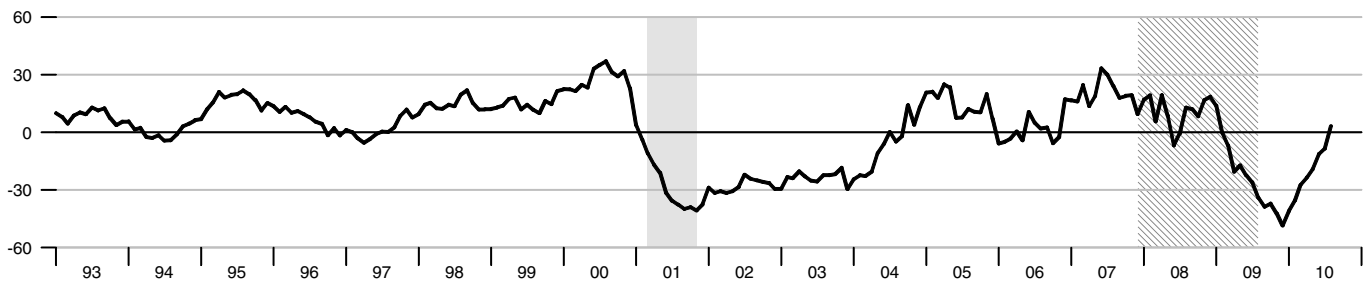
### Excess Reserves plus RCB Contracts

Billions of dollars



### Nonfinancial Commercial Paper

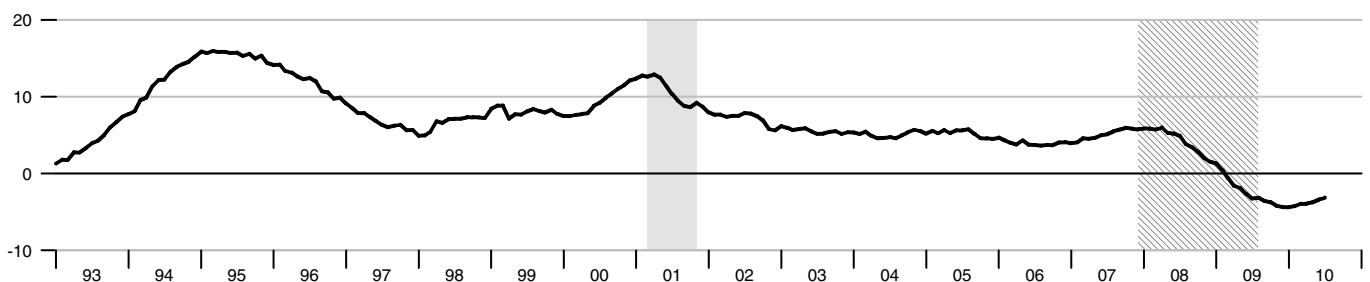
Percent change from year ago



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>.

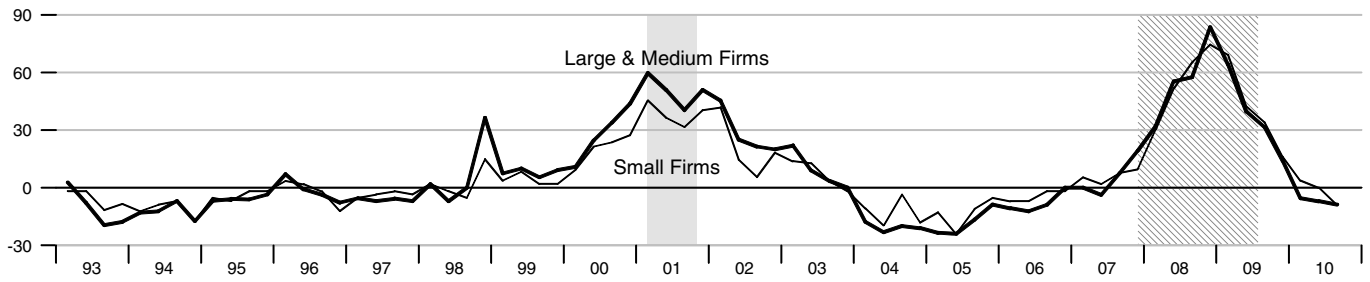
### Consumer Credit

Percent change from year ago



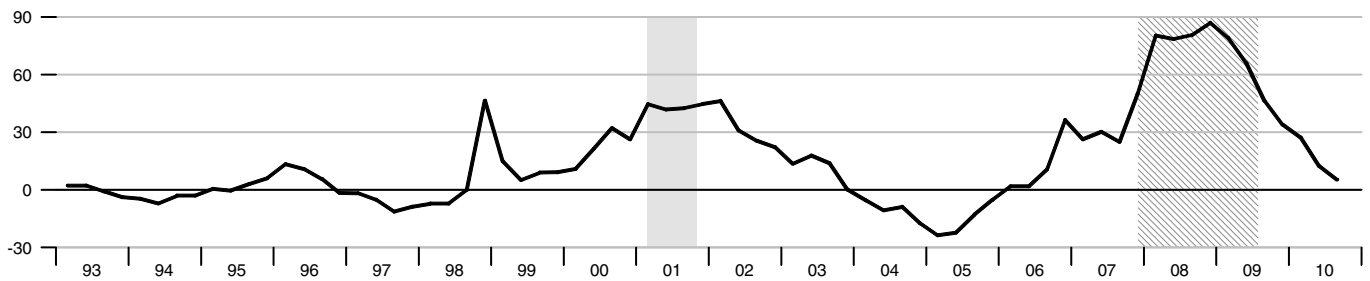
**Net Percentage of Domestic Banks Tightening Standards for Commercial and Industrial Loans**

Percentage



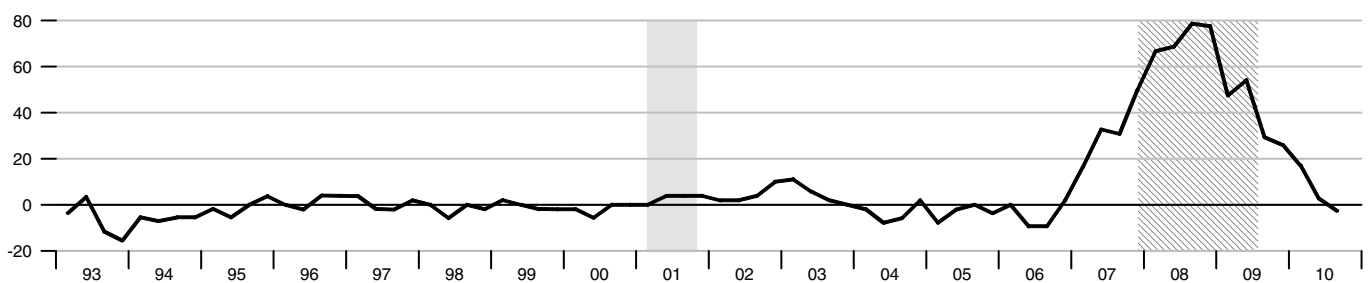
**Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans**

Percentage



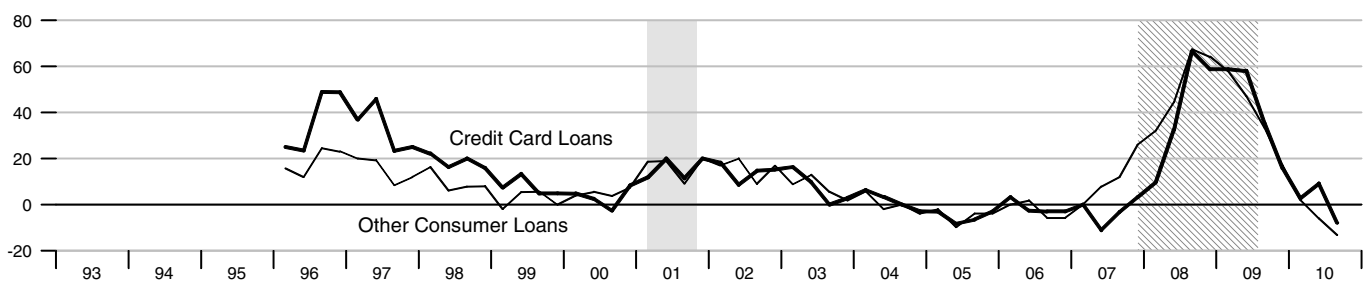
**Net Percentage of Domestic Banks Tightening Standards for Residential Mortgage Loans**

Percentage

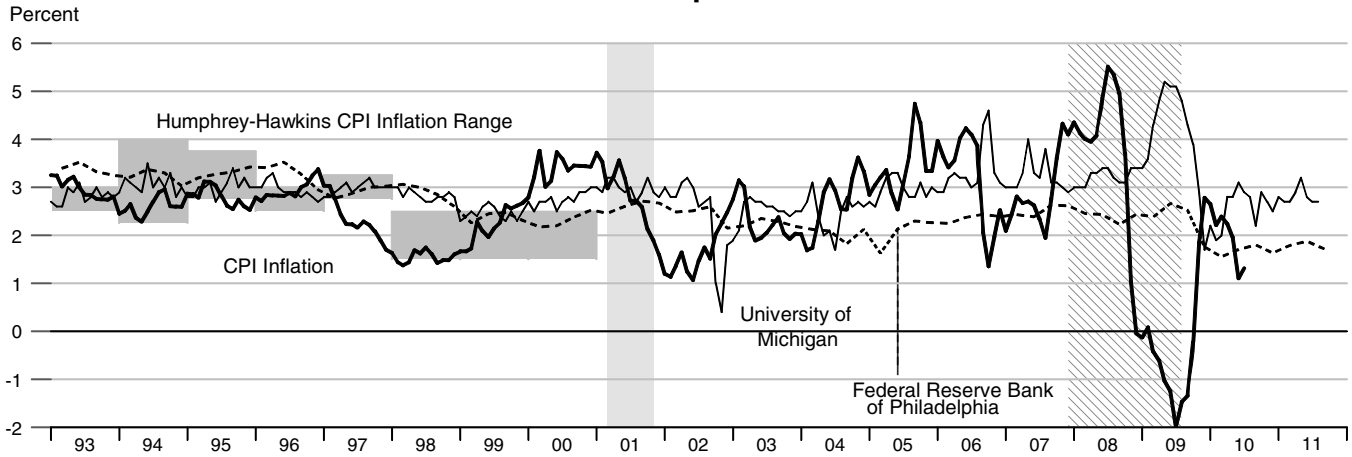


**Net Percentage of Domestic Banks Tightening Standards for Consumer Loans**

Percentage

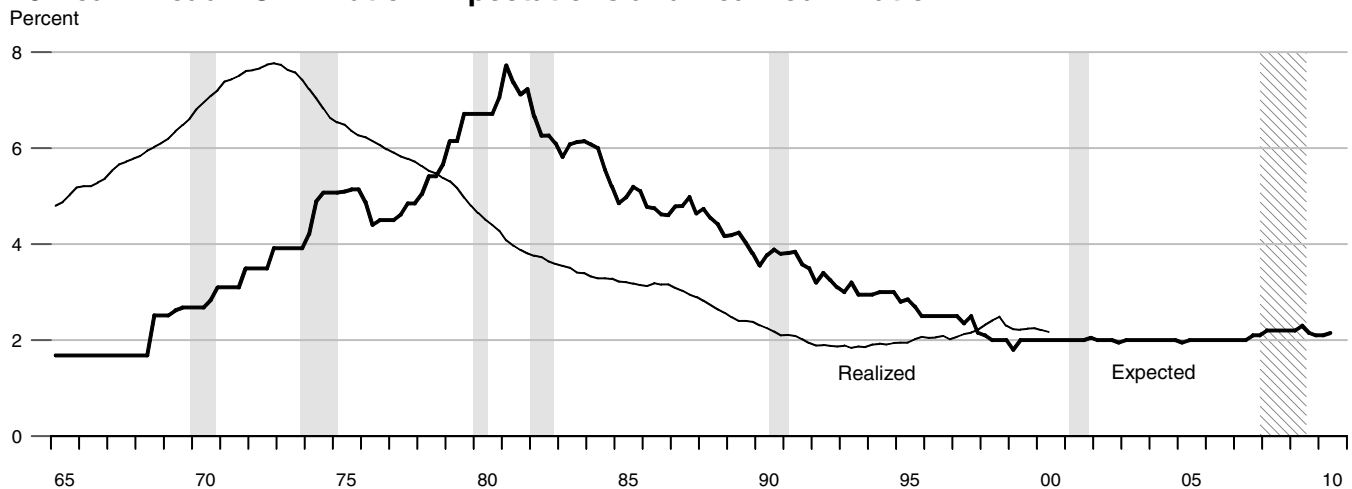


### CPI Inflation and 1-Year-Ahead CPI Inflation Expectations



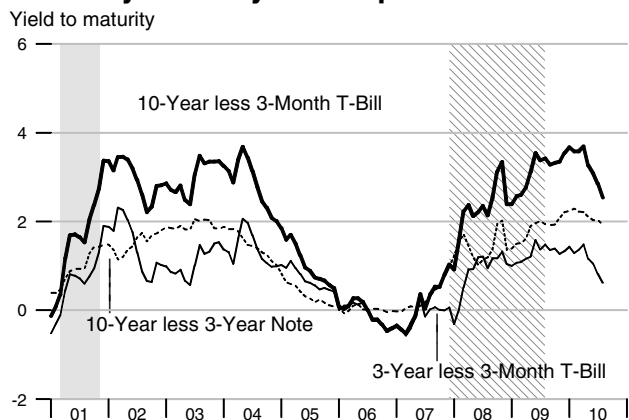
The shaded region shows the Humphrey-Hawkins inflation range. Beginning in January 2000, the Humphrey-Hawkins inflation range was reported using the PCE price index and therefore is not shown on this graph.

### 10-Year Ahead PCE Inflation Expectations and Realized Inflation

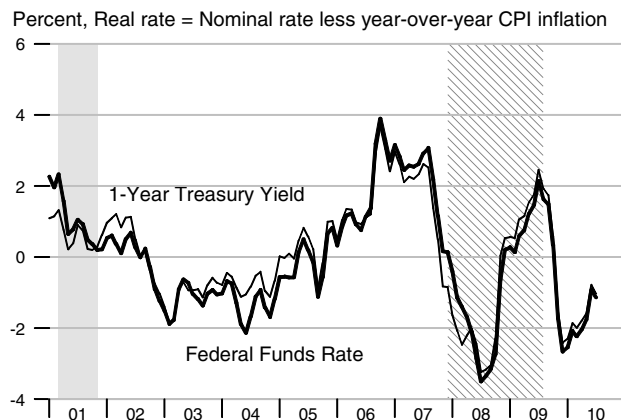


See the notes section for an explanation of the chart.

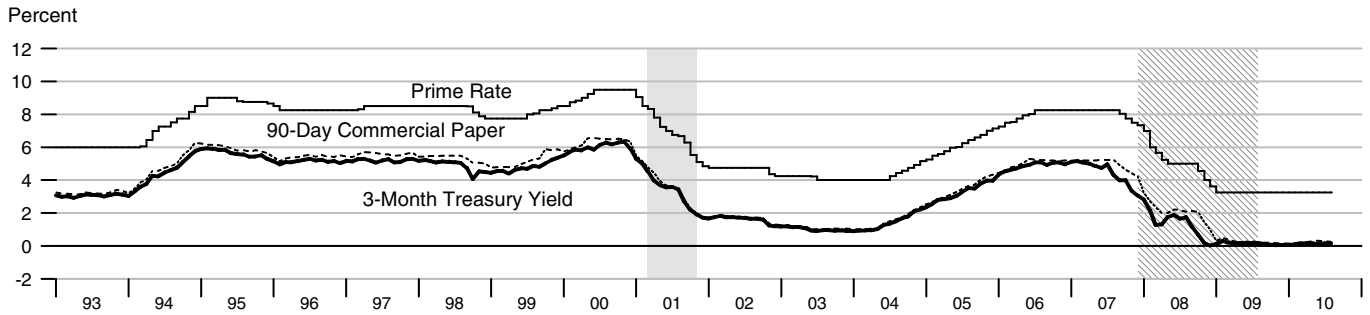
### Treasury Security Yield Spreads



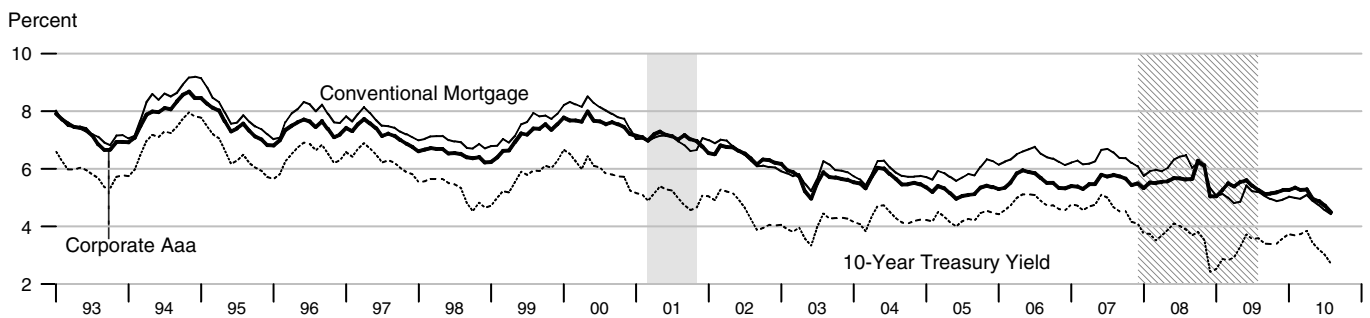
### Real Interest Rates



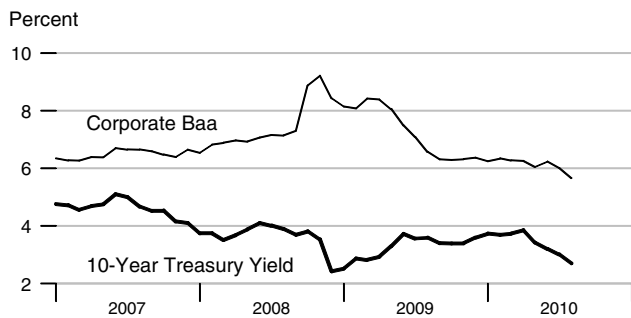
### Short-Term Interest Rates



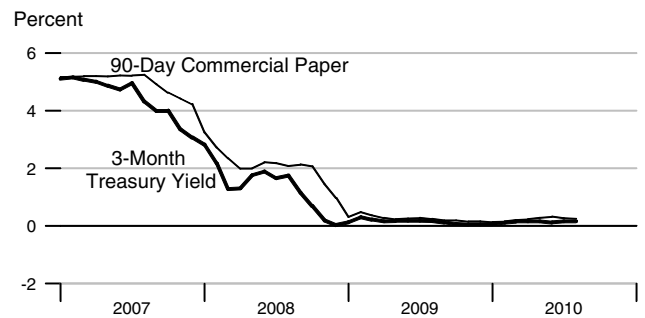
### Long-Term Interest Rates



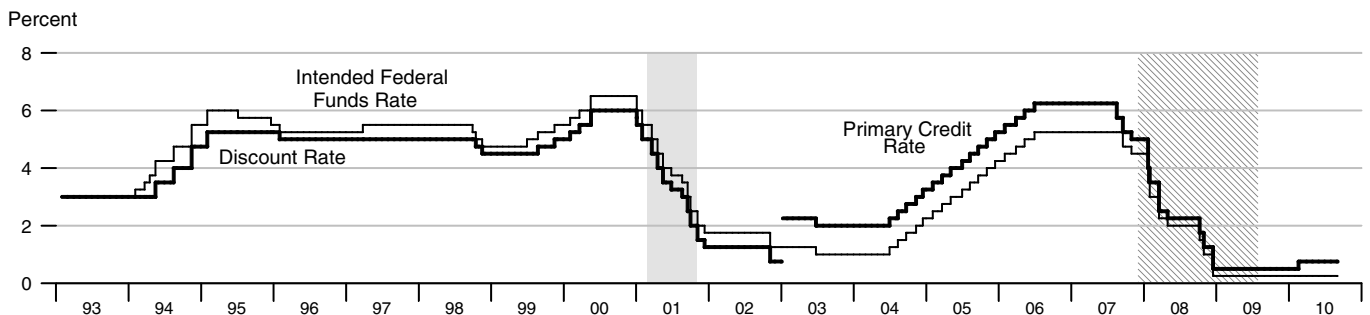
### Long-Term Interest Rates



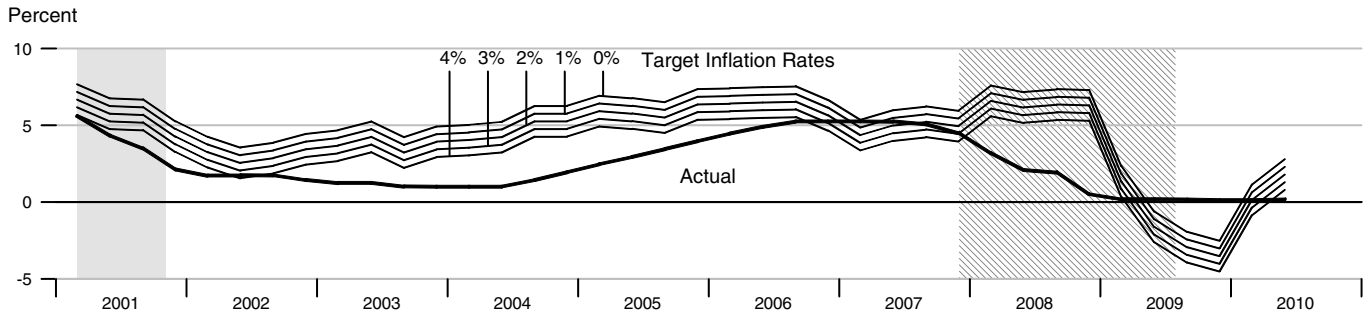
### Short-Term Interest Rates



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



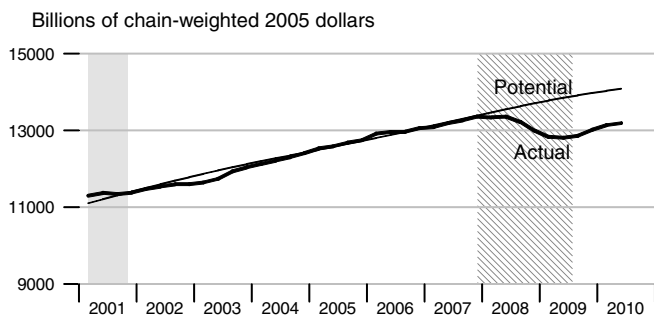
### Federal Funds Rate and Inflation Targets



Calculated federal funds rate is based on Taylor's rule.

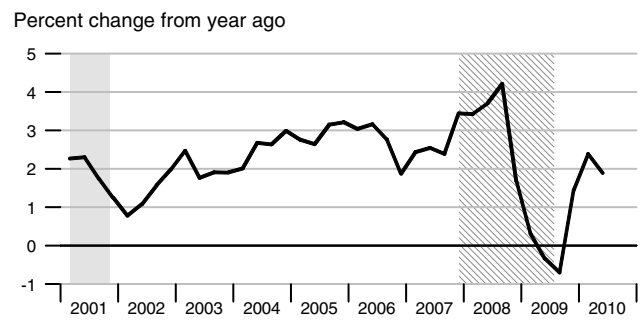
### Components of Taylor's Rule

#### Actual and Potential Real GDP

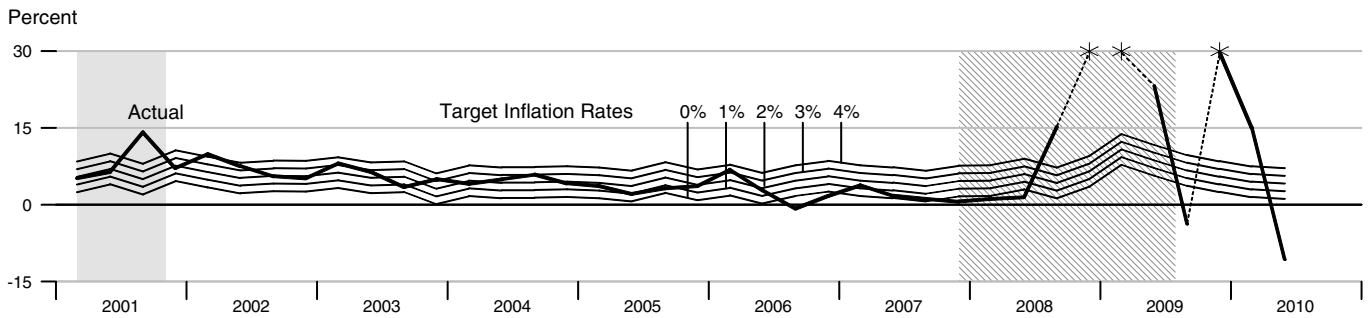


See notes section for further explanation.

#### PCE Inflation



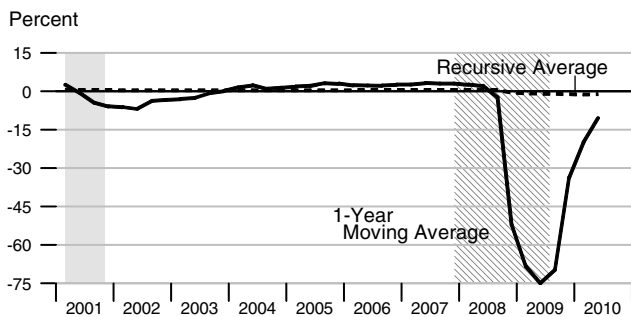
### Monetary Base Growth and Inflation Targets



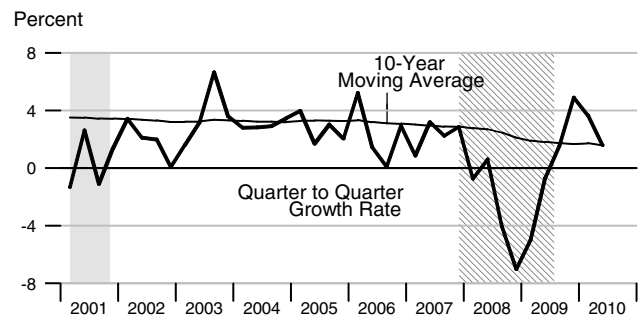
Calculated base growth is based on McCallum's rule. Actual base growth is percent change from the previous quarter.  
\*Actual values for 2008:Q4, 2009:Q1, and 2009:Q4 are 188.38 percent, 60.77 percent, and 56.51, respectively.

### Components of McCallum's Rule

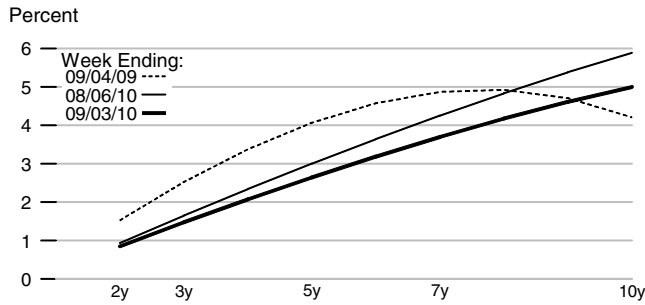
#### Monetary Base Velocity Growth



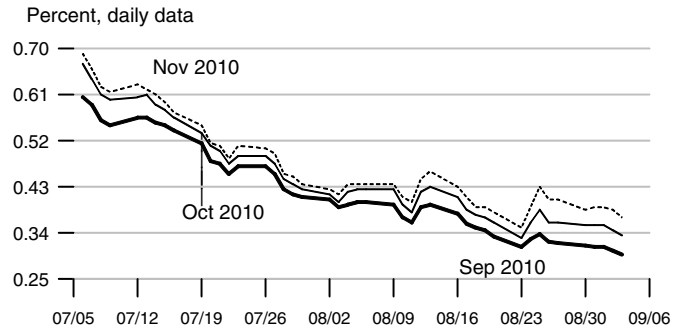
#### Real Output Growth



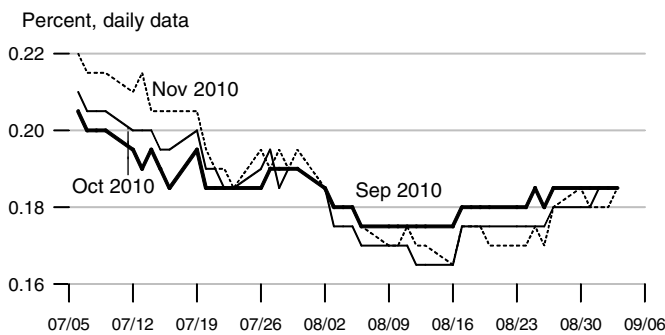
### Implied One-Year Forward Rates



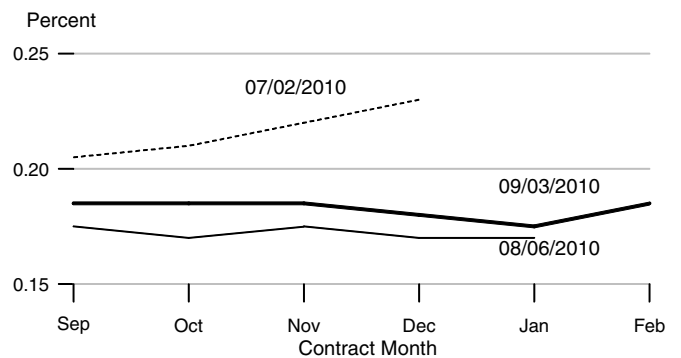
### Rates on 3-Month Eurodollar Futures



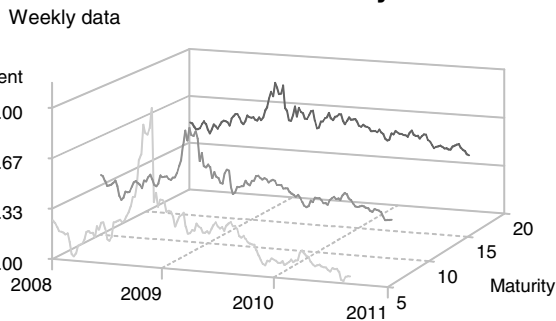
### Rates on Selected Federal Funds Futures Contracts



### Rates on Federal Funds Futures on Selected Dates

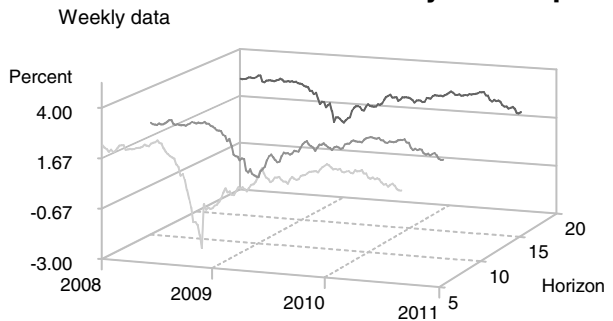


### Inflation-Indexed Treasury Securities



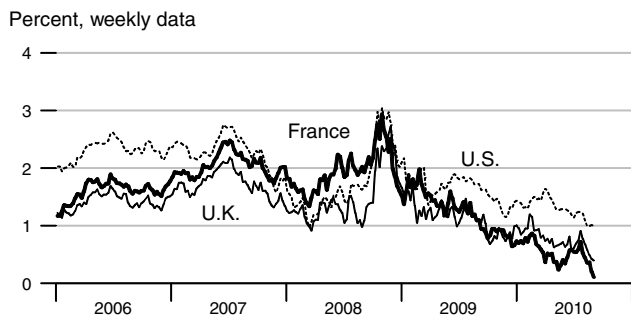
Note: Yields are inflation-indexed constant maturity U.S. Treasury securities

### Inflation-Indexed Treasury Yield Spreads

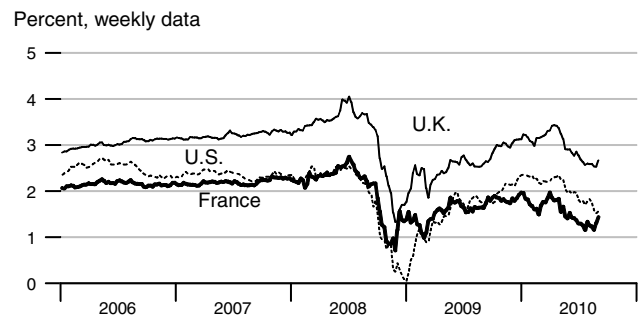


Note: Yield spread is between nominal and inflation-indexed constant maturity U.S. Treasury securities.

### Inflation-Indexed 10-Year Government Notes

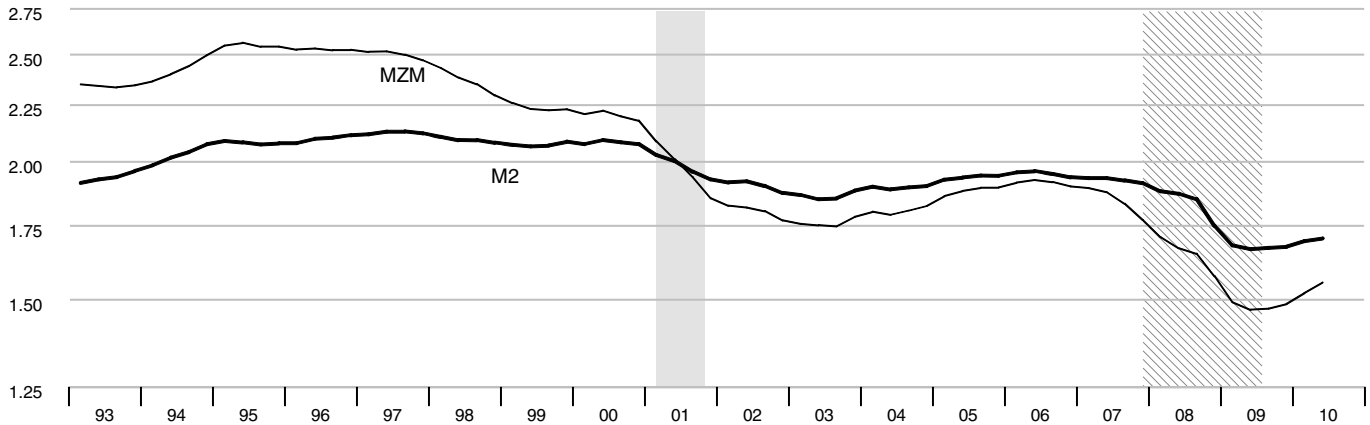


### Inflation-Indexed 10-Year Government Yield Spreads



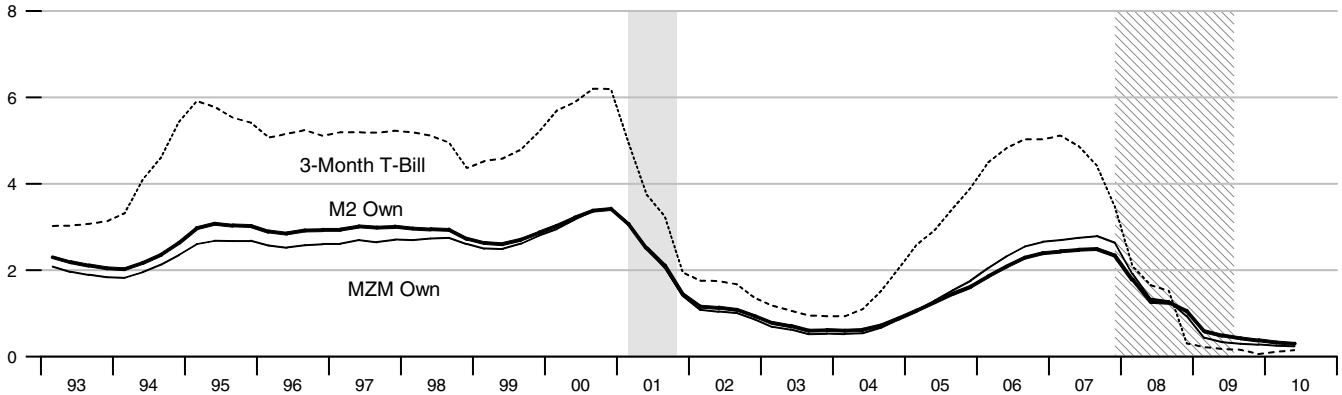
Velocity

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



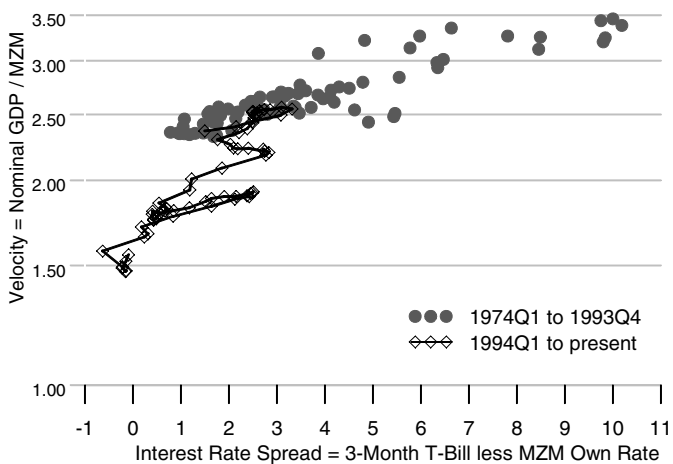
Interest Rates

Percent



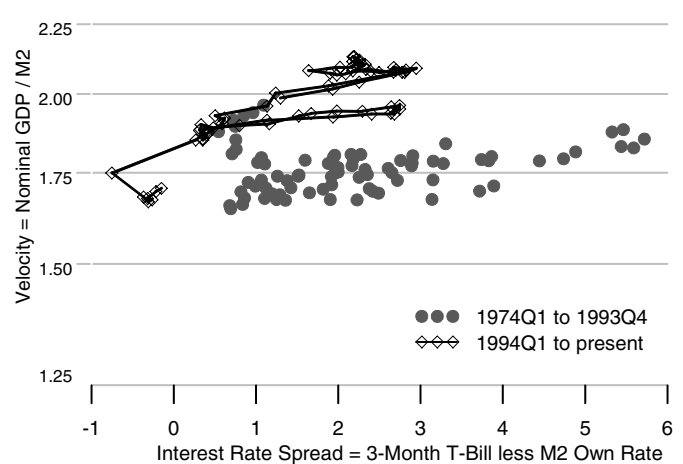
MZM Velocity and Interest Rate Spread

Ratio Scale



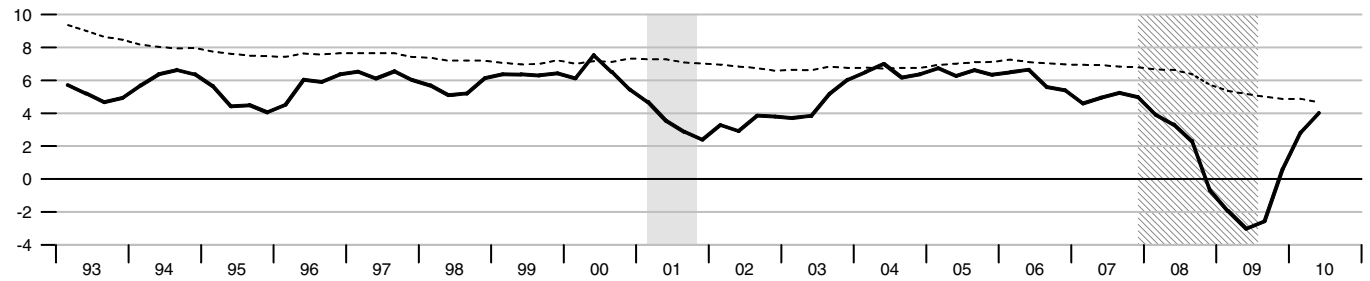
M2 Velocity and Interest Rate Spread

Ratio Scale



### Gross Domestic Product

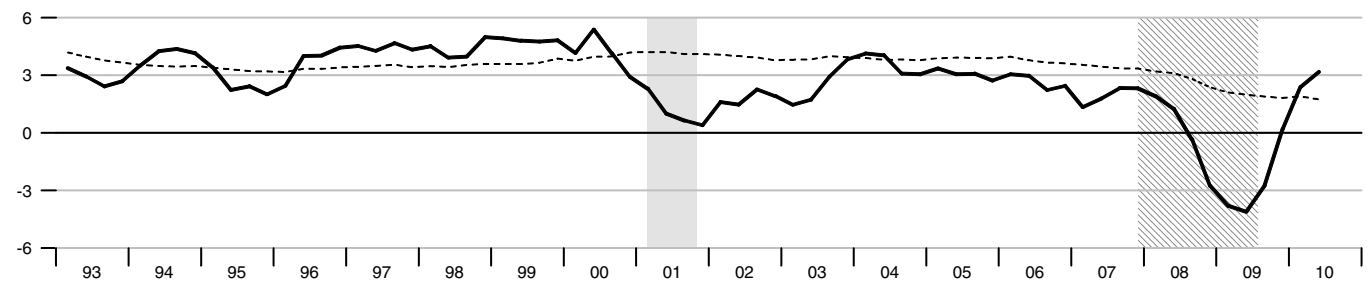
Percent change from year ago



Dashed lines indicate 10-year moving averages.

### Real Gross Domestic Product

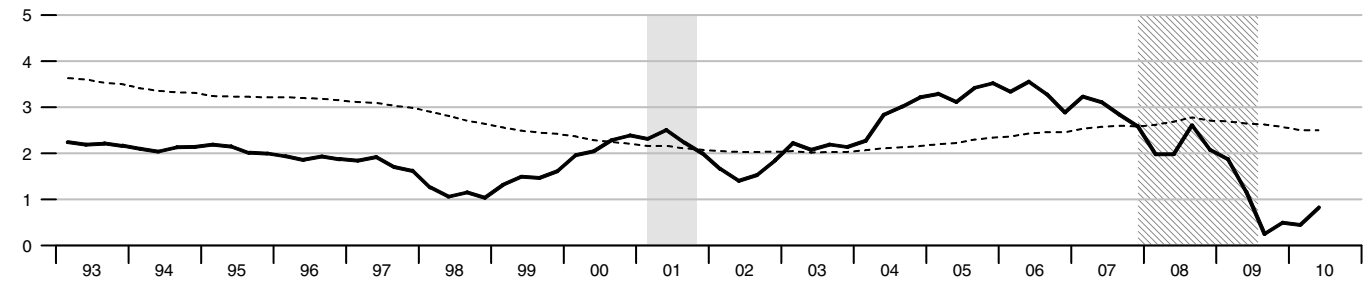
Percent change from year ago



Dashed lines indicate 10-year moving averages.

### Gross Domestic Product Price Index

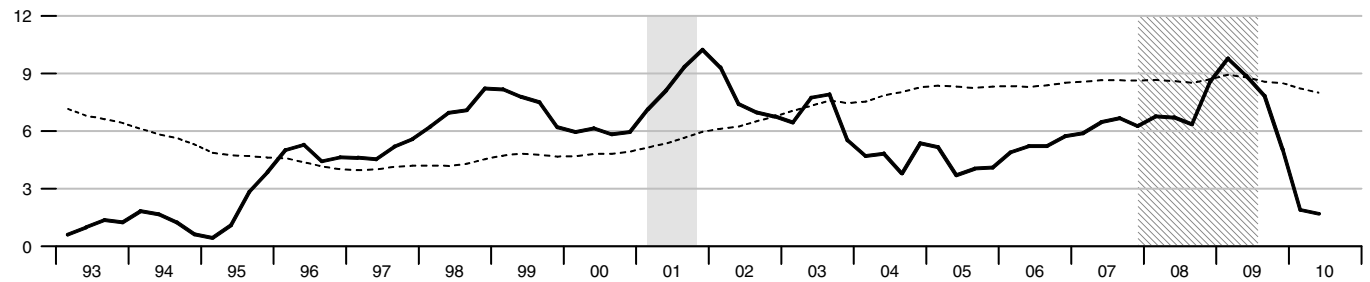
Percent change from year ago



Dashed lines indicate 10-year moving averages.

### M2

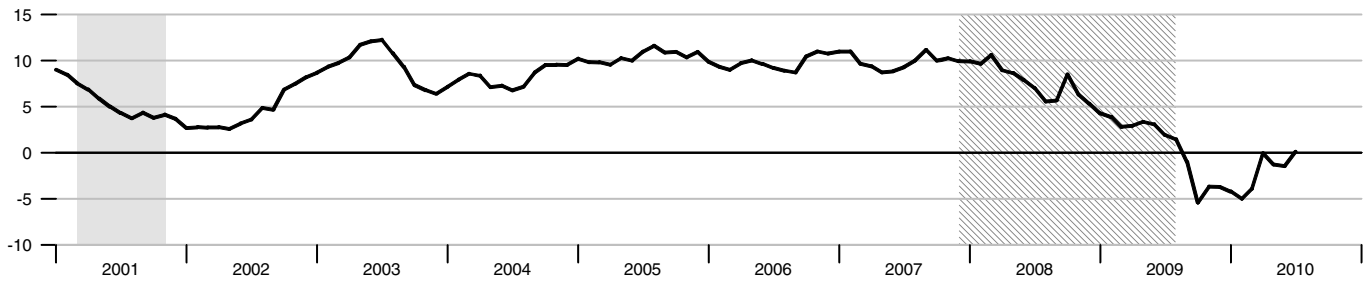
Percent change from year ago



Dashed lines indicate 10-year moving averages.

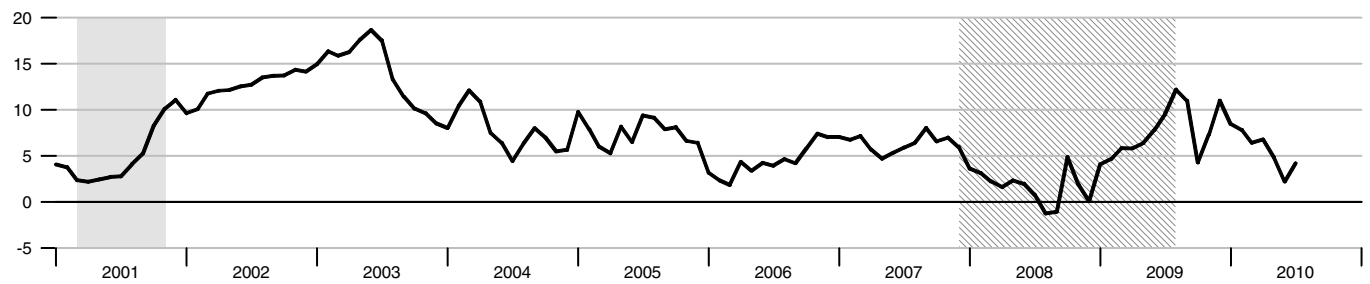
**Bank Credit**

Percent change from year ago



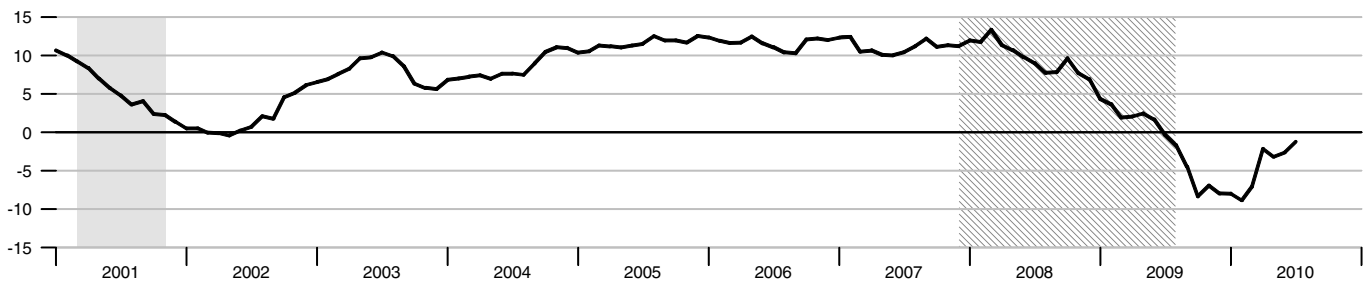
**Investment Securities in Bank Credit at Commercial Banks**

Percent change from year ago



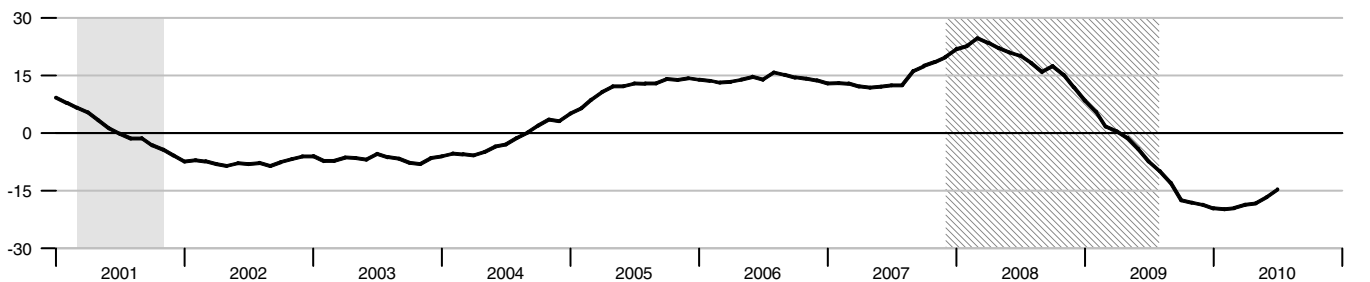
**Total Loans and Leases in Bank Credit at Commercial Banks**

Percent change from year ago

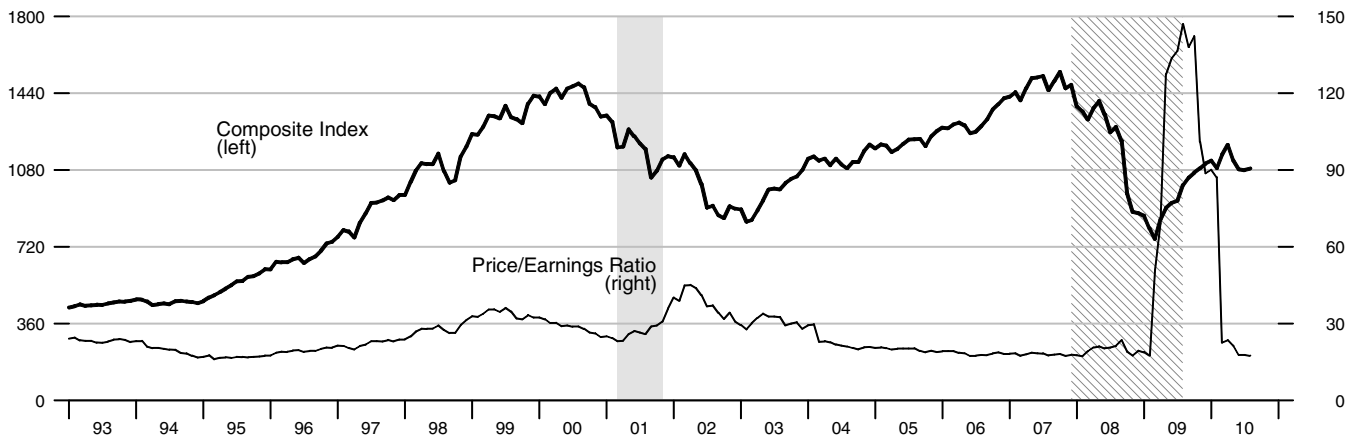


**Commercial and Industrial Loans at Commercial Banks**

Percent change from year ago



### Standard & Poor's 500

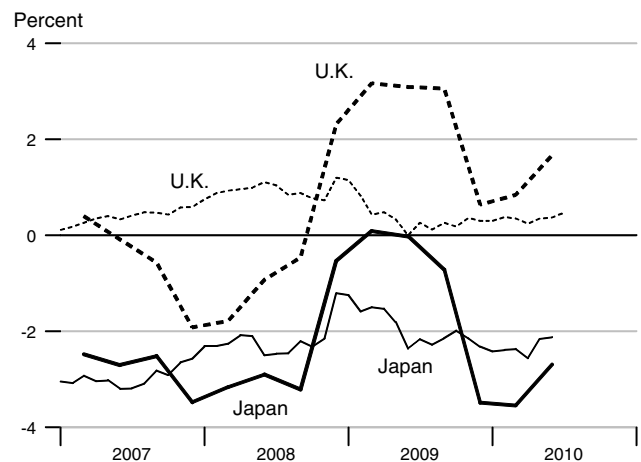
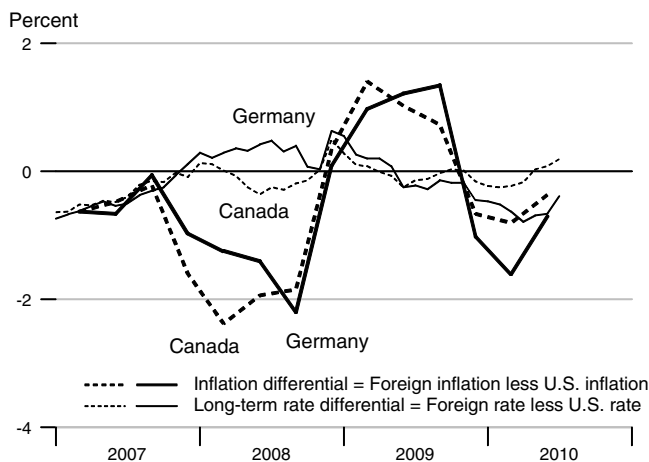


### Recent Inflation and Long-Term Interest Rates

	Consumer Price Inflation Rates				Long-Term Government Bond Rates			
	Percent change from year ago				Percent			
	2009Q3	2009Q4	2010Q1	2010Q2	May10	Jun10	Jul10	Aug10
United States	-1.60	1.46	2.42	1.77	3.42	3.20	3.01	2.70
Canada	-0.87	0.79	1.61	1.40	3.45	3.28	3.20	.
France	-0.42	0.36	1.32	1.61	3.08	3.07	.	.
Germany	-0.25	0.44	0.81	1.06	2.73	2.54	2.62	.
Italy	0.12	0.65	1.29	1.41	3.99	4.10	4.03	.
Japan	-2.31	-2.03	-1.12	-0.93	1.26	1.08	.	.
United Kingdom	1.46	2.09	3.26	3.44	3.77	3.57	3.48	.

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### Inflation and Long-Term Interest Rate Differentials



		Money Stock				Bank	Adjusted		MSI M2**	
		M1	MZM	M2	M3*	Credit	Monetary Base	Reserves		
2005		1371.536	6709.684	6524.832	9786.477	7015.642	806.623	96.555	343.539	
2006		1374.163	7000.882	6868.752	10270.74	7698.030	835.036	94.909		
2007		1372.079	7635.008	7303.199		8463.337	850.544	94.159		
2008		1432.775	8707.694	7823.088		9123.482	1009.767	232.170		
2009		1634.804	9537.118	8436.940		9193.247	1796.572	944.793		
2008	1	1384.590	8384.246	7618.254		9001.155	856.263	96.115		
	2	1392.557	8664.175	7733.424		9004.581	859.333	94.378		
	3	1423.718	8773.061	7829.293		9072.266	892.762	117.838		
	4	1530.237	9009.295	8111.382		9415.925	1430.712	620.349		
2009	1	1578.272	9413.546	8363.350		9330.060	1663.022	820.691		
	2	1621.078	9550.893	8420.406		9285.616	1763.719	917.109		
	3	1653.103	9585.002	8442.804		9144.193	1747.153	895.408		
	4	1686.765	9599.029	8521.200		9013.121	2012.393	1145.965		
2010	1	1702.912	9497.220	8521.489		8922.226	2089.181	1216.986		
	2	1710.363	9387.769	8563.048		9199.405	2034.267	1158.289		
2008	Jul	1413.845	8768.068	7801.390		9027.693	870.707	97.012		
	Aug	1398.847	8752.714	7789.624		9028.065	871.469	96.673		
	Sep	1458.462	8798.402	7896.864		9161.040	936.110	159.830		
	Oct	1471.733	8845.564	8012.064		9498.832	1142.155	347.607		
	Nov	1516.921	8971.958	8064.557		9389.721	1480.742	674.073		
	Dec	1602.056	9210.362	8257.526		9359.223	1669.239	839.367		
2009	Jan	1583.474	9342.150	8318.930		9334.898	1730.414	870.183		
	Feb	1573.982	9412.811	8358.887		9350.707	1590.201	758.628		
	Mar	1577.360	9485.677	8412.234		9304.574	1668.452	833.261		
	Apr	1608.534	9472.155	8366.764		9261.193	1787.758	949.349		
	May	1608.536	9579.490	8439.162		9313.723	1799.320	946.195		
	Jun	1646.163	9601.034	8455.293		9281.932	1704.080	855.782		
	Jul	1649.971	9599.330	8445.331		9202.625	1693.690	841.454		
	Aug	1648.483	9560.317	8421.966		9159.403	1728.096	879.570		
	Sep	1660.854	9595.358	8461.114		9070.552	1819.673	965.200		
	Oct	1676.188	9598.647	8493.987		8984.716	1975.377	1122.191		
	Nov	1687.511	9605.793	8525.219		9043.586	2044.519	1182.207		
	Dec	1696.597	9592.648	8544.394		9011.060	2017.284	1133.497		
2010	Jan	1680.757	9522.816	8488.470		8942.069	2010.112	1105.430		
	Feb	1714.827	9528.544	8549.933		8883.944	2150.910	1296.143		
	Mar	1713.151	9440.299	8526.064		8940.664	2106.522	1249.385		
	Apr	1701.691	9349.126	8498.054		9255.630	2044.296	1178.953		
	May	1706.769	9398.968	8579.979		9194.380	2034.542	1149.699		
	Jun	1722.630	9415.214	8611.111		9148.204	2023.962	1146.215		
	Jul	1718.488	9433.686	8610.356		9211.634	2015.148	1131.017		

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			Corporate Aaa Bonds	Municipal Aaa Bonds	Conventional Mortgage
						3-mo	3-yr	10-yr			
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
2007		5.02	5.86	8.05	5.27	4.47	4.34	4.63	5.56	4.13	6.34
2008		1.93	2.39	5.09	2.97	1.39	2.24	3.67	5.63	4.58	6.04
2009		0.16	0.50	3.25	0.56	0.15	1.43	3.26	5.31	4.27	5.04
2008	1	3.18	3.67	6.21	3.23	2.09	2.17	3.66	5.46	4.39	5.88
	2	2.09	2.33	5.08	2.76	1.65	2.67	3.89	5.60	4.43	6.09
	3	1.94	2.25	5.00	3.06	1.52	2.63	3.86	5.65	4.50	6.31
	4	0.51	1.31	4.06	2.82	0.30	1.48	3.25	5.82	5.02	5.87
2009	1	0.18	0.50	3.25	1.08	0.22	1.27	2.74	5.27	4.64	5.06
	2	0.18	0.50	3.25	0.62	0.17	1.49	3.31	5.51	4.43	5.03
	3	0.16	0.50	3.25	0.30	0.16	1.56	3.52	5.27	4.11	5.16
	4	0.12	0.50	3.25	0.22	0.06	1.39	3.46	5.20	3.91	4.92
2010	1	0.13	0.61	3.25	0.21	0.11	1.47	3.72	5.29	3.93	5.00
	2	0.19	0.75	3.25	0.42	0.15	1.38	3.49	5.04	3.83	4.91
2008	Aug	2.00	2.25	5.00	2.79	1.75	2.70	3.89	5.64	4.44	6.48
	Sep	1.81	2.25	5.00	3.59	1.15	2.32	3.69	5.65	4.61	6.04
	Oct	0.97	1.81	4.56	4.32	0.69	1.86	3.81	6.28	5.05	6.20
	Nov	0.39	1.25	4.00	2.36	0.19	1.51	3.53	6.12	4.83	6.09
	Dec	0.16	0.86	3.61	1.77	0.03	1.07	2.42	5.05	5.17	5.33
2009	Jan	0.15	0.50	3.25	1.02	0.13	1.13	2.52	5.05	4.64	5.06
	Feb	0.22	0.50	3.25	1.16	0.30	1.37	2.87	5.27	4.56	5.13
	Mar	0.18	0.50	3.25	1.07	0.22	1.31	2.82	5.50	4.74	5.00
	Apr	0.15	0.50	3.25	0.89	0.16	1.32	2.93	5.39	4.48	4.81
	May	0.18	0.50	3.25	0.57	0.18	1.39	3.29	5.54	4.26	4.86
	Jun	0.21	0.50	3.25	0.39	0.18	1.76	3.72	5.61	4.56	5.42
	Jul	0.16	0.50	3.25	0.35	0.18	1.55	3.56	5.41	4.36	5.22
	Aug	0.16	0.50	3.25	0.30	0.17	1.65	3.59	5.26	4.17	5.19
	Sep	0.15	0.50	3.25	0.25	0.12	1.48	3.40	5.13	3.81	5.06
	Oct	0.12	0.50	3.25	0.24	0.07	1.46	3.39	5.15	3.85	4.95
	Nov	0.12	0.50	3.25	0.21	0.05	1.32	3.40	5.19	3.99	4.88
	Dec	0.12	0.50	3.25	0.22	0.05	1.38	3.59	5.26	3.89	4.93
2010	Jan	0.11	0.50	3.25	0.20	0.06	1.49	3.73	5.26	3.96	5.03
	Feb	0.13	0.59	3.25	0.19	0.11	1.40	3.69	5.35	3.91	4.99
	Mar	0.16	0.75	3.25	0.23	0.15	1.51	3.73	5.27	3.91	4.97
	Apr	0.20	0.75	3.25	0.30	0.16	1.64	3.85	5.29	3.95	5.10
	May	0.20	0.75	3.25	0.45	0.16	1.32	3.42	4.96	3.75	4.89
	Jun	0.18	0.75	3.25	0.52	0.12	1.17	3.20	4.88	3.81	4.74
	Jul	0.18	0.75	3.25	0.41	0.16	0.98	3.01	4.72	3.69	4.56
	Aug	0.19	0.75	3.25	0.32	0.16	0.78	2.70	4.49	3.44	4.43

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

		M1	MZM	M2	M3*
<b>Percent change at an annual rate</b>					
2005		2.04	2.11	4.25	5.97
2006		0.19	4.34	5.27	4.95
2007		-0.15	9.06	6.32	
2008		4.42	14.05	7.12	
2009		14.10	9.53	7.85	
<hr/>					
2008	1	2.63	15.73	7.90	
	2	2.30	13.35	6.05	
	3	8.95	5.03	4.96	
	4	29.93	10.77	14.41	
2009	1	12.56	17.95	12.43	
	2	10.85	5.84	2.73	
	3	7.90	1.43	1.06	
	4	8.15	0.59	3.71	
2010	1	3.83	-4.24	0.01	
	2	1.75	-4.61	1.95	
<hr/>					
2008	Jul	14.61	7.74	8.03	
	Aug	-12.73	-2.10	-1.81	
	Sep	51.14	6.26	16.52	
	Oct	10.92	6.43	17.51	
	Nov	36.84	17.15	7.86	
	Dec	67.35	31.89	28.71	
<hr/>					
2009	Jan	-13.92	17.17	8.92	
	Feb	-7.19	9.08	5.76	
	Mar	2.58	9.29	7.66	
	Apr	23.72	-1.71	-6.49	
	May	0.00	13.60	10.38	
	Jun	28.07	2.70	2.29	
	Jul	2.78	-0.21	-1.41	
	Aug	-1.08	-4.88	-3.32	
	Sep	9.01	4.40	5.58	
	Oct	11.08	0.41	4.66	
	Nov	8.11	0.89	4.41	
	Dec	6.46	-1.64	2.70	
<hr/>					
2010	Jan	-11.20	-8.74	-7.85	
	Feb	24.32	0.72	8.69	
	Mar	-1.17	-11.11	-3.35	
	Apr	-8.03	-11.59	-3.94	
	May	3.58	6.40	11.57	
	Jun	11.15	2.07	4.35	
	Jul	-2.89	2.35	-0.11	

\*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](http://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](http://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/](http://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. **Retail Money Market Mutual Funds** are included in M2. **Institutional** money market funds are not included in M2.

**Page 6:** **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 7:** Data are reported in the Senior Loan Officer Opinion Survey on Bank Lending Practices.

**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.

From 1991 to the present the source of the long-term PCE inflation expectations data is the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters*. Prior to 1991, the data were obtained from the Board of Governors of the Federal Reserve System. Realized (actual) inflation is the annualized rate of change for the 40-quarter period that corresponds to the forecast horizon (the expectations measure). For example, in 1965:Q1, annualized PCE inflation over the next 40 quarters was expected to average 1.7 percent. In actuality, the average annualized rate of change measured 4.8 percent from 1965:Q1 to 1975:Q1. Thus, the vertical distance between the two lines in the chart at any point is the forecast error.

**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,  $\pi_{t-1}$  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 estimated by the Congressional Budget Office (CBO).

**Monetary Base Growth and Inflation Targets** shows the quarterly growth of the adjusted monetary base implied by applying McCallum's (2000, p. 52) equation

$$\Delta b_t = \Delta x_t^* - \Delta v_t^a + \lambda (\Delta x_t^* - \Delta x_{t-1}),$$

$$\Delta x_t^* = \pi^* + \Delta y_t^*$$

to five alternative target inflation rates,  $\pi^* = 0, 1, 2, 3, 4$  percent, where  $\Delta b_t$  is the implied growth rate of the adjusted monetary base,  $\Delta y_t^*$  is the 10-year

moving average growth in real GDP,  $\Delta v_t^\alpha$  is the average base velocity growth (calculated recursively),  $\Delta x_{t-1}$  is the lag growth rate of nominal GDP, and  $\lambda = 0.5$ .

**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  $m = 1, \dots, 10$  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 4/16/2020, and the current U.S. note has a maturity date of 5/15/2020. **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 2005 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. Senior Loan Officer Opinion Survey on Bank Lending Practices.

*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/](http://research.stlouisfed.org/publications/review/).