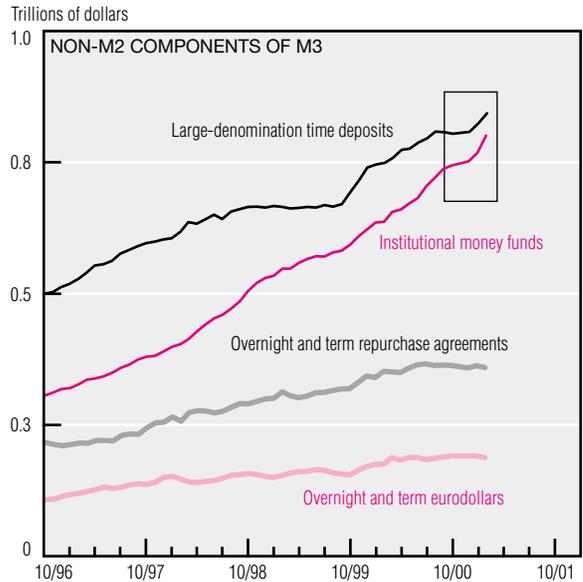
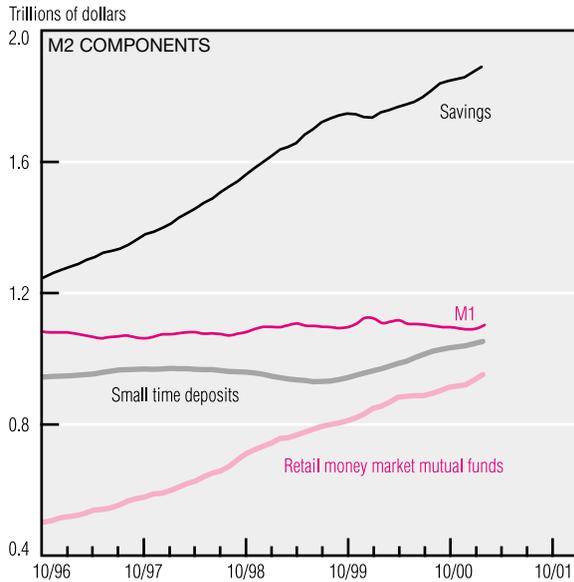
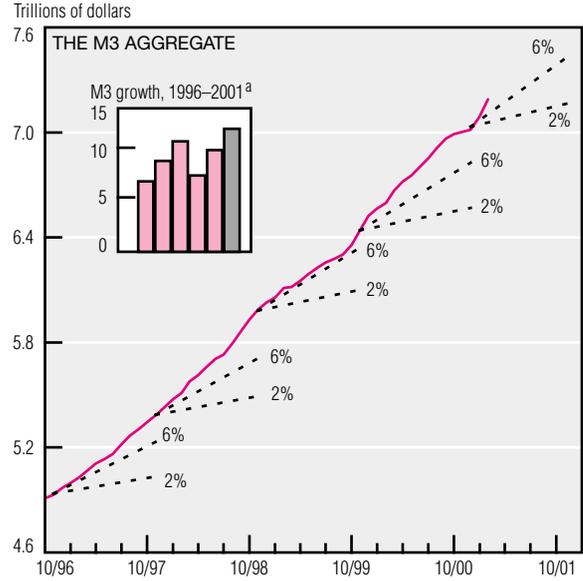
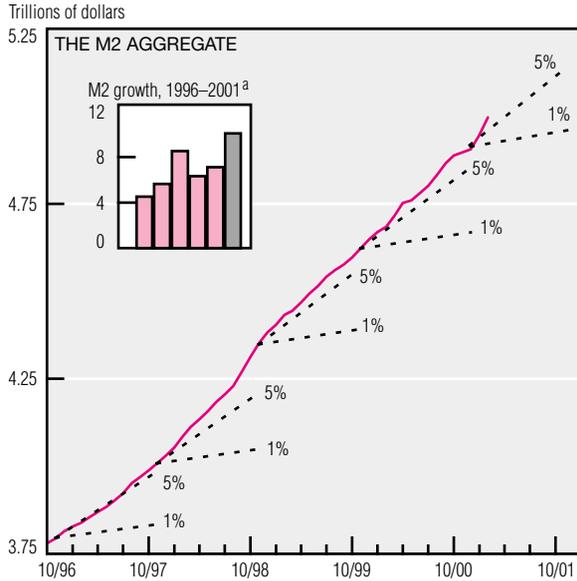


Money and Financial Markets



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. The 2001 growth rates for M2 and M3 are calculated on a January over 2000:IVQ basis. Data are seasonally adjusted.
 NOTE: Last plots for M2 and M3 are January 2001. Prior to November 2000, dotted lines for M2 and M3 are FOMC-determined provisional ranges. Subsequent dotted lines represent growth rates and are for reference only.
 SOURCE: Board of Governors of the Federal Reserve System.

Growth in the broad monetary aggregates accelerated sharply in January. Annualized year-to-date M2 growth reached 10.2% and annualized year-to-date M3 growth hit a remarkable 13.2%. The annualized monthly changes for these aggregates were the largest posted in the last 10 years (13.1% and 17.9%, respectively).

The components of M2 reveal that about 8.5 percentage points of the 13.1% January increase can be attributed equally to demand deposits and retail

money market mutual funds. The recent buildup in these components, however, results primarily from transitory factors. Much of the increase in demand deposits, for example, reflects a surge in mortgage refinancings, which in turn enlarge custodial balances between the time old mortgages are extinguished and the time when payment is made to mortgage-backed securities holders.

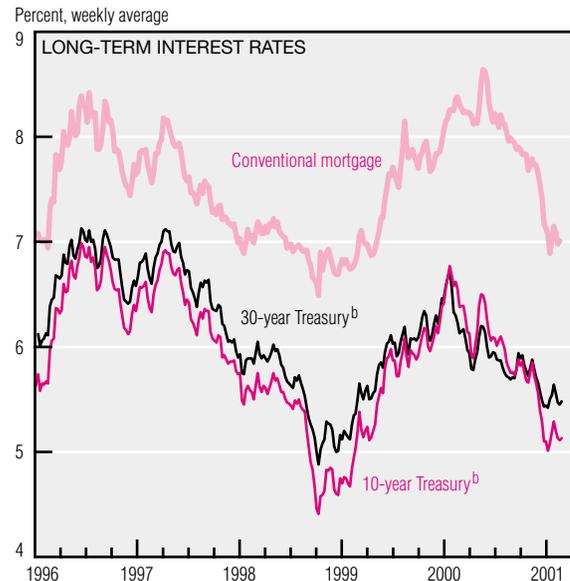
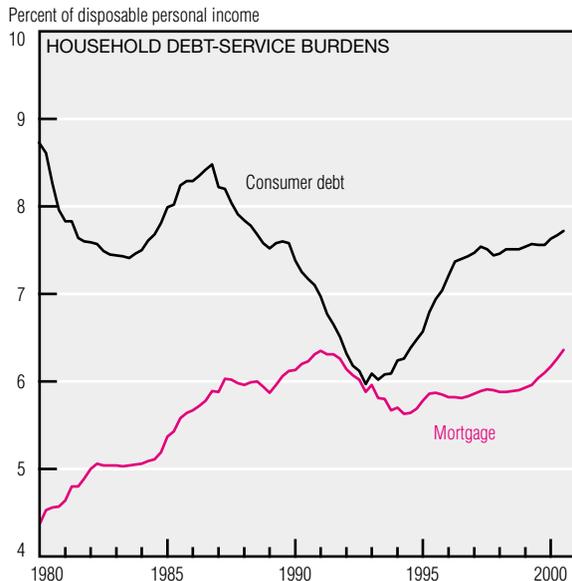
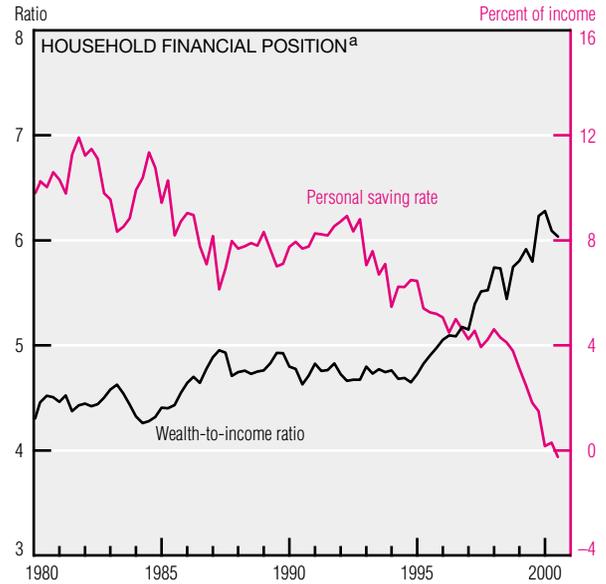
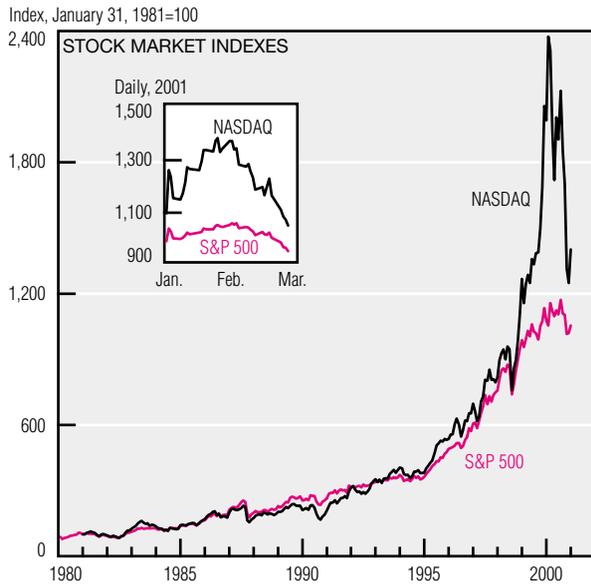
Acceleration in retail money funds, on the other hand, reflects the recent increase in stock market uncertainty.

Money market mutual funds give tentative investors a temporary parking lot for funds. Even as temporary factors abate, however, M2 growth will be sustained by recent declines in interest rates, which lower the opportunity cost of holding money.

As for M3, about 11 percentage points of its nearly 18% January increase comes from institutional money market mutual funds and large-denomination certificates of deposit (CDs), with most

(continued on next page)

Money and Financial Markets (cont.)



a. Wealth is defined as household net worth. Income is defined as personal disposable income. Data are not seasonally adjusted.

b. Constant maturity.

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

of the rest accounted for by the increase in M2. Institutional money funds, like retail funds, swelled as many investors headed for the sidelines. The increase in large CDs mirrors the sudden January rise in commercial and industrial loans, for which CDs are a convenient source of funding.

The stock market remains the big story. The sharp ascent of equity prices, especially in the late 1990s, greatly increased household wealth, pushing up the ratio of wealth to income almost

50%. With stock prices four times their 1990 levels, many households have seen less reason to save part of their current income. Indeed, the personal saving rate has dropped below zero as wealth-induced spending grew faster than income.

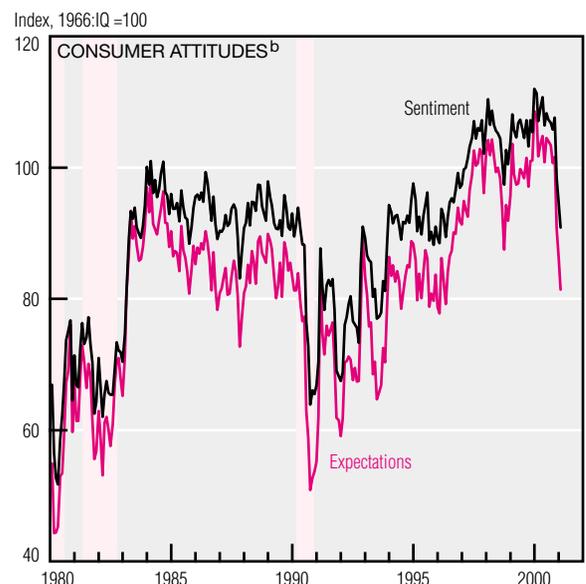
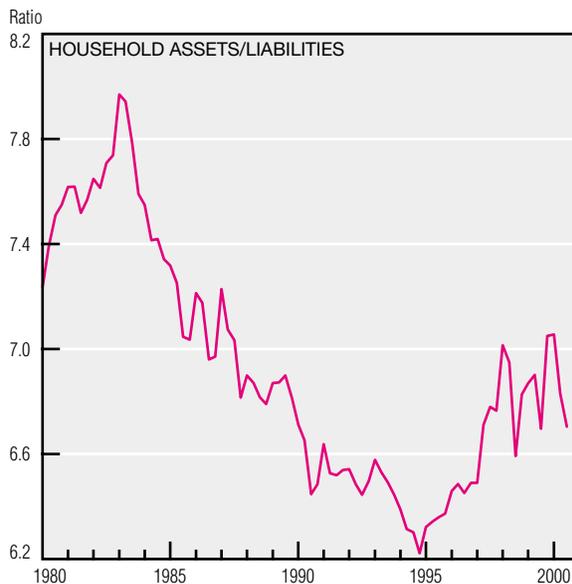
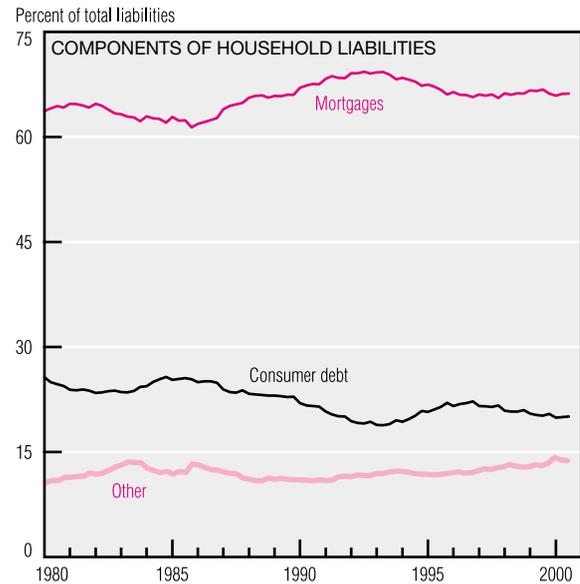
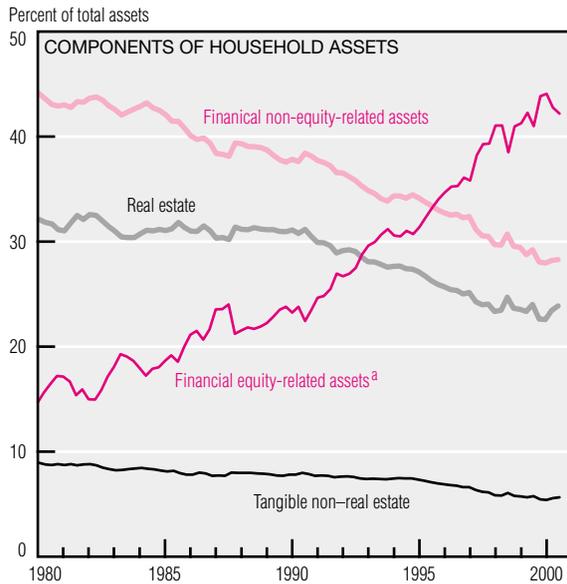
After rallying in January, stock prices drifted downward in February, erasing all gains on the year. A key element is participants' uncertainty about the seriousness of the current economic slowdown. Private economic projections—such as those of the Reserve Bank presidents

and Board of Governors—anticipate weakness in the first half of this year, with economic activity beginning to accelerate again about midyear.

The major impetus for this projected rebound in growth is a cessation of inventory rebalancing. Higher energy prices, another dampening factor, could also abate. The recent decline in both spot and futures energy prices, if sustained, could boost purchasing power and thereby become a key support for recovering demand over the rest of the year.

(continued on next page)

Money and Financial Markets (cont.)



a. Equity-related assets are defined as corporate equities, mutual fund shares, and pension fund reserves.

b. Shaded areas indicate recessions.

SOURCES: Board of Governors of the Federal Reserve System; and University of Michigan, Survey of Consumers.

Another likely contributor to household purchasing power in 2001 is the recent surge in mortgage refinancing. Refinancing reduces households' debt-service burdens, freeing up funds for spending on other goods and services. Moreover, home equity financing has given households an important means of consolidating consumer debt. Because home equity loan rates are substantially lower than rates paid on credit card debt, such consolidation offers households another way to reduce their overall debt burden.

As stock prices soared in the late 1990s, equity-related assets approached 45% of total household assets, up from about 15% in 1980. During the same period, the ratio of household assets to liabilities declined. This raises concerns about households' financial vulnerability to the vagaries of the stock market. And, as Chairman Greenspan noted in his February 13 testimony, changes in stock market wealth have become more important than changes in current household income when it comes to determining shifts in consumer spending.

Sharply lower equity prices seem to affect consumer confidence as well. The University of Michigan's indexes on consumer sentiment and expectations both fell in February but were revised up from preliminary estimates. Although all measures of consumer confidence have fallen precipitously in recent months, their levels nonetheless remain higher than those that formerly have been consistent with economic growth.