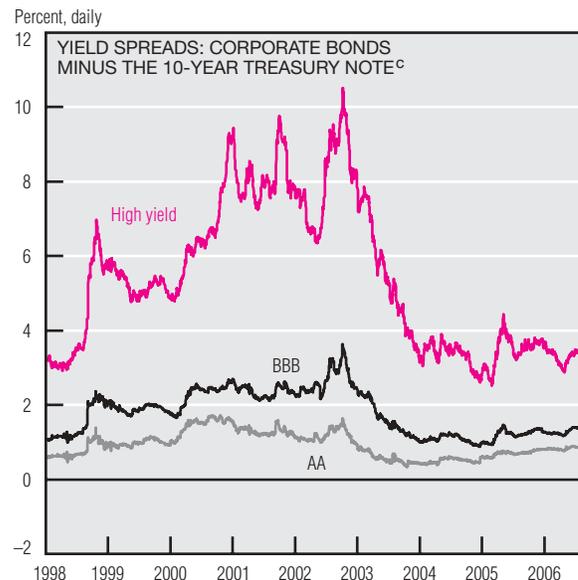
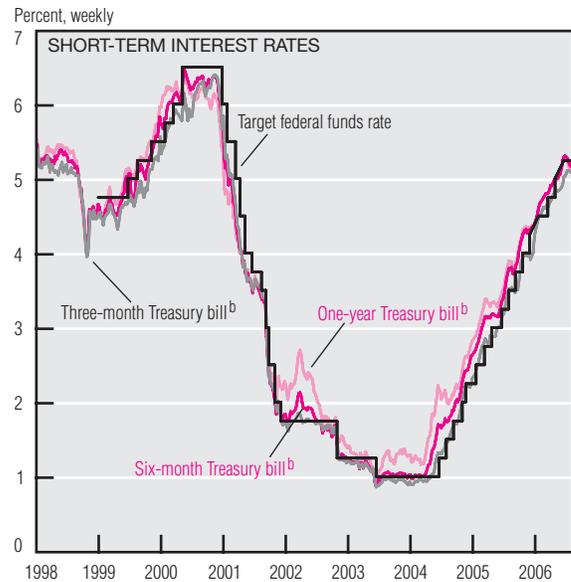
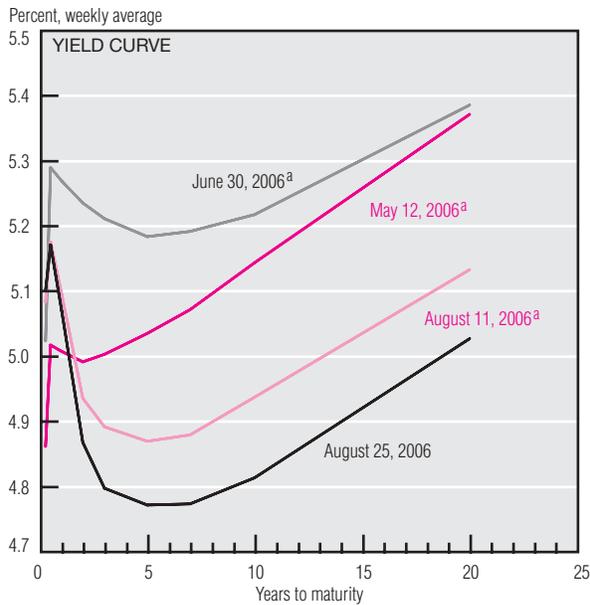


Money and Financial Markets



a. The Friday after the FOMC meeting.

b. Yields from constant-maturity series.

c. 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," *Federal Reserve Statistical Releases*, H.15; and Bloomberg Financial Information Services.

Throughout the summer, the 10-year Treasury note yield has been below that of the one-year Treasury bill, implying an inverted yield curve in that range of maturities. In recent weeks, the gap between the two yields has increased to nearly 20 basis points (bp).

Short-term rates have risen in step with increases in the federal funds rate. Since the current round of policy tightening began in June 2004, the 90-day Treasury bill rate has increased nearly 380 bp.

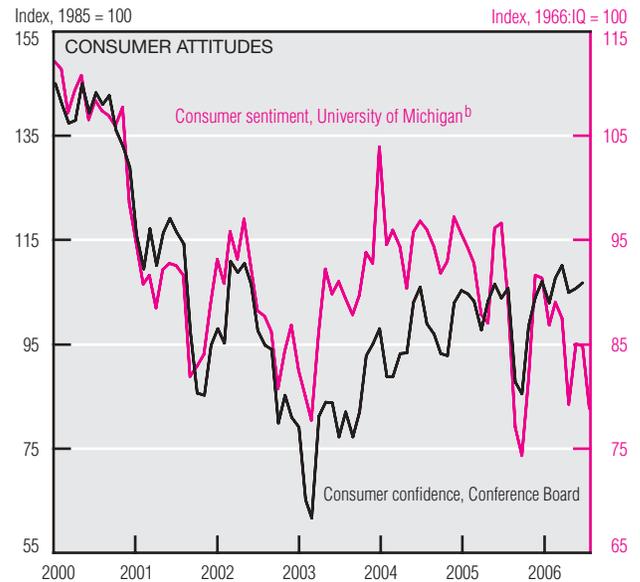
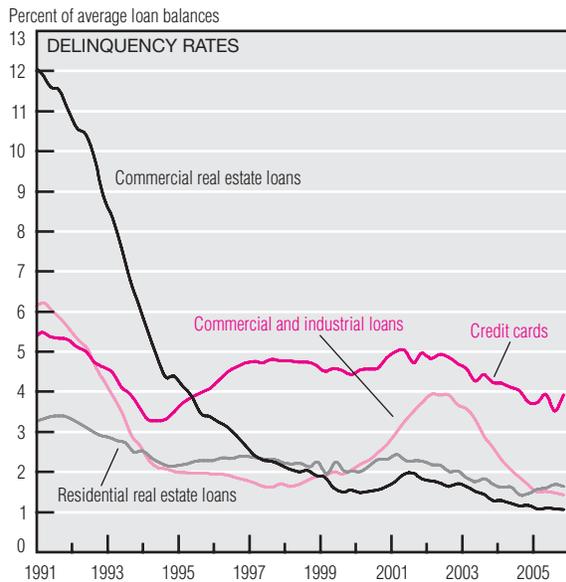
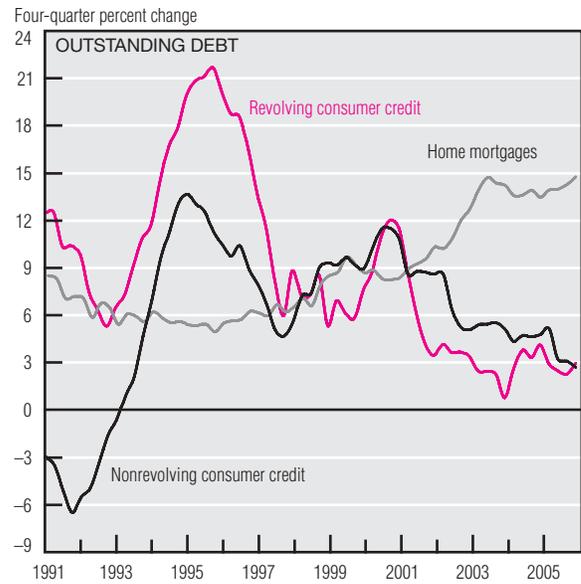
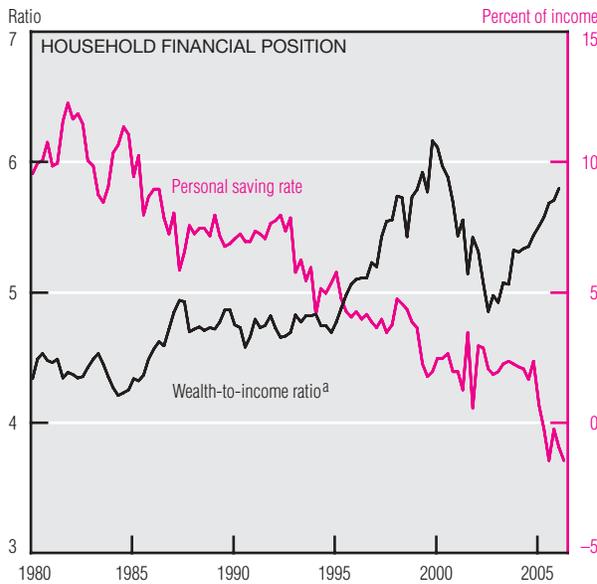
Nominal yields on long-term Treasury securities rose by about 80 bp during the first half of the year, but have since fallen back about 30 bp. After rising more than one full percentage point from September 2005 through mid-July 2006, long-term rates on conventional mortgages also drifted downward nearly 30 bp during the last month. The earlier mortgage rate increases have taken a toll on sales of new and existing homes in the last several months.

The strength and liquidity of corporate balance sheets have kept risk premiums on their debt at historically low levels. Since early 2004, risk spreads on AA- and BBB-rated corporate debt have remained fairly flat, but risk premiums on lower-rated corporate debt have been more volatile. From mid-May to mid-July, the risk spread on high-yield corporate bonds increased more than 60 bp.

Since mid-2005, the U.S. personal saving rate has resided in negative territory. As of 2006:IIQ, it stood at

(continued on next page)

Money and Financial Markets (cont.)



a. Wealth is defined as household net worth; income is defined as personal disposable income.

b. Data are not seasonally adjusted.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Flow of Funds Accounts of the United States," *Federal Reserve Statistical Releases*, Z.1; University of Michigan; and the Conference Board.

-1.5%. For the last 25 years, the saving rate has displayed a significant downward trend. Whereas the personal saving rate averaged 9% in the 1980s, its average from 2000 to the present was only 1.5%. Counterbalancing this is an upward trend in the wealth-to-income ratio over the same period. Higher levels of wealth have supported a higher level of spending relative to income.

Since 2002:1Q, mortgage debt has grown at annual rates exceeding 10%. Outstanding home mortgage

debt grew at a year-to-year rate of nearly 15% in 2006:1Q, partly because households extracted their accumulated gains in home equity. This has slowed consumer credit growth. Despite high levels of consumer debt, delinquency rates on residential mortgages remain subdued by historical standards.

The Conference Board's Index of Consumer Confidence rose modestly in July. Most of the increase came from a rise in the expectations component of the index, although the present-

conditions component also posted an increase. In the survey, consumers viewed labor markets as strong and indicated a greater propensity to buy homes and autos in the coming months. The University of Michigan's Consumer Sentiment Index remained basically unchanged in July, but its preliminary August value shows marked deterioration. The expectations component, which dominated this decline, reached its lowest level since 1992.