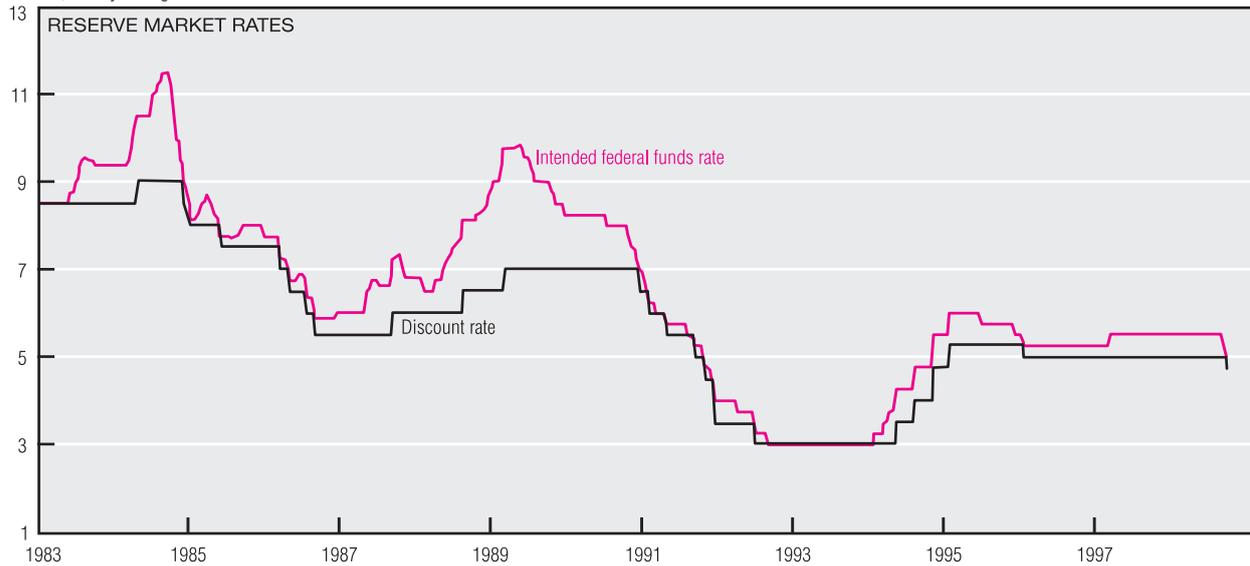
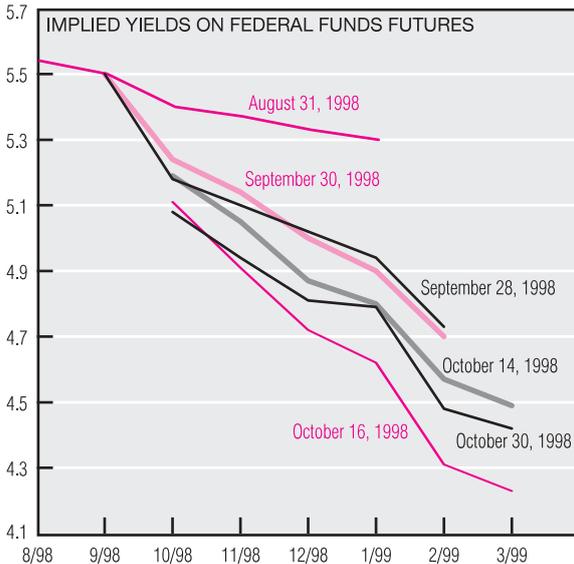


# Monetary Policy

Percent, weekly averages



Percent



a. Constant maturity.

SOURCES: Board of Governors of the Federal Reserve System; and the Chicago Board of Trade.

Percent, weekly averages



At its September 29 meeting, the Federal Open Market Committee (FOMC) lowered the federal funds rate target to 5.25%, a decline of 25 basis points. Chairman Greenspan initiated a further decline of 25 basis points roughly two weeks later, on October 15, lowering the target rate to 5.0%. This second decline in the federal funds rate target was accompanied by a decrease from 5.0% to 4.75% in the discount rates charged by Federal Reserve district banks.

These interest-rate declines follow a period of remarkable stability. Prior to the September reduction, the federal funds rate target had stood at 5.5% since March 1997 and had remained between 5.25% and

5.75% since July 1995. The discount rates had held steady at 5.0% since January 1996.

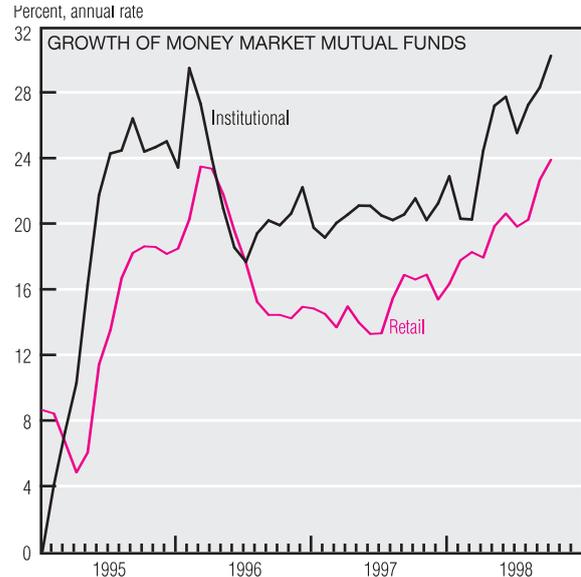
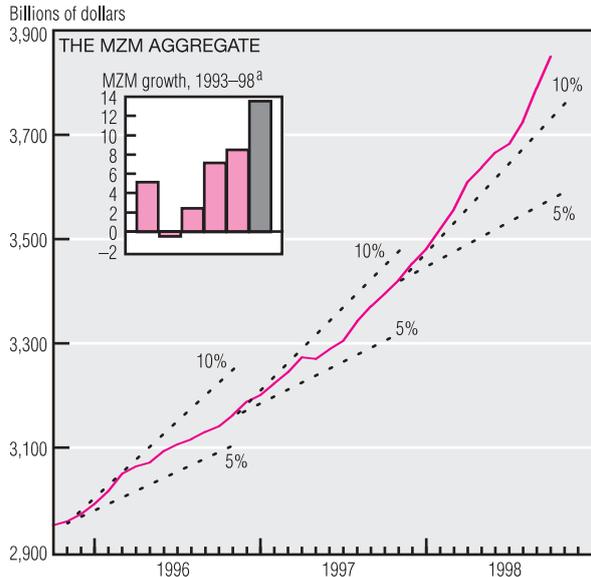
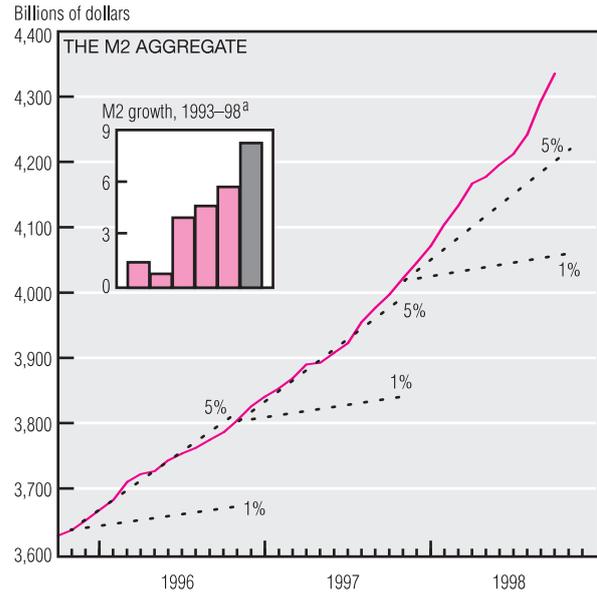
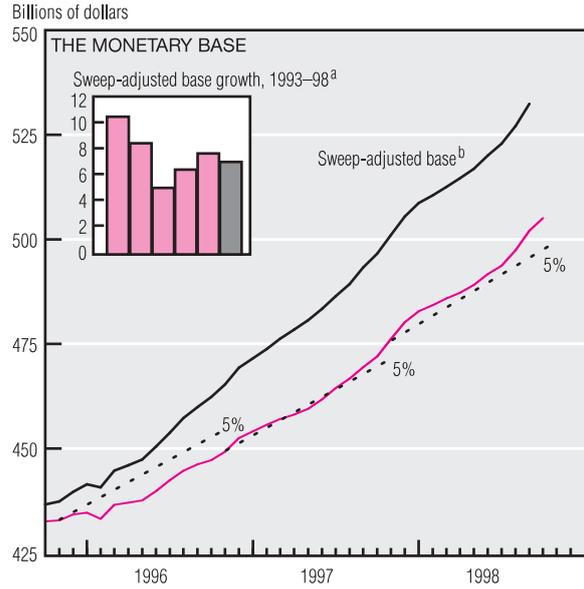
Such stability in these rates is unprecedented in the period since the Federal Reserve stopped explicitly targeting monetary aggregates in the early 1980s. Between 1983 and 1995, the federal funds rate target was adjusted 112 times (an average of more than eight times per year) and typically varied by at least one percentage point during each year. Including the recent pair of adjustments, the target has moved four times since the beginning of 1996, falling from 5.5% to 5.0%. This stability has been associated with a combination of sustained economic growth and

low inflation during this period.

Implied yields on federal funds futures fell substantially between the end of August and the September FOMC meeting and continued to fall through mid-October. Fed funds futures allow market participants to hedge against or speculate on future changes in the federal funds rate. These yields provide a measure of where market participants believe the federal funds rate will be in the coming months. As of August 31, these futures were trading at about 5.3% for January 1999. By the end of September, the January 1999 futures rate had declined to about 4.9%, and by the end of October to 4.8%. Based

*(continued on next page)*

# Monetary Policy (cont.)



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rates for M2 and MZM in 1998 are calculated on an estimated October over 1997:IVQ basis; for the sweep-adjusted base, 1998 growth is calculated on a September over 1997:IVQ basis.

b. The sweep-adjusted base includes an estimate of required reserves saved when balances are temporarily shifted from reservable to nonreservable accounts.

NOTE: Data are seasonally adjusted. Last plots for M2 and MZM are estimated for October 1998. Dotted lines for M2 and the monetary base are FOMC-determined provisional ranges. Dotted lines for MZM represent growth in levels and are for reference only.

SOURCE: Board of Governors of the Federal Reserve System.

on these futures yields, the federal funds rate is now expected to be near 4.5% by March of next year.

It is interesting to note that while the September 29 decline in the federal funds rate target had little impact on federal funds futures rates, the October 15 decrease had a substantial downward effect. This is consistent with the conventional wisdom that the September decrease was widely anticipated by financial markets, while the October change was quite unexpected.

Yields on both short- and long-term Treasury securities have de-

clined substantially since August, although they have rebounded slightly in recent weeks. As is often pointed out in these pages, a decline in the federal funds rate target in an environment of falling interest rates might not represent an "easing" of policy in any meaningful sense, but instead may be viewed as a neutral policy response to a changing economic environment.

The monetary aggregates continue to increase at a relatively rapid pace, and there is little indication that these growth rates are slowing significantly. Using projections for Octo-

ber, the estimated year-to-date growth rate for M2 is about 8%, well above the 5% upper bound of the provisional target range set by the FOMC. Since July, M2 is estimated to have grown at well over 11%. Year-to-date growth in MZM is estimated to have exceeded 13%. Growth in the monetary base has also accelerated in recent months. The continued high growth rates of these monetary aggregates, combined with the recent acceleration of growth rates, may provide a warning signal of future inflation.