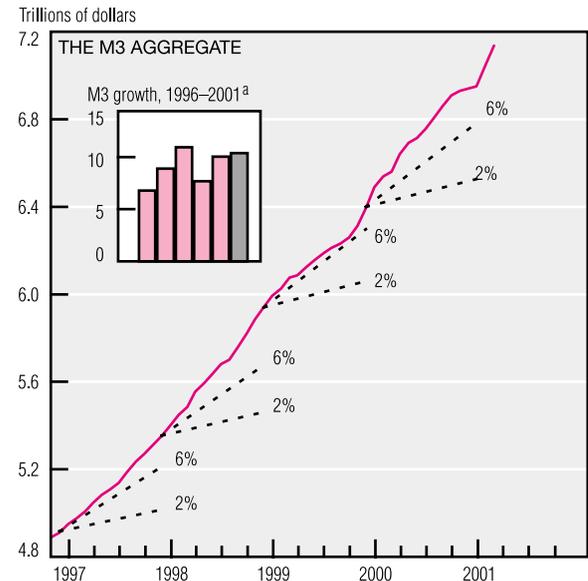
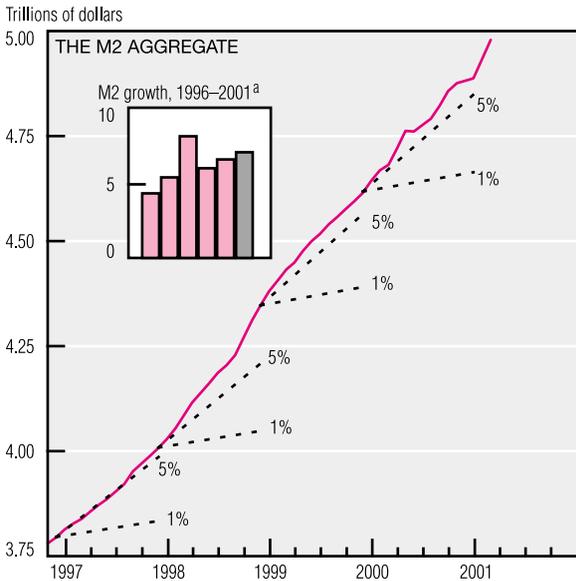
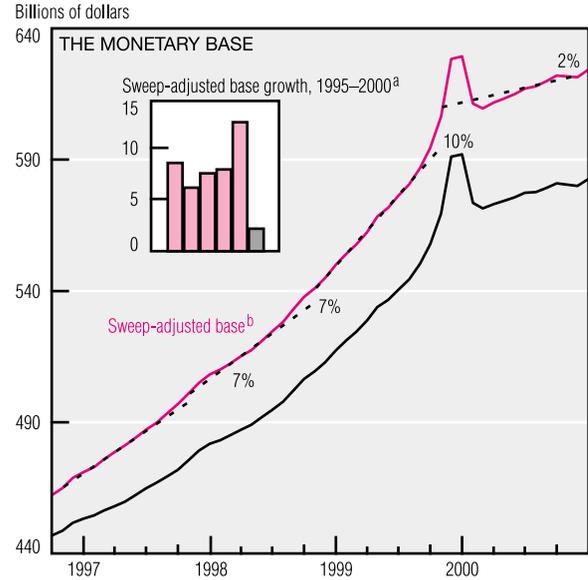
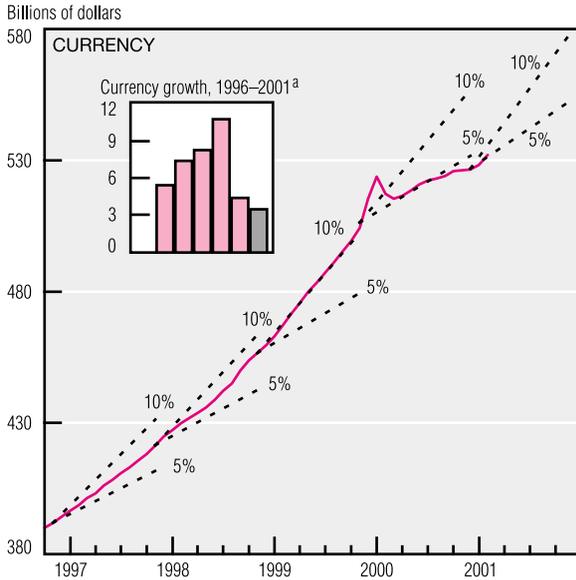


# Money and Financial Markets



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. The 2001 growth rates for currency, M2, and M3 are calculated on an estimated January over 2000:IVQ basis. Data are seasonally adjusted.

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

NOTE: Last plots for currency, the monetary base, M2, and M3 are estimated for January 2001. Last plot for the sweep-adjusted base is December 2000. Dotted lines for M2 and M3 are FOMC-determined provisional ranges.

SOURCE: Board of Governors of the Federal Reserve System.

Now that 2000 is history, we can put its monetary and financial developments into perspective and, at the same time, use them to illuminate the current state of the economy.

Let's start with the growth rate of money, the key long-run determinant of inflation. We cannot discuss the monetary aggregates' behavior during 2000 without recalling the grave concerns that surrounded the century date change. These concerns led to the substantial run-up in

liquidity that characterized late 1999 and early 2000, as well as its subsequent fall-off when no significant problems occurred.

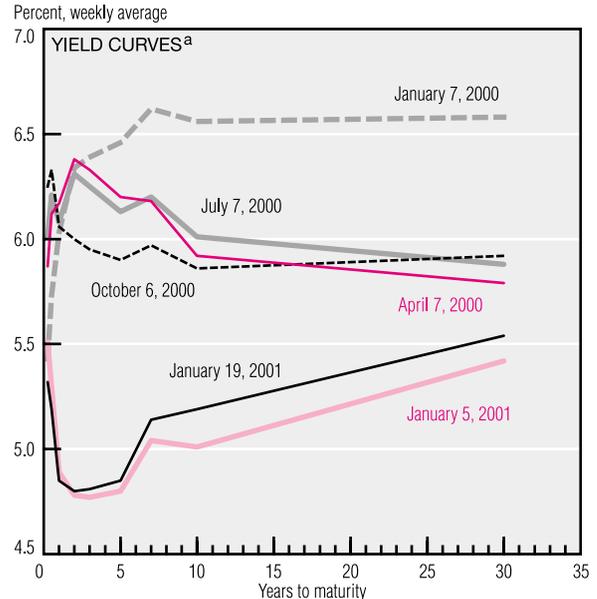
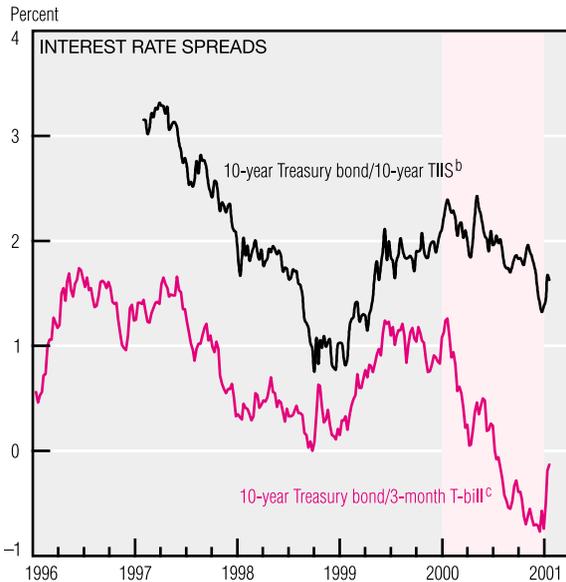
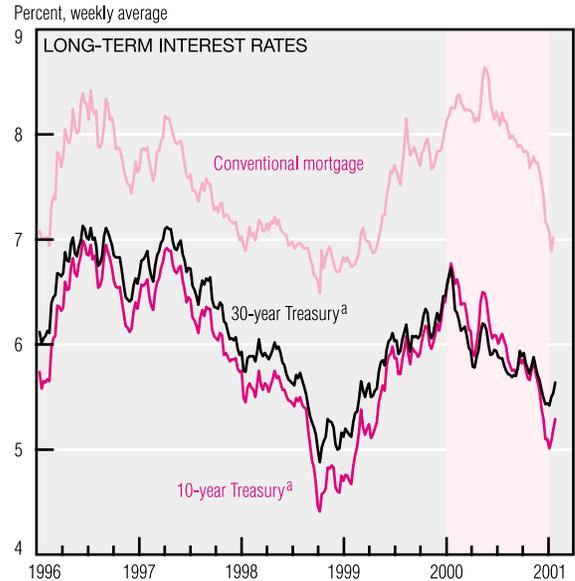
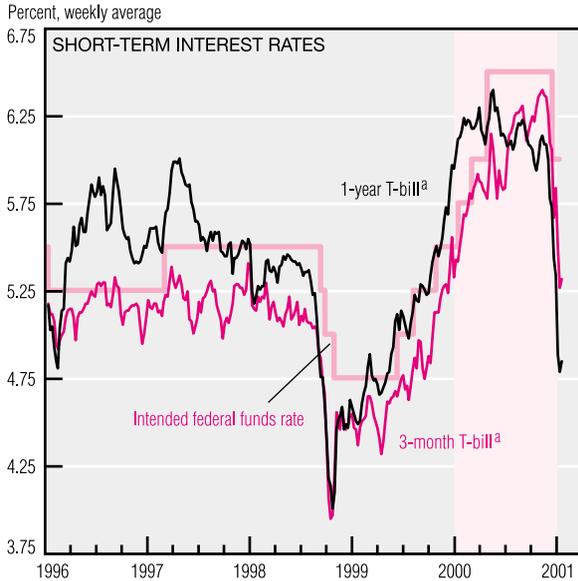
In retrospect, we see that Y2K dominated the behavior of the narrow monetary aggregates. Growth rates for currency and the sweep-adjusted base were 4.5% and 2.1% for the year. But it is important to recognize that these low rates are calculated relative to the elevated pre-Y2K levels that resulted in sizable growth rates during 1999. When the last two years are

combined, currency and the sweep-adjusted base have grown at annual rates of 7.9% and 7.5%, similar to the growth experienced in preceding years.

Y2K considerations had relatively little impact on the broad monetary aggregates, which grew robustly throughout 2000. M2 and M3 ended the year up 6.8% and 10%, respectively, and neither shows signs of slowing thus far in 2001. Year-to-date annualized growth rates for January are

*(continued on next page)*

## Money and Financial Markets (cont.)



- a. Constant maturity.  
b. Last day of week.  
c. Weekly average.

SOURCES: Board of Governors of the Federal Reserve System; and Bloomberg Financial Information Services.

estimated at 7.3% for M2 and 10.4% for M3. While these rates are in line with the experience of recent years, they arguably provide reason for concern. If the economy slows in 2001, as most analysts predict, the substantial money growth rates in 2000 may contribute to a significant rise in inflation rates later this year and into 2002.

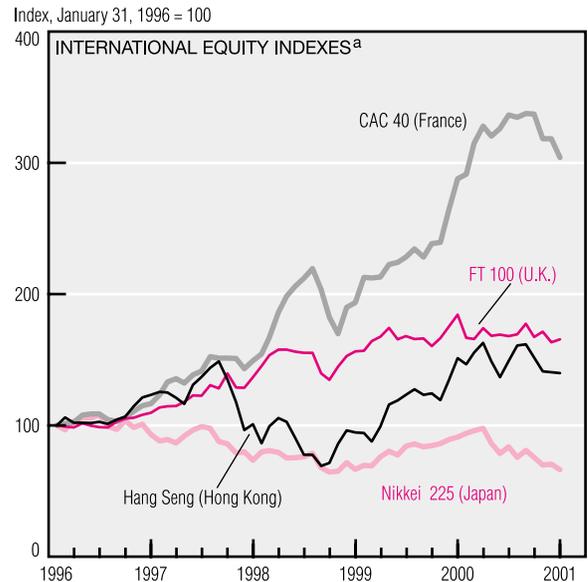
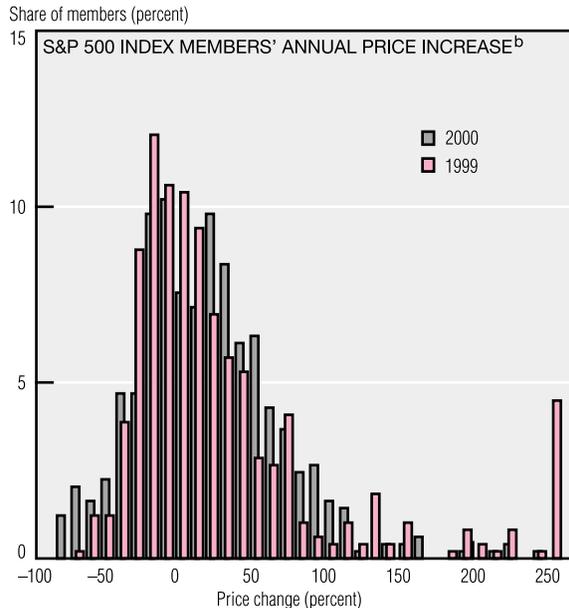
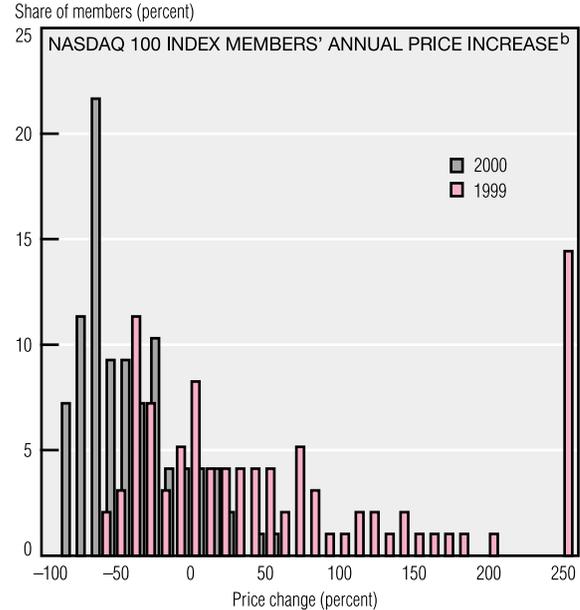
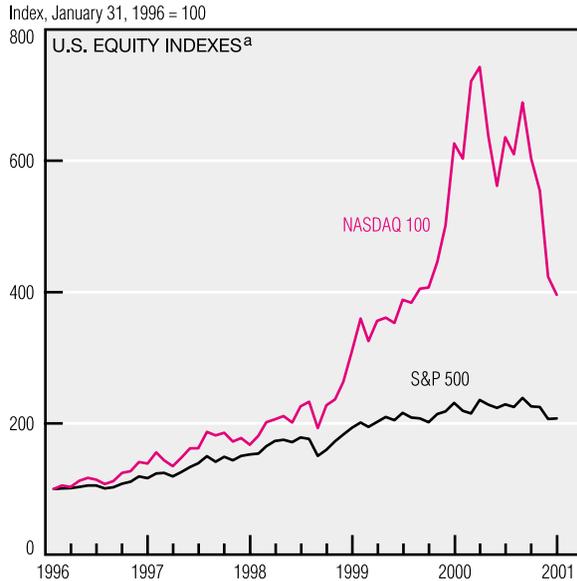
Regarding interest rates, we see that yields on the shortest-term government securities rose during most of 2000, in tandem with an increase of 100 basis points (bp) in the intended federal funds rate.

However, this trend reversed itself sharply at the end of the year as the economy weakened. The rate on the 3-month Treasury bill dropped substantially more when a 50 bp decline in the intended federal funds rate was announced on January 3. The 3-month rate has fallen roughly 100 bp since mid-November.

Medium- and long-term interest rates, on the other hand, fell steadily during most of 2000, even in the first half of the year when the news media were reporting that the Federal Reserve was “increasing inter-

est rates.” Rates on all Treasury securities with maturities of two years or longer fell more than 100 bp during the year, while rates on conventional 30-year mortgages fell 93 bp. All of these, except 30-year mortgages, have increased somewhat since the Federal Open Market Committee’s rate action, possibly reflecting market concerns about rising inflation. A recent increase in the difference between the 10-year Treasury rate and the 10-year TIPS rate (a spread that may indicate long-run  
*(continued on next page)*

# Money and Financial Markets (cont.)



a. Closing price, last day of month

b. Index members as of January 26, 2001.

SOURCES: Bloomberg Financial Information Services; Wall Street Journal; and Financial Times.

inflation expectations) is consistent with that view. Finally, the 10-year, 3-month Treasury spread, which has been negative since mid-July and dipped as low as  $-77$  bp, has narrowed to nearly zero. A negative spread sometimes signals an impending recession.

Finally, 2000 witnessed unprecedented fluctuations in equity markets. Most notably, the NASDAQ rose 15% between December 1999 and February 2000, fell 28% between February and May, gained 24% through August, then plummeted 41% between August and year's end (based on end-of-month closing

prices). Movements in the S&P 500 were much less dramatic, with the index down 10% for the year. These declines followed five annual increases of at least 19% each for both indexes.

Although these broad market indexes are so frequently reported, the wide disparity among their component stocks is not fully appreciated. It is true that the NASDAQ's decline reflected widespread decreases in the stocks included in the index. But consider the S&P 500, which rose 19.5% in 1999 before falling 10.1% last year. While this change seems fairly dramatic, note the overlap in the distribution of component stock price move-

ments over the two years. For example, in 1999 the stock prices of roughly 48% of S&P companies dropped, and 38% fell more than 10%, even as the index average was rising. And in 2000, when the index fell 10%, the stock price of 56% of its companies increased, and fully 49% rose more than 10%.

Many other countries' markets also had a rough 2000, although few matched the wild gyrations of the NASDAQ. Equity indexes in the U.K., Japan, and Hong Kong were down 10.2%, 7.5%, and 27%, respectively, while the index for France ended the year up 5.6%.