in other checkable deposits shifted from all other sources from the level of M-1B should pro-
duce adjusted figures more consistent with the 1981 target-growth ranges. Specifically, to
calculate the adjusted level of M-1A each month, the estimated fraction shifted from
demand deposits is multiplied by the monthly change in the level of non-seasonally adjusted
other checkable deposits, less the estimated trend growth in this component; this monthly
value is cumulated and added to observed M-1A after seasonal adjustment by the de-
mand-deposit seasonal factor. To calculate the adjusted M-1B level, the estimated fraction
from non-M-1B sources is multi-
plied by the monthly change in the level of non-seasonally adjusted other checkable deposits
in excess of trend growth; this monthly
value is cumulated and, after sea-
sonal adjustment by the commercial-bank savings deposit seasonal factor, subtracted from
observed M-1B.

Although the nationwide authorization of NOW accounts on December 31, 1980, has had a marked impact on the observed levels of the narrow M-1 aggregates, these money measures are still useful guidelines for interpreting changes if allowance is made for the unusual deposit shifts. Adjusting ob-
served levels may be preferable to adjusting target-growth ranges. Development of reli-
able, adjusted long-run target ranges for the whole year will be possible only at year-end, when the full set of actual values becomes available. Although the adjusted levels of the aggregates would incorporate actual values, target ranges with which they can be compared are already established for the entire year.

Target-Setting Implications

Either of the adjustment alternatives alleviates the distortion of the revised target
aggregates caused by introduction of nation-
wide NOW accounts. This makes it possible to compare incoming money data with the
Federal Open Market Committee targets for the
year.

Another complication that arises in inter-
preting policy effectiveness and monetary
stock growth in a longer-run context is base
drift. This is the "let-bygones-be-bygones"
practice that biases the target-growth range for the current period on the actual, rather than
targeted, final value of the previous period. While this issue may not be relevant to day-to-
day Fed-facard, it is meaningful for longer-
run monetary policy considerations.

The 1981 targets for the narrow aggregates incorporate changes in the base due to introduction of NOW accounts and can be illustrated by reviewing the target ranges for 1980 and 1981. The upper limit of the target growth for M-1B was 6 percent for 1980 and is 6 percent for 1981. The maximum expansion desirable for that aggregate over the two years is 6.4 percent, implying a

maximum 1981-I/VO level of $434.4 billion. However, the 1981 M-1B target is based on the actual (above-target) $412.5 billion of M-1B in 1980-I/VO, implying a max-
imum 1981-I/VO of $437.3 billion and a growth rate over two years of 6.82 percent. The figures used in this illustration obviously would be different if the calculations were made from the midpoint of the announced money-growth ranges.

A second form of base drift has been in-
troduced through inclusion of a portion of
other checkable deposits in the M-1B base.
A portion of other checkables repre-
sents funds shifted from demand deposits
previously included in M-1B. One reason for
above-target growth of M-1B in 1980 was that other checkable deposits increased by a significantly larger amount than had been anticipated when 1980 targets were set. Be-
cause of the impending introduction of NOW accounts, banks began to market ATS accounts aggressively in the latter part of the year, causing a greater diversion of funds into these other checkable M-1B accounts than had been expected. If approximately one-third of the unforeseen growth of these accounts represented portfolio shifts from non-M-1B assets, then the 1980-I/VO mea-
sured level of M-1B was distorted in the same way that currently observed M-1B is

Interpreting the Ms after the NOWs

Theresa Gwazdauskas

The nationwide introduction of negot-
iable order of withdrawal (NOW) accounts on December 31, 1980, has had a significant
change in the sources of funds among market participants whose decisions are in-
fluenced by expectations about short-run System operations in the money market.

This Economic Commentary examines possible methods to help gauge and evaluate the
NOW-account phenomenon and its impact on the money-supply statistics. Although the
importance to note, however, that the intro-
duction of NOW accounts, and the large
shifts of funds that have resulted, has had
a sharp impact on the statistics. Although
adjustments are necessary, they are bound to be less than fully satisfactory.

Interpreting the Money-Supply Figures

Because the narrower M-1 aggregates are distorted more than either M-2 or M-3, some
of the controversy that has attended the use of the aggregate includes the M-1 aggregates for policy insight. However, data for M-2 are only available on a monthly basis, preliminary weekly Fed-facard. Furthermore, many of the components of M-2 are less controllable by the Federal Reserve System than the narrower M-1 measures, and the components of M-1 are more difficult to align with Federal Reserve policy because of the introduction of NOW accounts.

The views stated herein are those of the author and not necessarily those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.
The NOW shifts. There are two operating Targets," Staff Economic Studies 100 gates under Reserves and Federal Funds Rate Op-
control generally is strengthened with aggregates with the path of money targets as consistent with the actual path of December 1978).

2. Under a reserve operating procedure, monetary reflect incoming information reported each week cannot be al money-supply figures re-
ranges without adjusting for NOW-account-related shifts in related deposit shifts. Lacking
ranges such as the monetary base, which includes M-2 plus large-denomination accounts; it increases the range for M-1A to -4% accounts in a small number of states and able deposits (in excess of trend growth)

The Targets
The Federal Reserve is required by the Full Employment and Balanced Growth Act of 1978 to report money-supply figures since the beginning of the year overstate M-1B and understate M-1A, respectively. Observed money numbers since the beginning of the year overstate M-1B and understate M-1A.

3. The Targets for 1980 are based on the annual average of the M-1B target range, adjusted for the estimated impact of seasonally trend adjusted other checkable deposits and large-denomination accounts which originate from demand deposits over the


5. The 1981 target-growth ranges for both of the M-1 targets measure the proportion of the increase in other checkable deposits (in excess of trend growth) originating from non-M-1B sources has increased since early in the year, much as was expected. In

6. Some difficulty arises in seasonally adjusting other checkable deposits, because those funds that contain a greater component of larger deposits. See Kenneth J. Kappeler, “The Relationship between Consumer Savings and Pi-
gates: Other analysts have turned to nar-
ner aggregates such as the monetary base, which directly reflects Federal Reserve opera-

Adjusting the Targets
Based on pre-1981 experience with NOW accounts in a small number of states and nationwide experience with ATS accounts, various analysts have turned to other checkable deposits (in excess of trend growth)

to its established growth range than to a target range that does not assume stable growth in other checkable deposits. This problem can be resolved by adjusting the tar-

Change in aggregate that consists of M-2 plus large-denomination accounts.

The unexpectedly large in-

Adjusting the Money-Supply Figures
A second method for evaluating current money-stock levels is to use those adjusted growth to gauge relative to the 3 percent to 5 percent and other checkable deposits seasonal-adjustment factors. That is, the proportion of growth in other checkable deposits driven from demand deposits is divided by the commercial bank savings deposits seasonal-adjustment factor.

1981. Non-seasonally adjusted other checkable deposits grew 7.9 billion, and trend growth amounted to $700 million. If 27.5 percent of the trend-adjusted increase came from non-M-1B balances, then adding the January and February portions, after adjusting for the appropriate lower end of the M-1 target range $422.1 billion.

Target-growth levels are adjusted for past months as data becomes available. Re-
targeted range for the year can be estimated from assumptions about the proportion of the increase in other checkable deposits from non-M-1B sources and the increase in other checkable deposits in excess of trend. If the proportion of the increase in other checkable deposits stemming from demand deposits over the year estimated to average 33 percent, and the expected in-
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