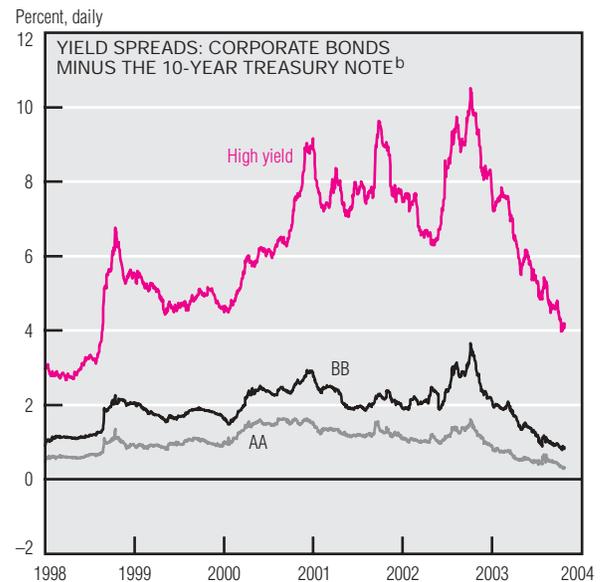
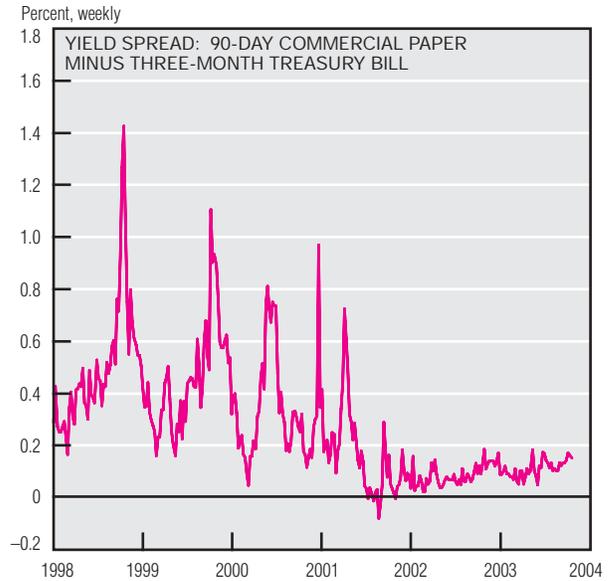
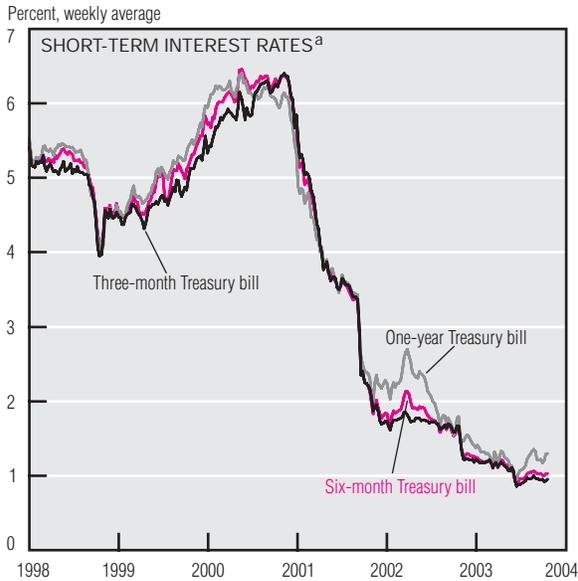


Money and Financial Markets



a. Yields from constant-maturity series.

b. Merrill Lynch AA, BBB, and High Yield Master II indexes, each minus the yield on the 10-year Treasury note.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," H.15, *Federal Reserve Statistical Releases*; and Bloomberg Financial Information Services.

Short-term interest rates have been trending downward since late 2000, moving roughly in tandem with changes in the federal funds rate. In fact, the downward trend has moderated since late July, with yields on three- and six-month Treasury bills staying essentially constant during a period when the federal funds rate held at 1%. The one-year Treasury bill rate has varied considerably more during this period.

The spread between the 90-day commercial paper rate and three-month Treasury bill rate has increased

moderately since the end of August, possibly because lower-quality issuers began to reenter the market as the expansion proceeded. After falling for two consecutive months, total commercial paper outstanding rose during October.

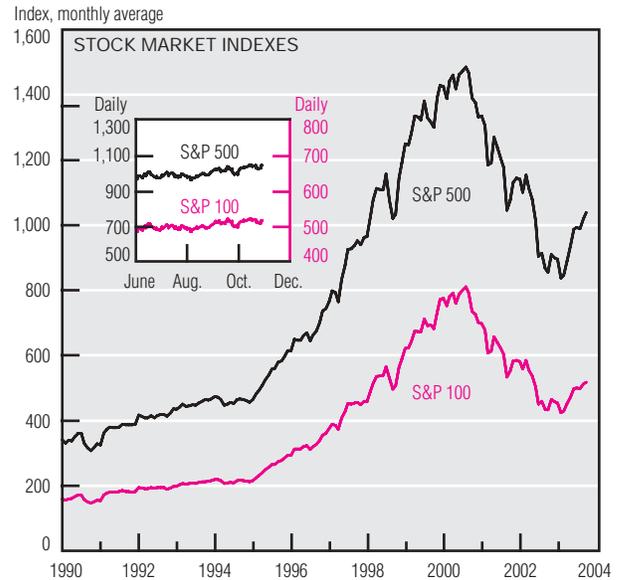
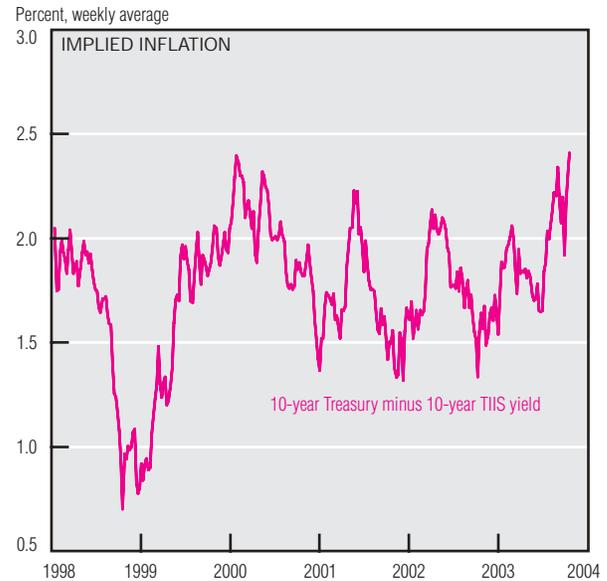
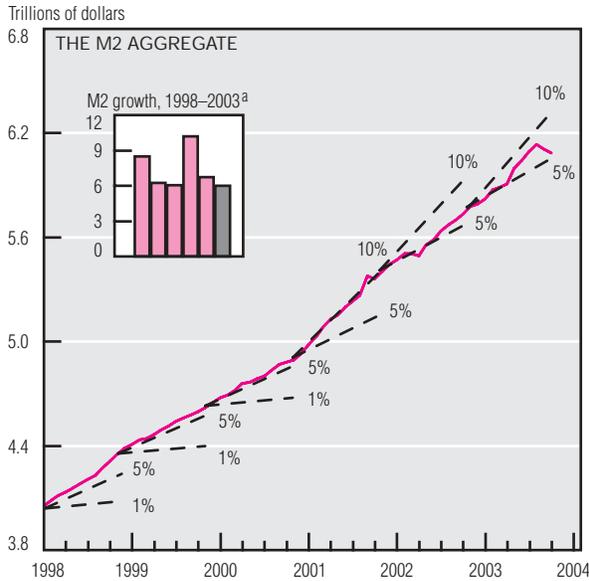
Significant swings in long-term interest rates have occurred in the last couple of months. From early September to early October, long-term rates fell between 40 basis points (bp) and 60 bp. During the rest of October, the 10- and 20-year Treasury rates retraced most of that decline. The

uptick in the conventional mortgage rate was accompanied by a decrease in mortgage applications.

Yield spreads between corporate bonds and Treasury notes have trended downward since October 2002. High-grade, AA-rated bonds show a risk premium of only 30 bp over Treasury notes. The premium on high-yield corporate bonds has fallen nearly 6.5 percentage points since a year ago. The decline in risk spreads should facilitate the expansion of business fixed investment.

(continued on next page)

Money and Financial Markets (cont.)



a. Growth rates are calculated on a fourth-quarter over fourth-quarter basis. The 2003 growth rate for M2 is calculated on an October over 2002:IVQ basis. Data are seasonally adjusted.
 SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," H.15, and "Money Stock Measures," H.6, *Federal Reserve Statistical Releases*; and Bloomberg Financial Information Services.

After increasing almost at double-digit annual rates in June through August, M2 fell at an annual 4.75% rate in September and seems headed toward a decline for October as well. These decreases probably result from a sharp drop-off in mortgage refinancing. Certain prepaid mortgage balances are held temporarily in liquid deposits before being disbursed to mortgage-backed securities holders. A decline in mortgage refinancing reduces these liquid deposits.

A measure of expected inflation can be derived by subtracting the interest

rate on Treasury inflation-indexed securities (a real rate) from that on non-indexed Treasury securities (a nominal rate). This measure can fluctuate markedly but has had a generally upward trend throughout 2003. Participants in this market do not expect deflation to be a problem over the horizon of these securities.

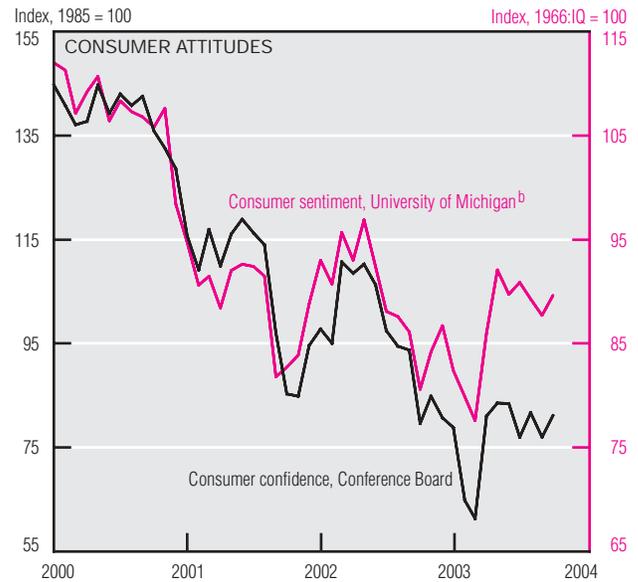
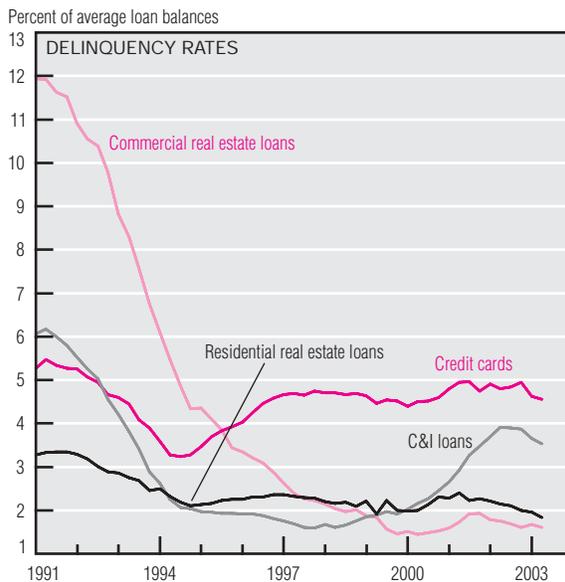
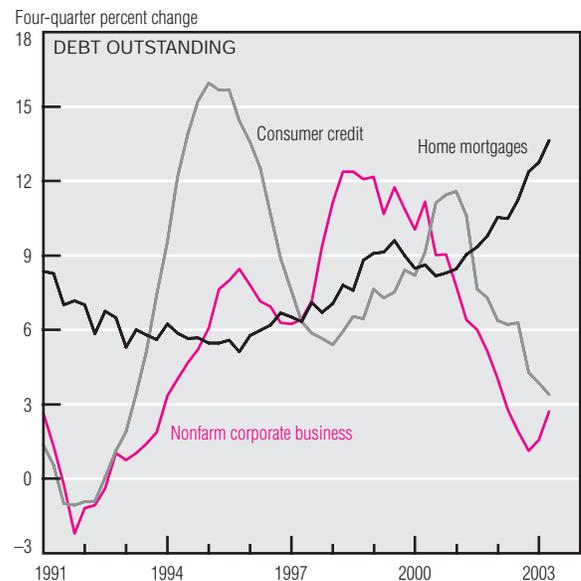
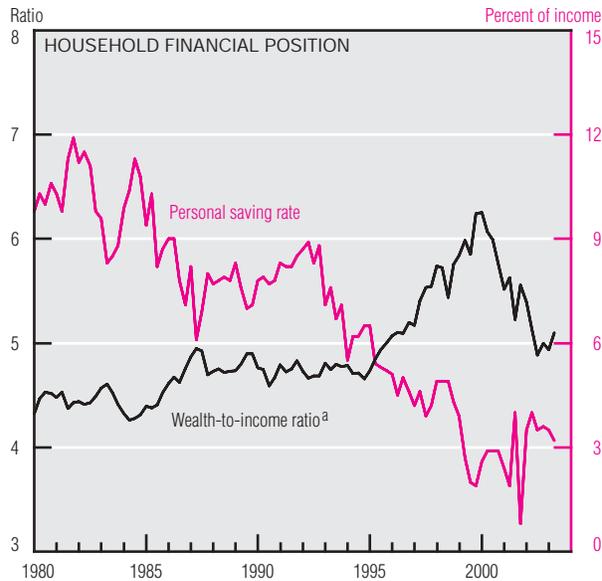
Treasury inflation-indexed securities, which measure the economy's real interest rate directly, show a drop of 50 bp in the last three months and currently stand at 1.9%. The average

real interest rate from 1997 to the present was nearly 3.4%.

The major stock markets fared well in October, with the S&P 500 price index gaining 1.8%. After hitting a low in February, the S&P 500 was up nearly 24% for the year to date. The decline in real interest rates probably has contributed to the year's strong stock market growth, as have the tax cuts on capital gains and dividends implemented in May. The substantial stock market gains, as well as increased holdings of real estate, helped

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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. Data are not seasonally adjusted.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks," and "Flow of Funds Accounts of the United States," Z.1, *Federal Reserve Statistical Releases*; University of Michigan; and the Conference Board.

buoy the wealth-to-income ratio over the last few months. The personal saving rate, currently at 3.2%, is less than half its 20-year average.

Home mortgage debt grew at brisk double-digit rates in the first half of 2003, but the decline in mortgage applications in the second half may dampen that growth. Cash-out refinancing of mortgages earlier in the year helped homeowners pay down credit card and other high-interest debt, slowing consumer credit growth markedly. Growth in nonfarm

corporate business debt remains constrained, partly because rising profits have lessened firms' need for external financing.

The delinquency rate on commercial and industrial loans moderated during most of 2002 and continued that trend into this year. Falling short- and long-term interest rates, along with slower growth in corporate debt, have facilitated firms' repayment of loans. Consumer credit delinquency rates show similar improvement.

The Conference Board's index of consumer confidence rose slightly in

October, but survey respondents expressed concern about their future income levels and the weak labor market. The share of respondents who expect their income to increase in the next six months is at a 10-year low. Nonetheless, the expectations component of the index did increase slightly. The University of Michigan's consumer sentiment index also increased in October, showing small rises in the components for both expectations and present conditions.