Until recently, the Federal Open Market Committee (FOMC) established growth ranges for the broad monetary aggregates (M2 and M3) and domestic nonfinancial debt. For some time, these ranges have not been meaningful indicators in terms of defining specific rates consistent with the goal of price stability. Federal Reserve Chairman Alan Greenspan noted in his October 19 remarks at the Cato Institute, “We have difficulty defining those (money growth) limits with precision, and within any such limits, there remains significant scope for discretion in setting policy.”

A casual inspection of the aggregates illustrates the difficulty: For almost four years, the growth rates of M2 and M3 have consistently met or exceeded the upper limit of the FOMC-determined ranges—yet economic expansion has continued with relatively modest inflation. This is not to say that money growth is irrelevant: Inflation is still believed to result from excessive money growth. However, “excessive” is difficult to define over the short term. M2 growth of roughly 6% is not generally associated with price stability, but with real output growth averaging a remarkable 5%, the resulting inflation has been modest.

Through October, year-to-date growth rates of M2, M3, and debt are estimated to be 6.0%, 9.0%, and 5.8%, respectively. In keeping with the pattern established early this year,
growth in the narrower measures of
money is much less robust. Year-to-
date growth in the sweep-adjusted
base was only 1.8% through August
(the most recent sweeps data avail-
able), partly reflecting an offset to
rapid Y2K-related growth in 1999.

Looking at interest rates, the rapid
and sustained increases in short-term
Treasury yields of 1999 have not
characterized the 1-year T-bill so far
this year. Trading in a relatively nar-
row range, the 1-year yield was
down 9 basis points (bp) since the
beginning of the year to 5.94% as of
October 20. In contrast, the 3-month
T-bill yield has continued to climb,
reaching 6.3% (up 87 bp this year).
As a result, the inversion at the short
end of the yield curve, which first ap-
peared in July, continues to deepen.

Long-term Treasury yields peaked
simultaneously early in the year and
have largely moved together. Both
the 10-year and 30-year Treasury
bond yields are down (88 bp to
5.68% and 81 bp to 5.77%, respec-
tively) through October 20. The
spread between 30-year conventional
mortgage rates and long-term Trea-
sury yields has widened by around
50 bp over this period. While market
rates moved up sharply when the
FOMC tightened by 75 bp in 1999,
rates have not responded in similar
fashion this year despite an addi-
tional percentage point increase.

Expectations of policy action,
embodied in implied yields on fed-
eral funds futures, have changed sig-
ificantly since May. The steeply
sloped implied yield curves of the
first two quarters have gradually flat-
tened, culminating in the current in-
version of 15 bp between the Octo-
ber 2000 and March 2001 contracts.