In 2001, the monetary aggregates grew rapidly across the entire spectrum of liquidity. A number of factors combined to produce this surge in growth rates. Because 2001 calendar-year data are available for most of the aggregates, one can summarize their behavior and the driving forces behind their growth.

Narrowly defined, more liquid monetary aggregates, such as the sweep-adjusted monetary base and sweep-adjusted M1, grew robustly in 2001, showing increases of 8.4% and 7.3%, respectively. Year-over-year growth, already quite strong for most of 2001, rose sharply during the fourth quarter as the Federal Reserve moved to provide needed liquidity in the wake of the terrorist attacks.

However, annual growth rates are somewhat misleading because of unprecedented volatility in the narrow measures of money during the fourth quarter of recent years. Late in 1999, concerns about the century date change motivated an expansion of reserves which, when proven unnecessary, were drained out of the system during 2000. The abnormally elevated level of the narrow monetary aggregates during 1999:IVQ relative to 1998:IVQ relative to 1998:IVQ showed up as a sharp increase in the growth rate one year and a decline the next. A similar scenario followed the events of September 11. But if viewed over a two-year horizon, annualized sweep-adjusted M1 growth rose modestly
between 1999:IVQ and 2001:IVQ, and annualized sweep-adjusted base growth actually fell relative to 2000. The broader (less liquid) monetary aggregates such as M2, M3, and M2M are, by their very nature, more insulated from the types of shocks that cause the narrow monetary aggregates to expand or contract. Often, these forces simply wash out in the broad monetary aggregates. Nonetheless, 2001 growth in the broad monetary aggregates was, if anything, even stronger than in the narrower ones. In 2001:IVQ, growth from four quarters previous in M2, M3, and M2M reached 10.3%, 12.9%, and 20.4%, respectively.

Despite this growth in the broad monetary aggregates, inflation and inflation expectations have remained subdued. This is because velocity, which measures the rate at which dollar balances turn over during a given period, has been declining for both M2 and M2M. Opportunity cost measures earnings lost by holding the components of an aggregate instead of an alternative asset such as a U.S. Treasury security. Thus, swings in the opportunity cost of money often coincide with changes in its velocity. Essentially, dollars turn over more slowly when opportunity costs fall because they are less costly to hold. This enables money to grow faster without igniting inflation. Thus far, the good news is that despite elevated money growth, inflation expectations have not risen.