Monetary Trends

February 2010

Are Low Interest Rates Good for Consumers?

There seems to be little debate about the desirability of the Federal Reserve's policy of keeping the federal funds rate near zero. This is a bit surprising because the short-term interest rate is not just banks' marginal cost of borrowing in the reserve market but also the rate of return for households that save. And although banks' cost of funds has dropped dramatically with the federal funds rate target, households' cost of funds has remained high, especially if we look at their cost of borrowing relative to their rate of return on saving.

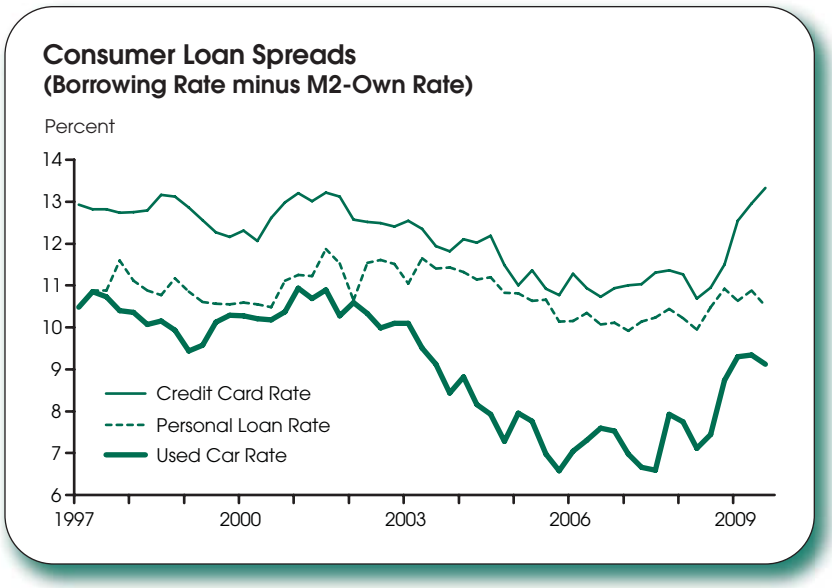
Savings accounts held at thrifts and banks (a component of the M2 aggregate) have grown rapidly with the recent sharp rise in the personal saving rate. But this is only one aspect of a higher saving rate. The other and more dramatic consequence is the paying down of accumulated debt.

The chart shows the average rate that bank customers would pay for three types of loans relative to the amount they would earn on a weighted average of funds held in M2 (which is essentially cash on hand or in easily accessible bank accounts). The rate with the highest spread is on credit card debt. This spread is higher today than at any time in the past decade—even when the federal funds rate was as high as 6.5 percent in 2000:Q4. The other rates are an unsecured (two-year) personal loan rate and the rate charged in used car loans, which is lowest because it is secured by the used car.

Households' cost of borrowing has remained high (see chart) even as the average rate of return on funds held in M2 has fallen to around 1/3 percent. Therefore, because interest rates on savings are so low, households have "saved" by paying down credit card and mortgage debt. Over the past year households have reduced credit card debt by 3.5 percent. It is true that credit card debt was reduced slightly at the ends of some previous recessions, but that was not the case in 2001 and the current reduction is the largest since the Fed began collecting such data (in the early 1950s). Households have also reduced mortgage debt by almost 2 percent, the first time since the series began that we have seen an actual year-over-year decline in mortgage debt.

As the Fed has followed unconventional monetary policies over the past year—near-zero federal funds rate target and the outright purchase of more than $1,300 billion of government and federal agency securities—the reserve deposits of banks at the Fed have skyrocketed from about $8.7 billion on August 27, 2008, to $1,069 billion on December 30, 2009. Yet this large increase in reserves has yet to have much impact in the market for consumer loans. The economy is currently in the worst recession since World War II. Conventional macroeconomic wisdom suggests that low interest rates will aid in the recovery by restoring health to the banking system and promoting lending to both businesses and households. So, if low interest rates are indeed good for consumers, then the benefits must come from the effect these policies have on future output growth.

—William T. Gavin



Views expressed do not necessarily reflect official positions of the Federal Reserve System.

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Conventions used in this publication:

1. Unless otherwise indicated, data are monthly.
2. Except where otherwise noted, solid shading indicates recessions, as determined by the National Bureau of Economic Research. The NBER has not yet determined the end of the recession that began in December 2007; however, the hatched shading shows that the recession ended in July 2009. We made this determination based on a statistical model for dating business cycle turning points developed by Marcelle Chauvet and Jeremy Piger ("A Comparison of the Real-Time Performance of Business Cycle Dating Methods," *Journal of Business and Economic Statistics*, 2008, 26, 42-49). For more information, see http://www.uoregon.edu/~jpiger/us_recession_probs.htm.
3. *Percent change at an annual rate* is the simple, not compounded, monthly percent change multiplied by 12. For example, using consecutive months, the percent change at an annual rate in x between month $t-1$ and the current month t is: $[(x_\tau/x_{\tau-1})-1]\times 1200$. Note that this differs from *National Economic Trends*. In that publication, monthly percent changes are compounded and expressed as annual growth rates.
4. The *percent change from year ago* refers to the percent change from the same period in the previous year. For example, the percent change from year ago in x between month $t-12$ and the current month t is: $[(x_\tau/x_{\tau-12})-1]\times 100$.

We welcome your comments addressed to:

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On March 23, 2006, the Board of Governors of the Federal Reserve System ceased the publication of the M3 monetary aggregate. It also ceased publishing the following components: large-denomination time deposits, RPs, and eurodollars.

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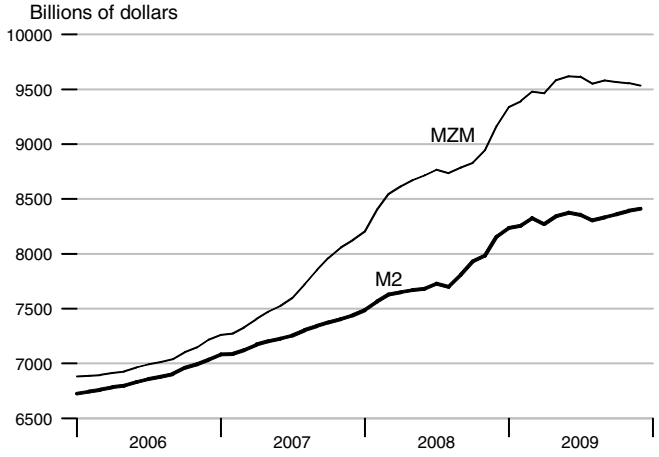
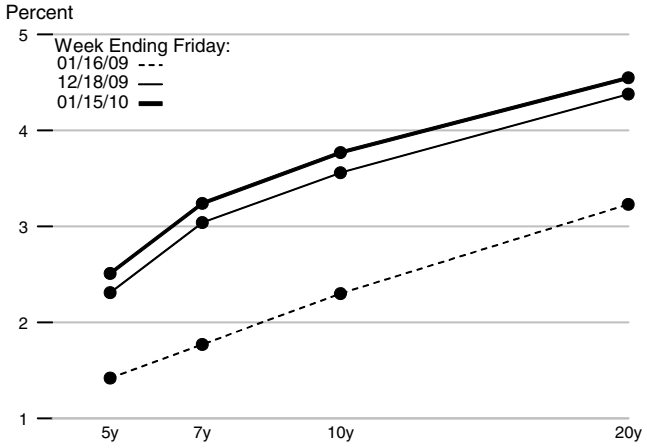
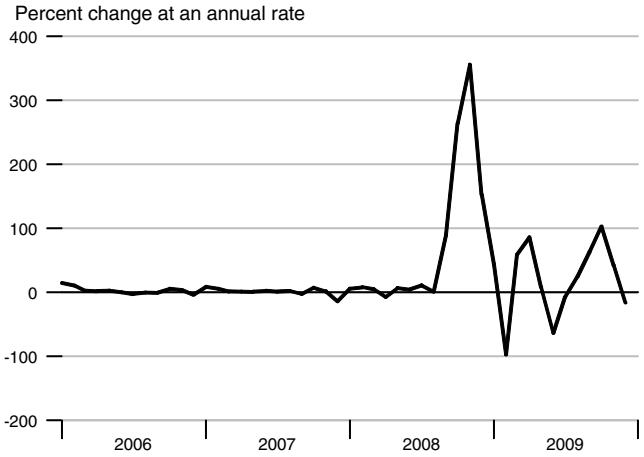
M2 and MZM



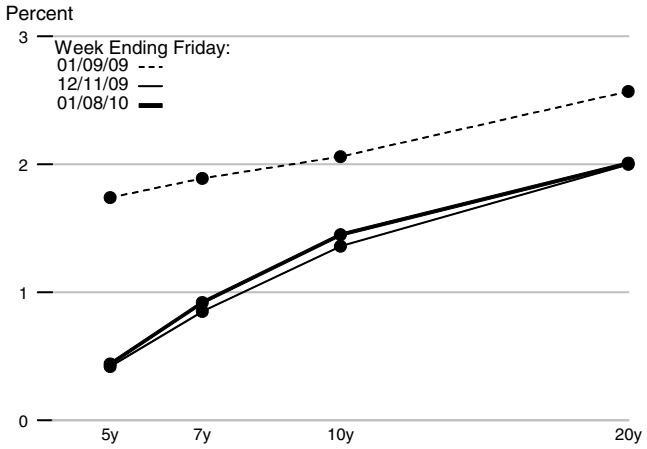
Treasury Yield Curve



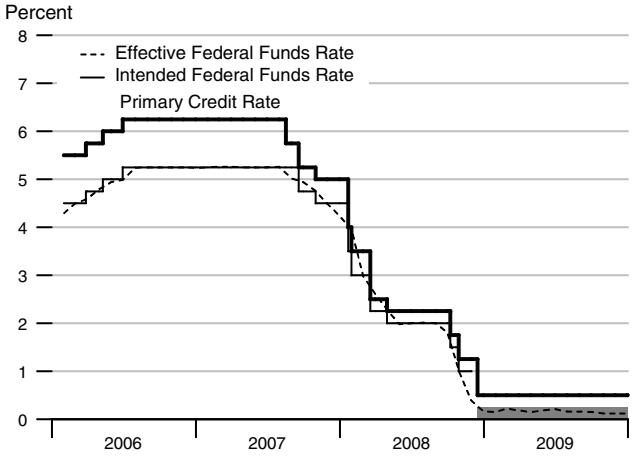
Adjusted Monetary Base



Real Treasury Yield Curve

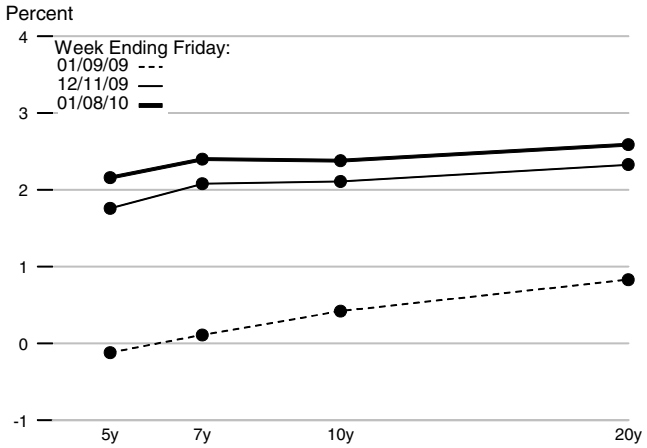


Reserve Market Rates



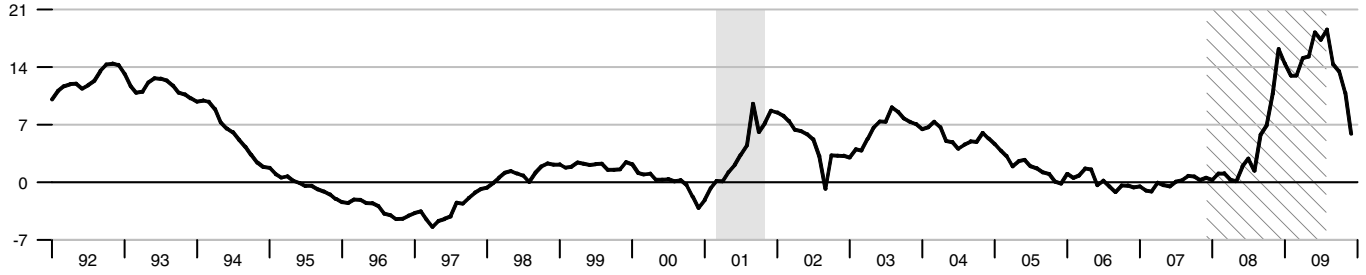
Note: Effective December 16, 2008, FOMC reports the intended Federal Funds Rate as a range.

Inflation-Indexed Treasury Yield Spreads



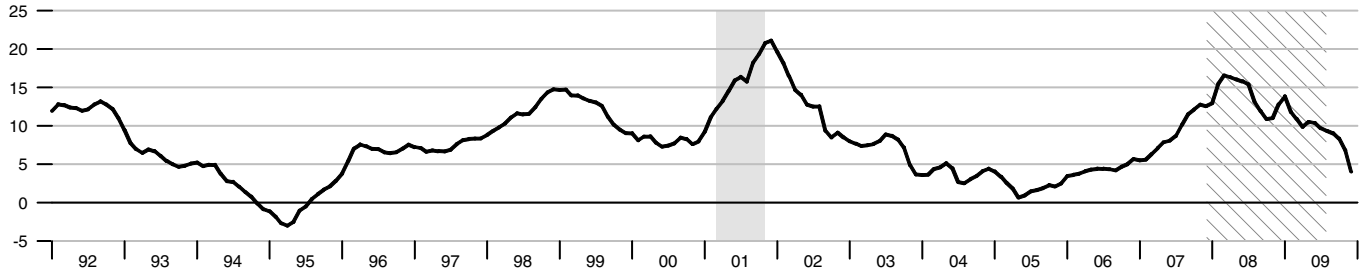
M1

Percent change from year ago



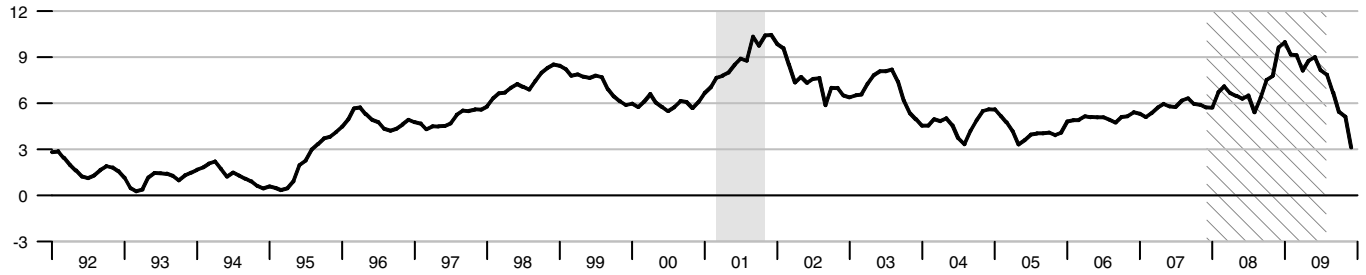
MZM

Percent change from year ago



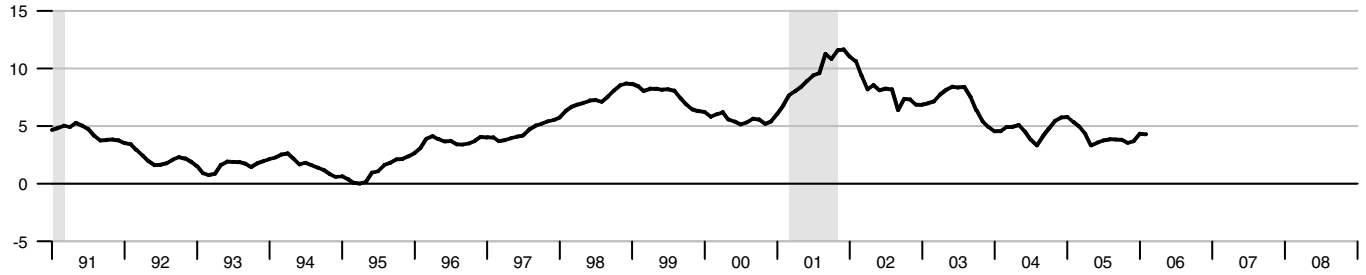
M2

Percent change from year ago



Monetary Services Index - M2**

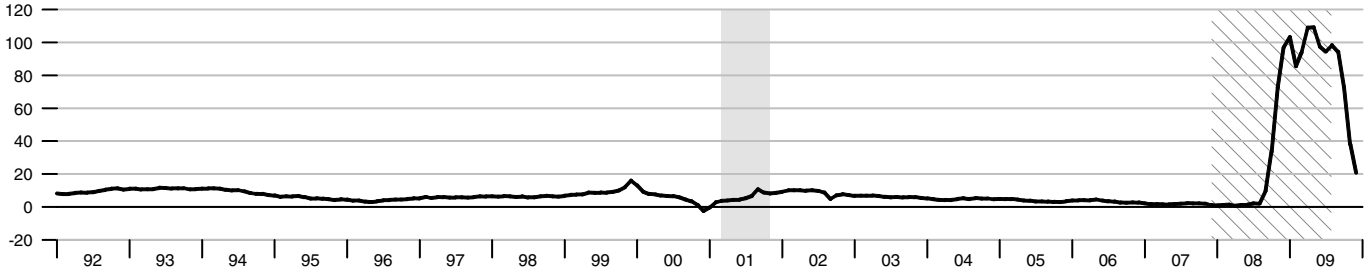
Percent change from year ago



**We will not update the MSI series until we revise the code to accomodate the discontinuation of M3.

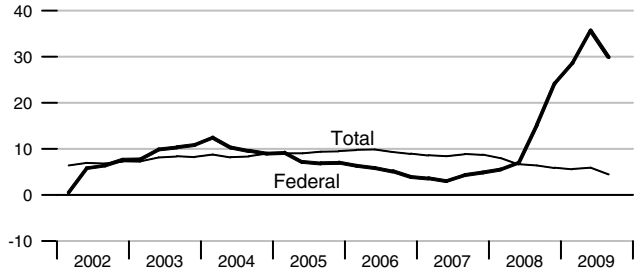
Adjusted Monetary Base

Percent change from year ago



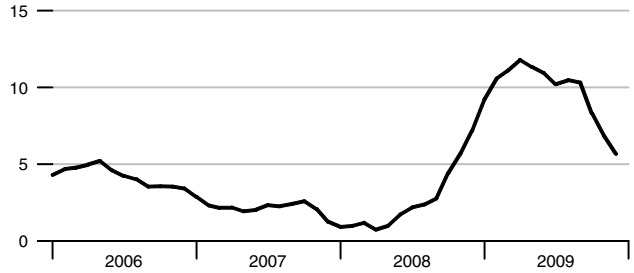
Domestic Nonfinancial Debt

Percent change from year ago



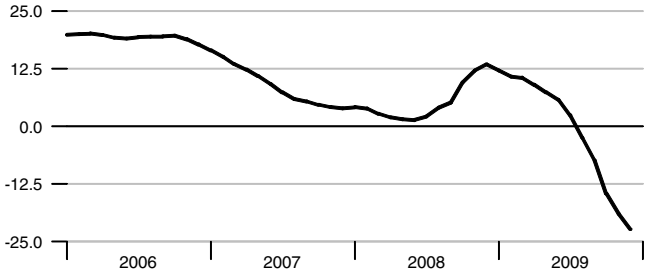
Currency Held by the Nonbank Public

Percent change from year ago



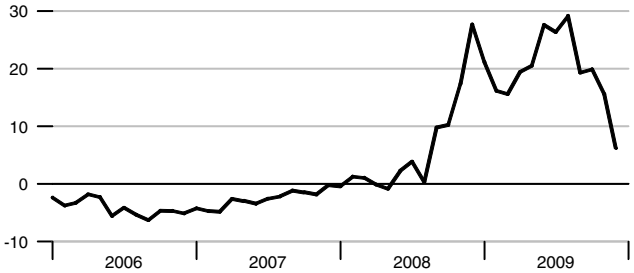
Small Denomination Time Deposits*

Percent change from year ago



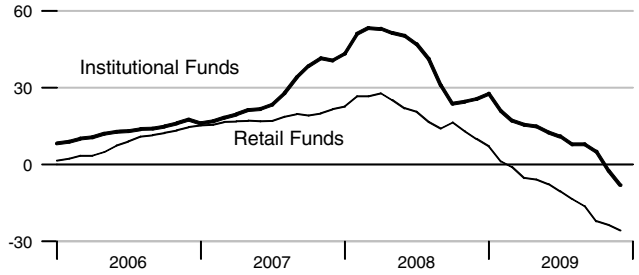
Checkable Deposits

Percent change from year ago



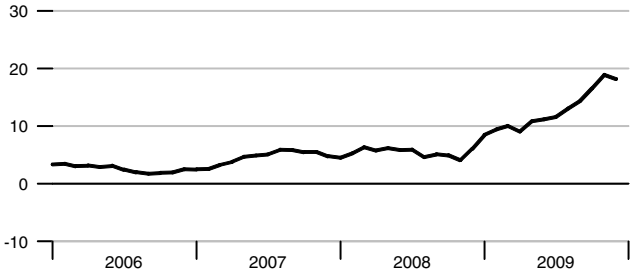
Money Market Mutual Fund Shares

Percent change from year ago



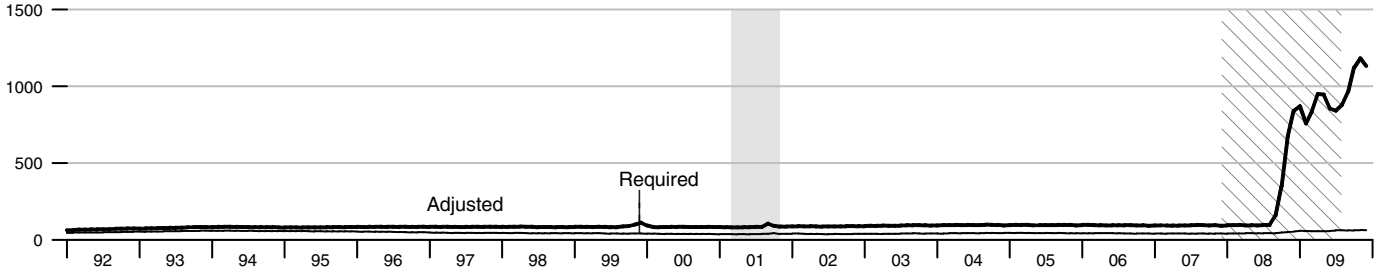
Savings Deposits

Percent change from year ago



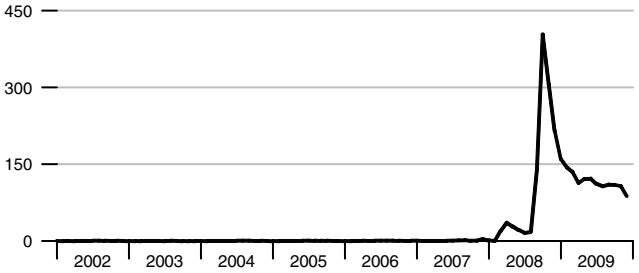
Adjusted and Required Reserves

Billions of dollars



Total Borrowings, nsa

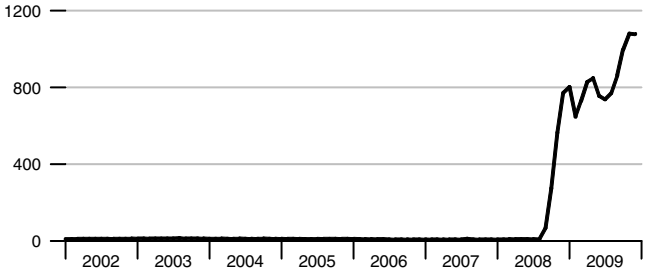
Billions of dollars



* Data exclude term auction credit

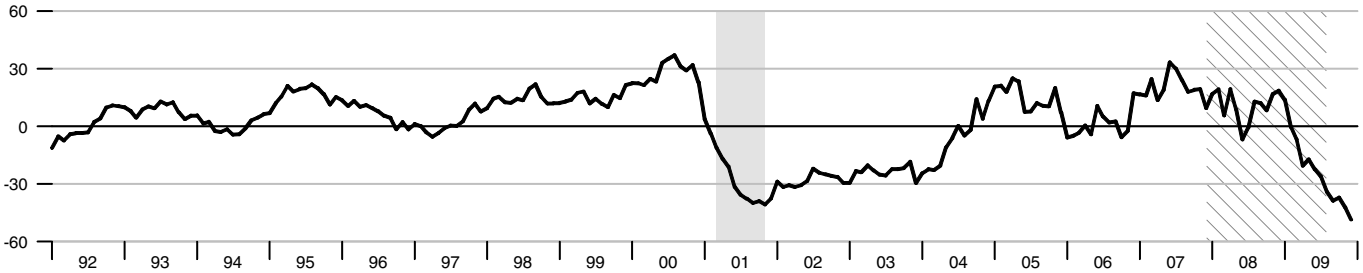
Excess Reserves plus RCB Contracts

Billions of dollars



Nonfinancial Commercial Paper

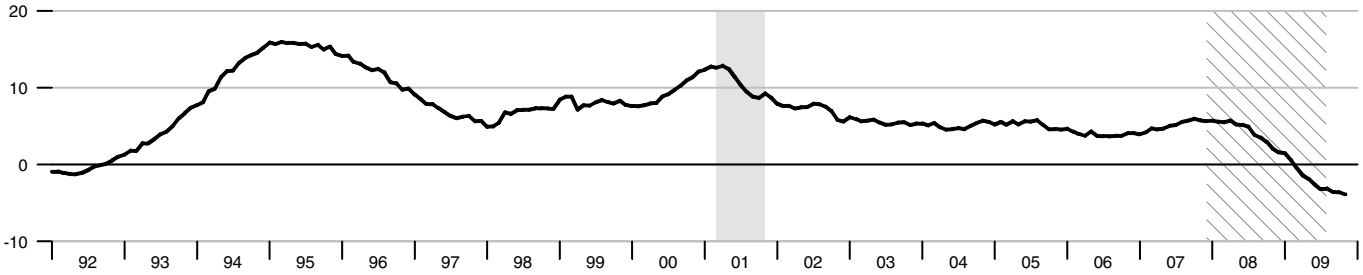
Percent change from year ago



As of April 10, 2006, the Federal Reserve Board made major changes to its commercial paper calculations.
For more information, please refer to http://www.federalreserve.gov/releases/cp/about.htm.

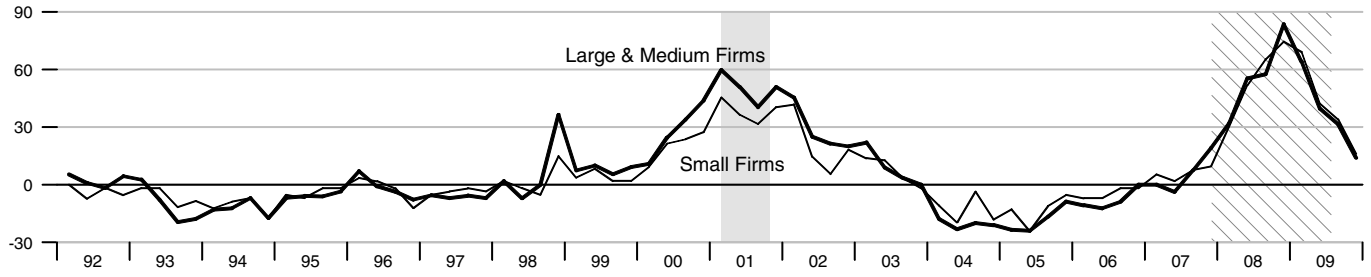
Consumer Credit

Percent change from year ago



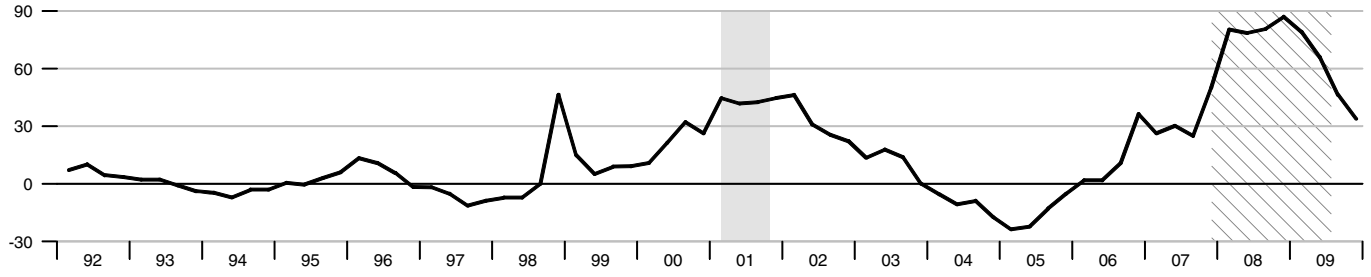
Net Percentage of Domestic Respondents Tightening Standards for Commercial and Industrial Loans

Percentage



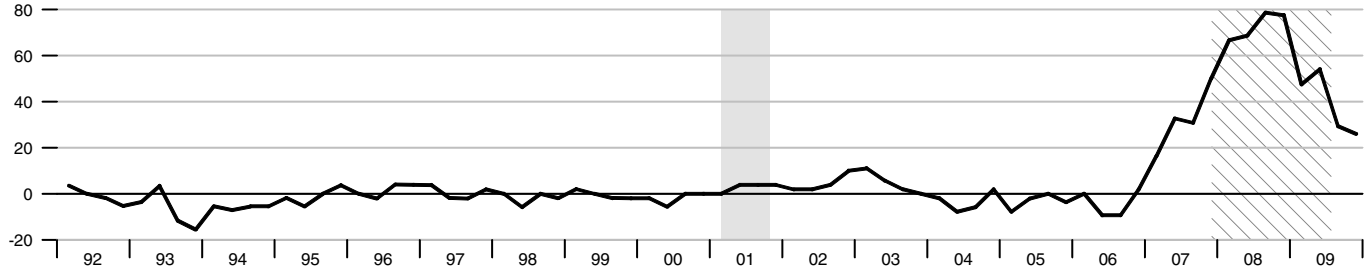
Net Percentage of Domestic Respondents Tightening Standards for Commercial Real Estate Loans

Percentage



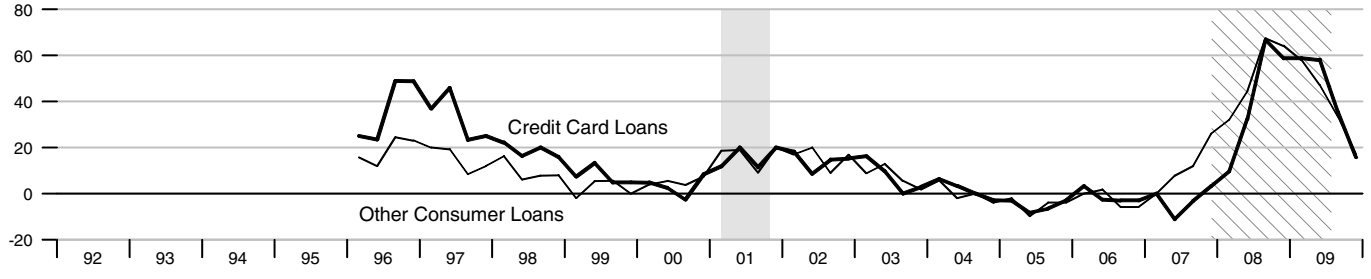
Net Percentage of Domestic Respondents Tightening Standards for Residential Mortgage Loans

Percentage



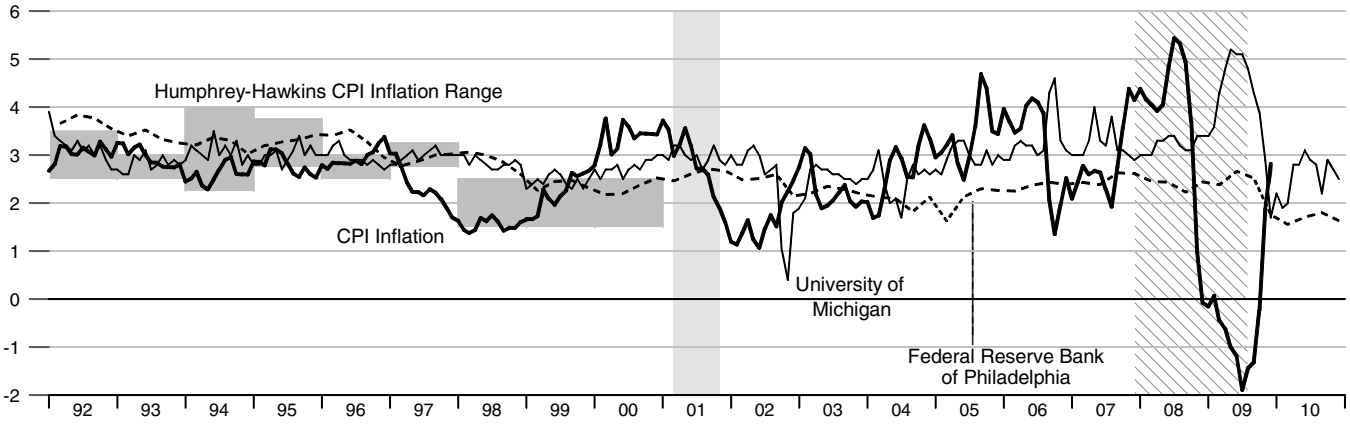
Net Percentage of Domestic Respondents Tightening Standards for Consumer Loans

Percentage



CPI Inflation and 1-Year-Ahead CPI Inflation Expectations

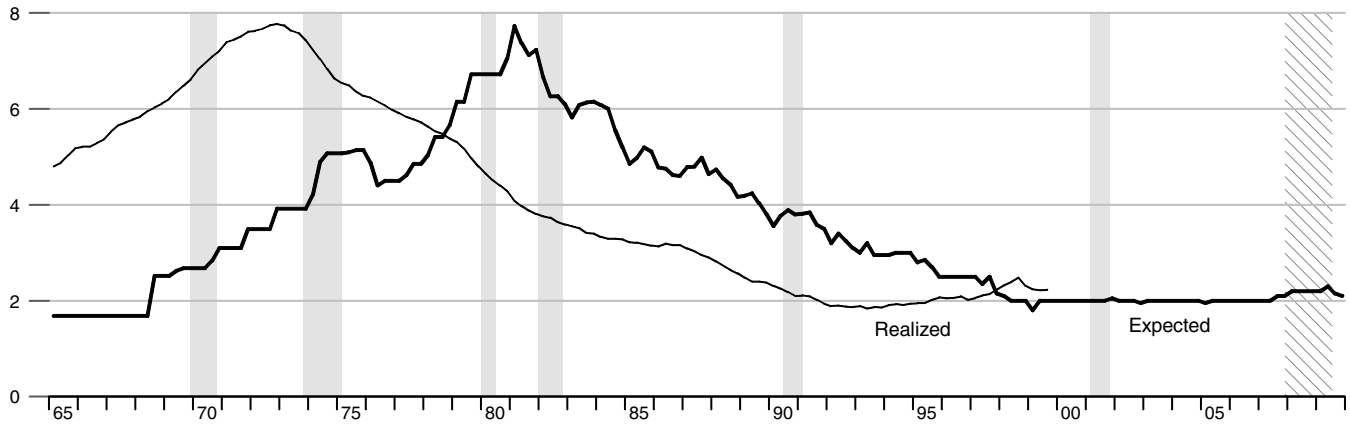
Percent



The shaded region shows the Humphrey-Hawkins CPI inflation range. Beginning in January 2000, the Humphrey-Hawkins inflation range was reported using the PCE price index and therefore is not shown on this graph.

10-Year Ahead PCE Inflation Expectations and Realized Inflation

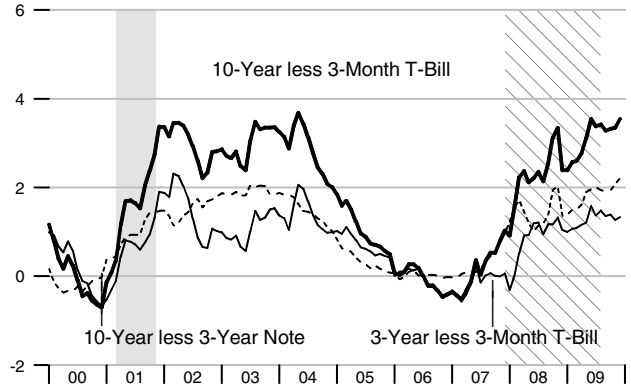
Percent



See the notes section for an explanation of the chart.

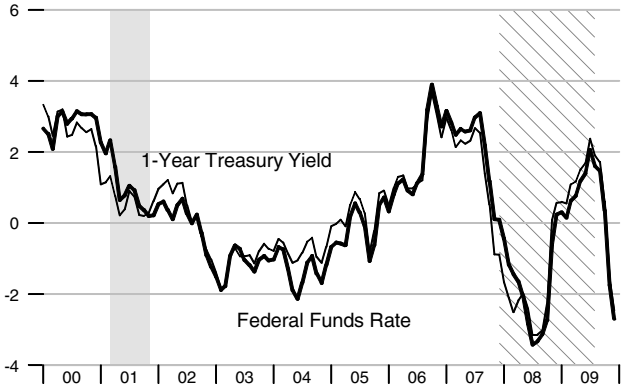
Treasury Security Yield Spreads

Yield to maturity

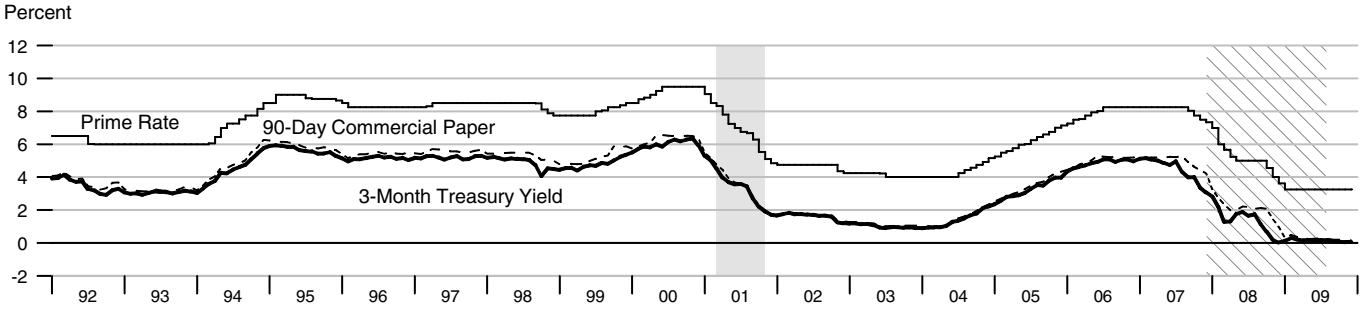


Real Interest Rates

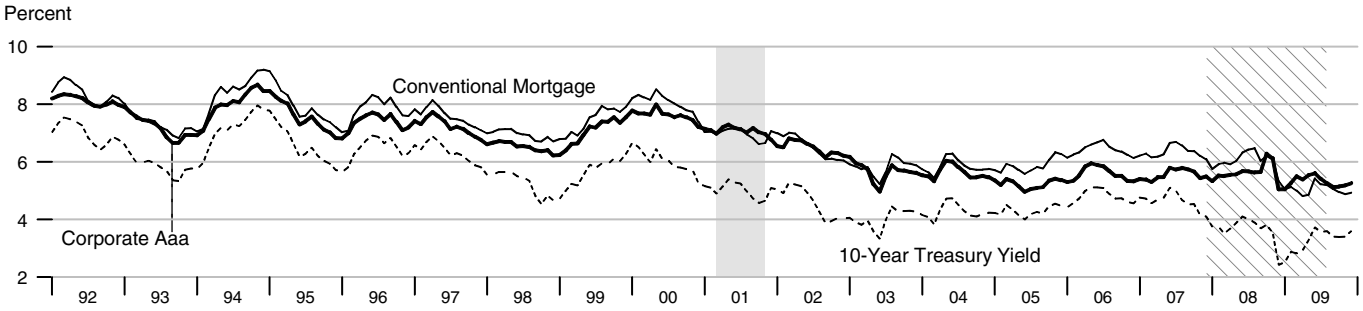
Percent, Real rate = Nominal rate less year-over-year CPI inflation



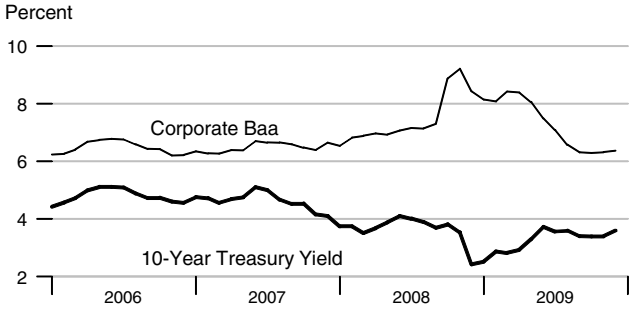
Short-Term Interest Rates



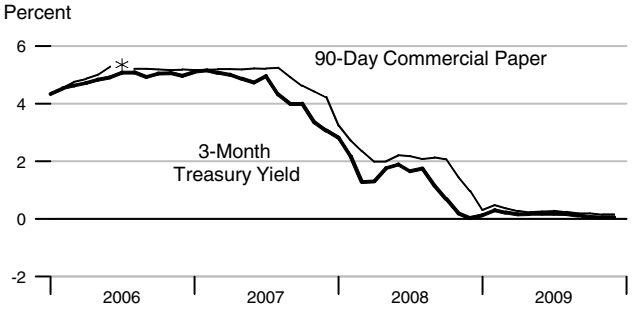
Long-Term Interest Rates



Long-Term Interest Rates

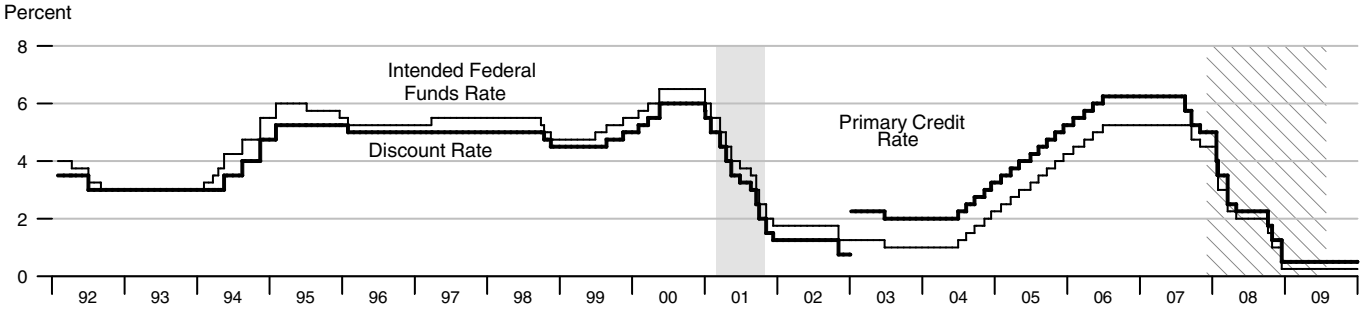


Short-Term Interest Rates

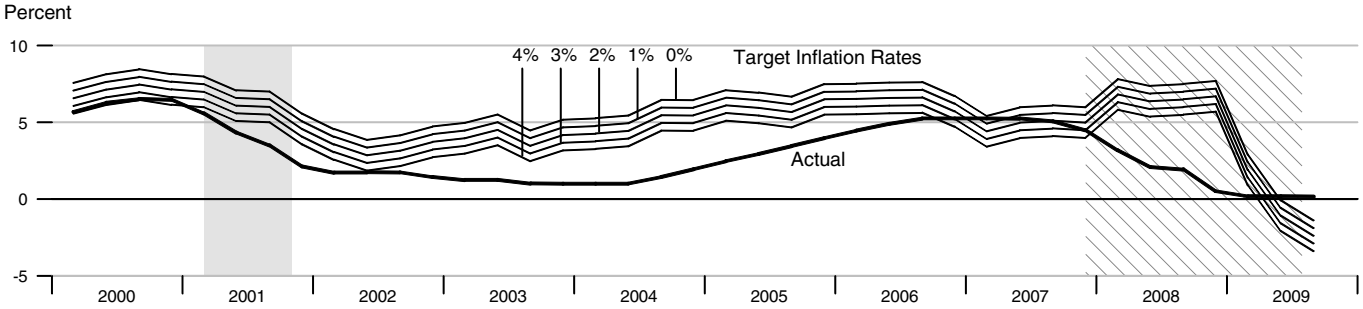


*90-Day Commercial Paper data are not available for December 2005, January 2006, and July 2006.

FOMC Intended Federal Funds Rate, Discount Rate, and Primary Credit Rate



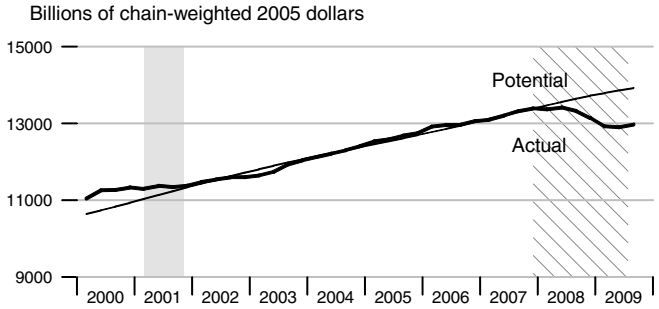
Federal Funds Rate and Inflation Targets



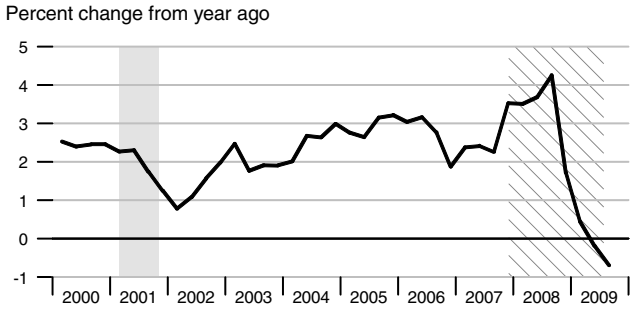
Calculated federal funds rate is based on Taylor's rule.

Components of Taylor's Rule

Actual and Potential Real GDP

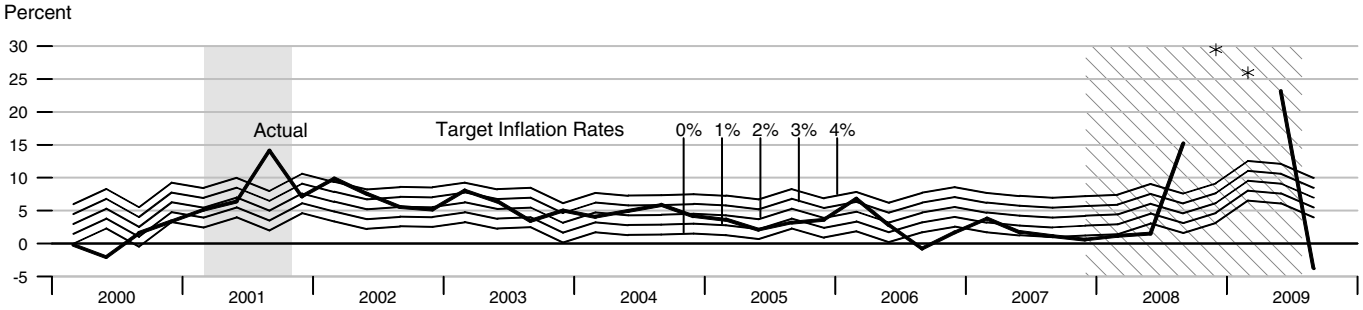


PCE Inflation



See notes section for further explanation.

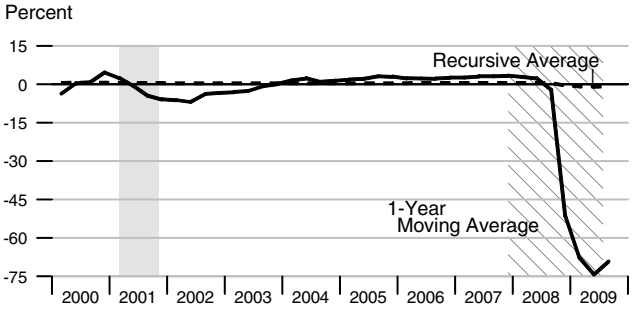
Monetary Base Growth and Inflation Targets



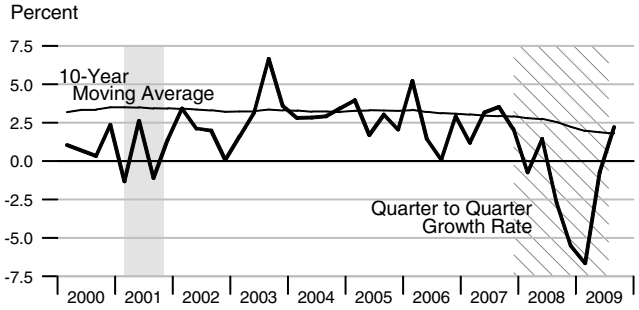
Calculated base growth is based on McCallum's rule. Actual base growth is percent change from the previous quarter
*Actual values for 2008:Q4 and 2009:Q1 are 188.38 percent and 60.77 percent, respectively.

Components of McCallum's Rule

Monetary Base Velocity Growth

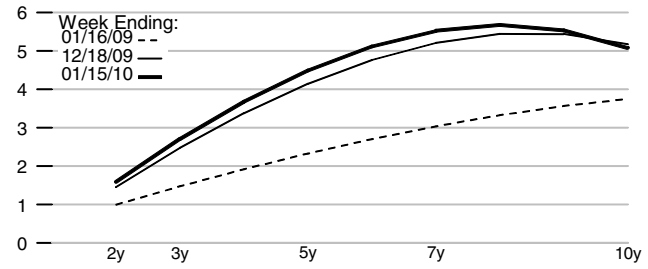


Real Output Growth



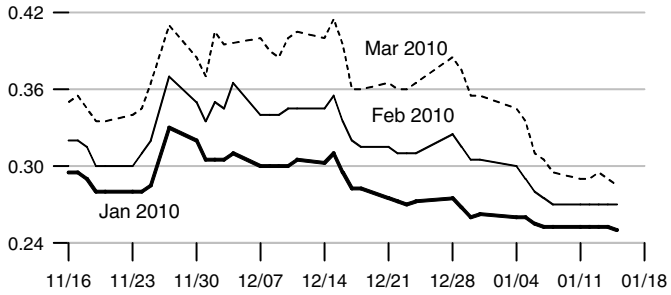
Implied One-Year Forward Rates

Percent



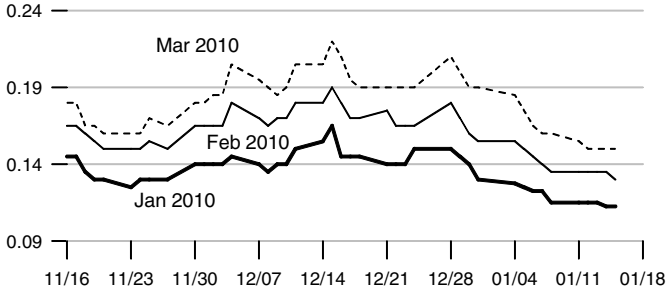
Rates on 3-Month Eurodollar Futures

Percent, daily data



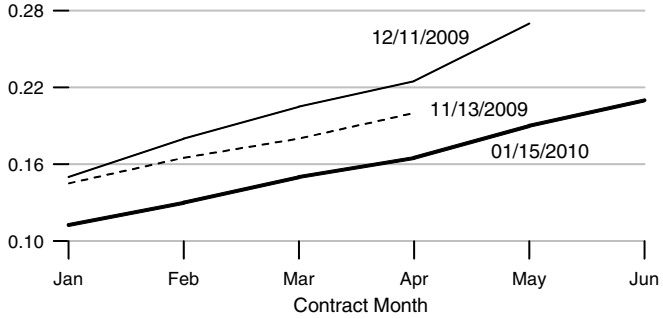
Rates on Selected Federal Funds Futures Contracts

Percent, daily data



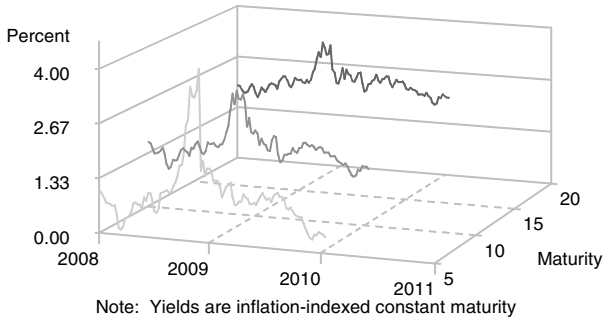
Rates on Federal Funds Futures on Selected Dates

Percent



Inflation-Indexed Treasury Securities

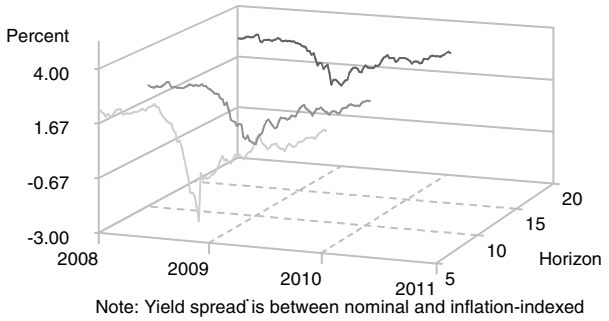
Weekly data



Note: Yields are inflation-indexed constant maturity U.S. Treasury securities

Inflation-Indexed Treasury Yield Spreads

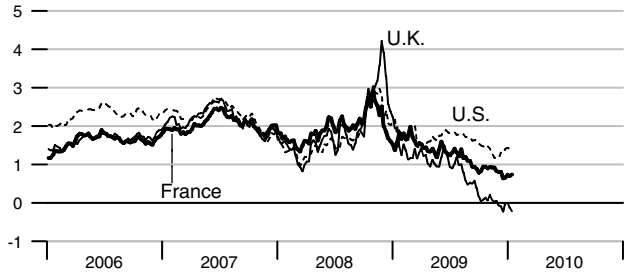
Weekly data



Note: Yield spread is between nominal and inflation-indexed constant maturity U.S. Treasury securities.

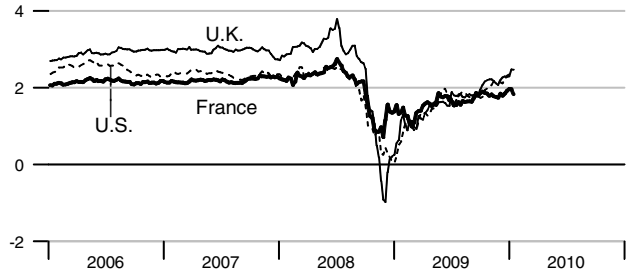
Inflation-Indexed 10-Year Government Notes

Percent, weekly data



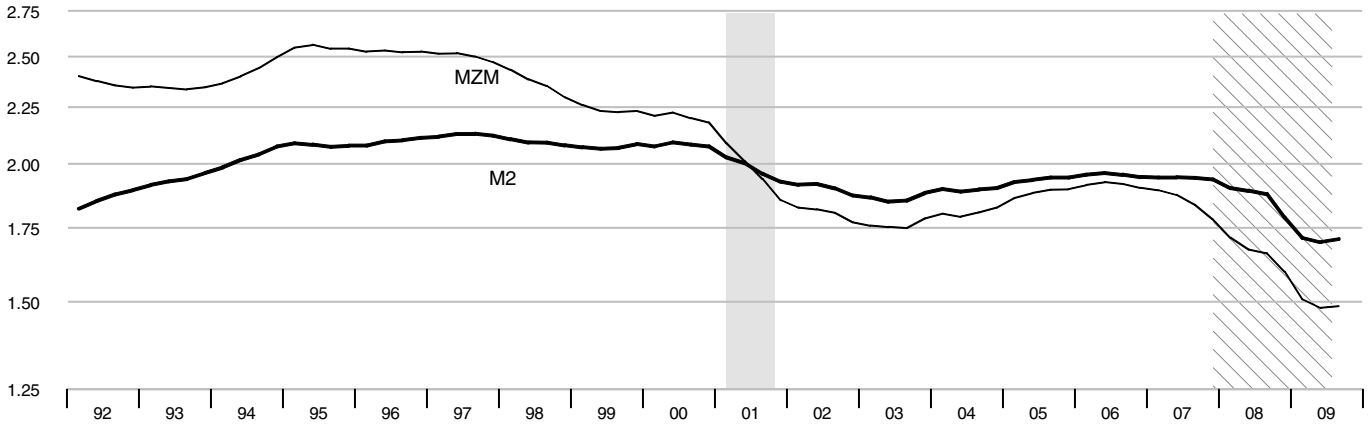
Inflation-Indexed 10-Year Government Yield Spreads

Percent, weekly data



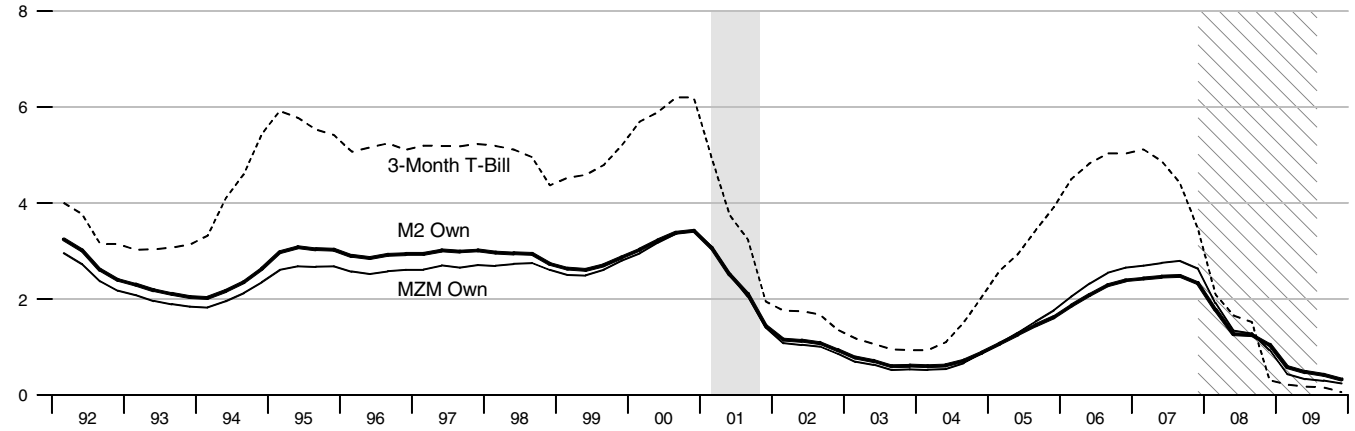
Velocity

Nominal GDP/MZM, Nominal GDP/M2 (Ratio Scale)



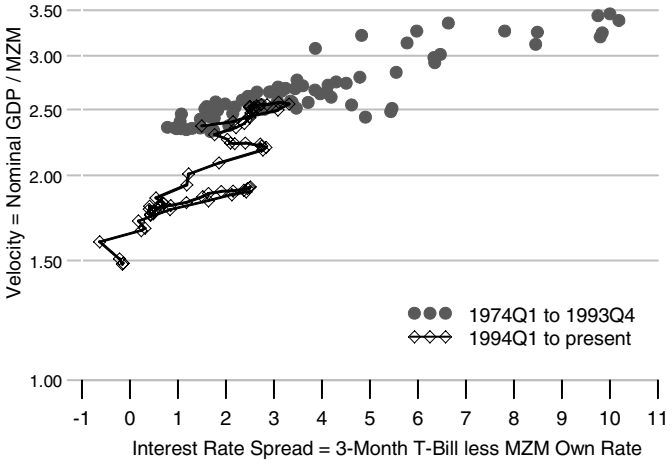
Interest Rates

Percent



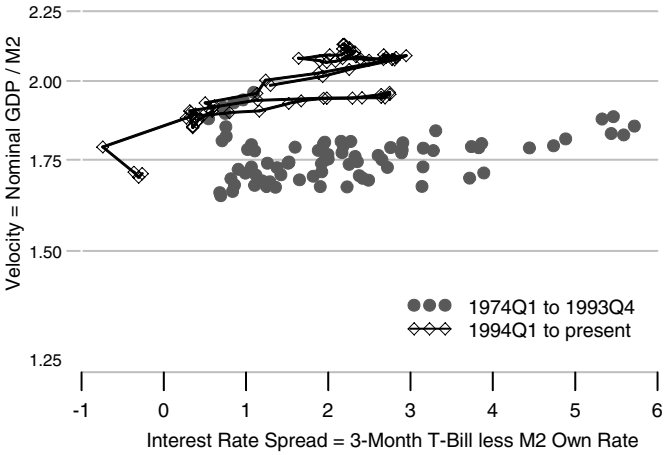
MZM Velocity and Interest Rate Spread

Ratio Scale



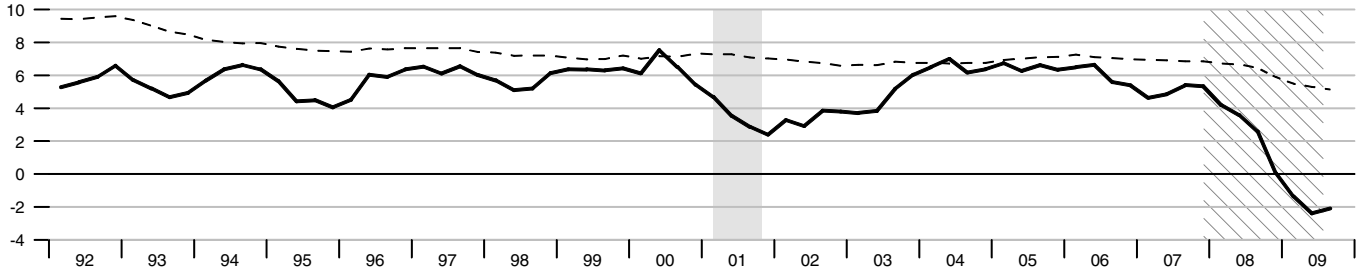
M2 Velocity and Interest Rate Spread

Ratio Scale



Gross Domestic Product

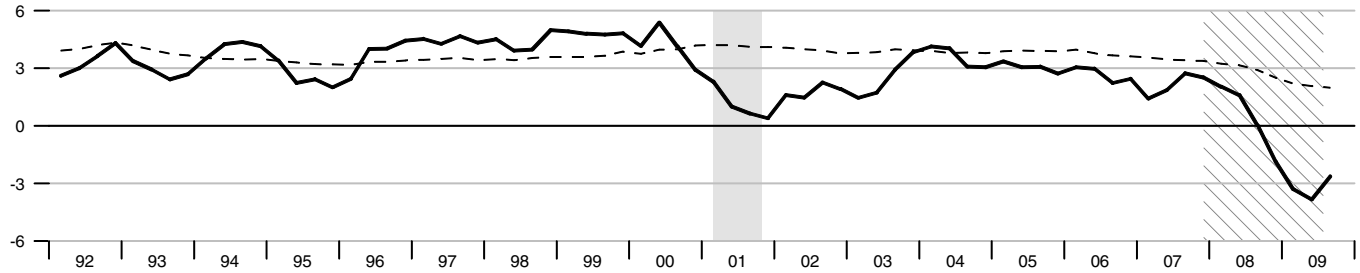
Percent change from year ago



Dashed lines indicate 10-year moving averages.

Real Gross Domestic Product

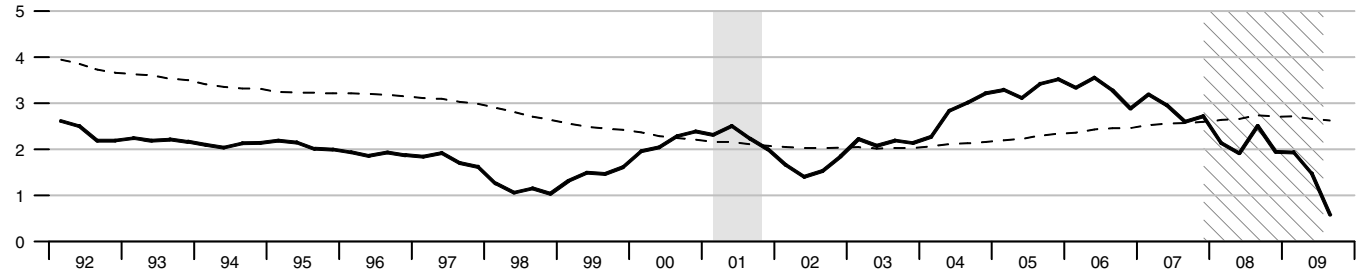
Percent change from year ago



Dashed lines indicate 10-year moving averages.

Gross Domestic Product Price Index

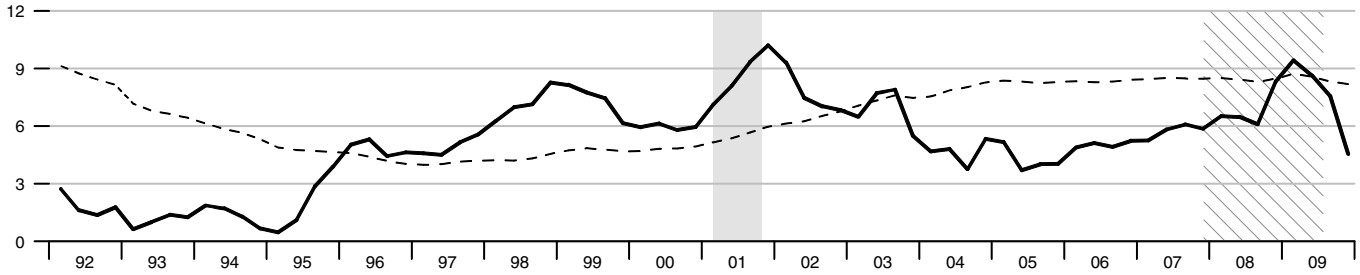
Percent change from year ago



Dashed lines indicate 10-year moving averages.

M2

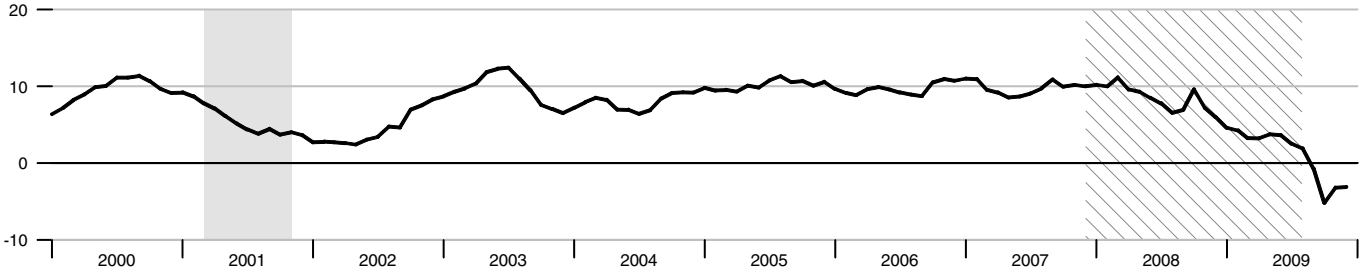
Percent change from year ago



Dashed lines indicate 10-year moving averages.

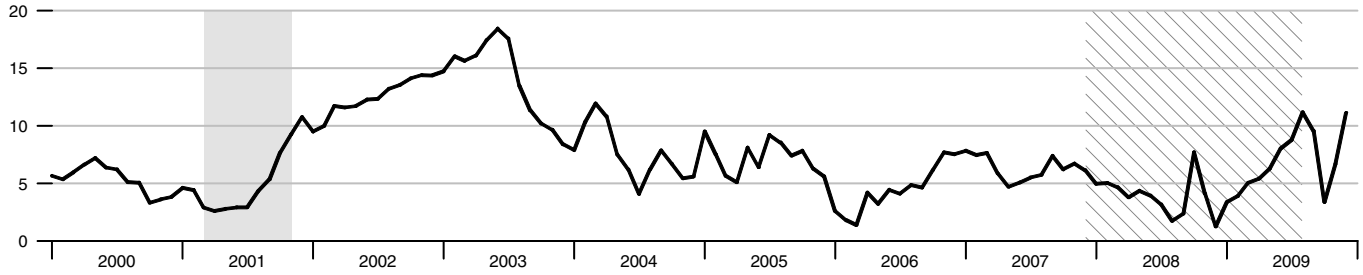
Bank Credit

Percent change from year ago



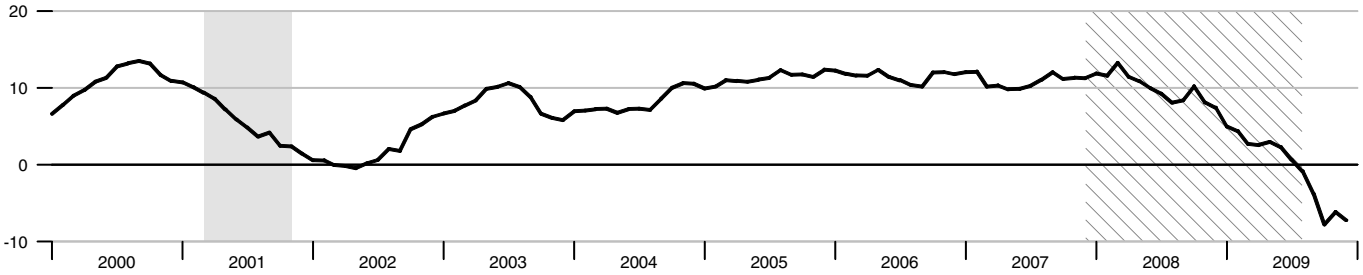
Investment Securities in Bank Credit at Commercial Banks

Percent change from year ago



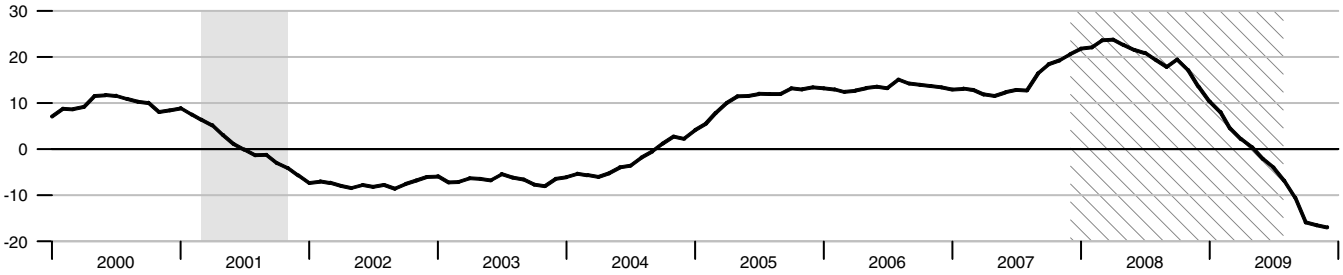
Total Loans and Leases in Bank Credit at Commercial Banks

Percent change from year ago

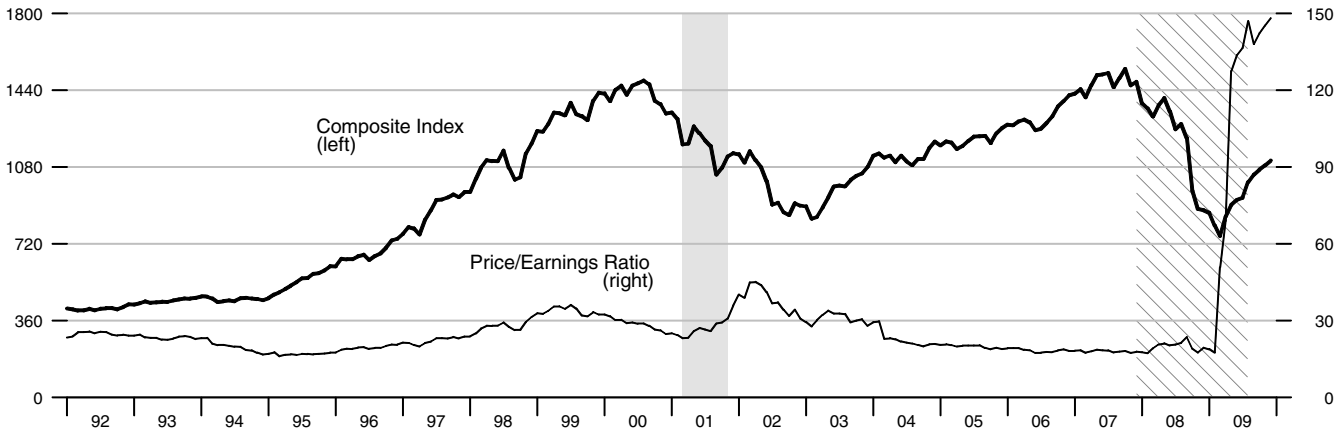


Commercial and Industrial Loans at Commercial Banks

Percent change from year ago



Standard & Poor's 500



Recent Inflation and Long-Term Interest Rates

	Consumer Price Inflation Rates				Long-Term Government Bond Rates			
	Percent change from year ago				Percent			
	2009Q1	2009Q2	2009Q3	2009Q4	Sep09	Oct09	Nov09	Dec09
United States	-0.18	-0.94	-1.55	1.47	3.40	3.39	3.40	3.59
Canada	1.25	0.06	-0.87	.	3.37	3.42	3.41	3.39
France	0.63	-0.21	-0.42	.	3.59	3.56	.	.
Germany	0.82	0.25	-0.25	.	3.26	3.21	3.22	3.14
Italy	1.48	0.85	0.12	0.65	4.09	4.10	4.06	4.01
Japan	-0.10	-0.98	-2.25	.	1.26	1.40	1.25	.
United Kingdom	3.01	2.12	1.46	.	3.66	3.57	3.76	3.89

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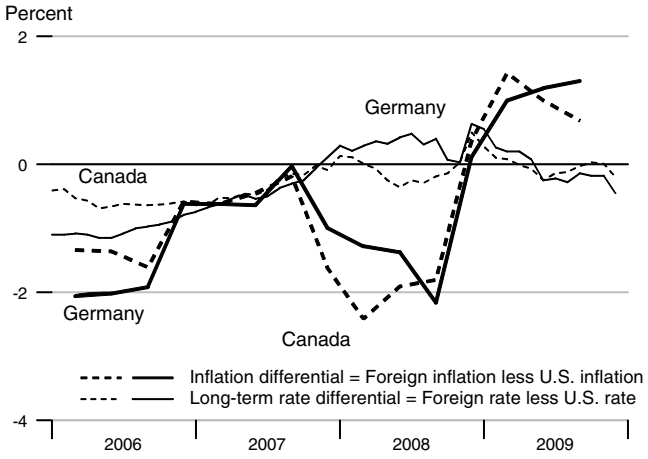
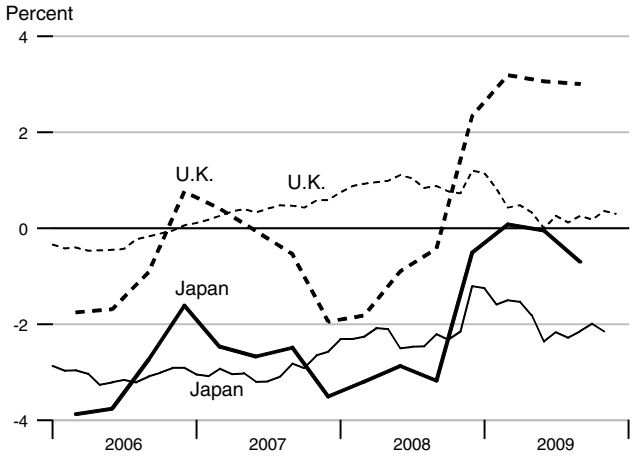
Inflation and Long-Term Interest Rate Differentials





		Money Stock				Bank	Adjusted		
		M1	MZM	M2	M3*	Credit	Monetary Base	Reserves	MSI M2**
2005		1371.751	6707.775	6527.248	9786.477	6979.881	806.628	96.560	343.539
2006		1374.358	6998.369	6856.042	10270.74	7654.675	835.039	94.913	
2007		1373.207	7632.049	7251.158		8405.882	850.565	94.182	
2008		1429.042	8698.672	7748.994		9122.718	1009.814	232.217	
2009		1629.233	9523.810	8330.505		9229.973	1796.604	944.820	
2007	1	1369.341	7289.108	7097.940		8126.387	846.309	94.123	
	2	1376.333	7467.984	7200.443		8238.876	849.917	93.536	
	3	1371.420	7722.863	7300.125		8482.787	852.247	95.410	
	4	1375.734	8048.240	7406.125		8775.478	853.787	93.658	
2008	1	1380.439	8384.159	7560.830		8975.618	856.300	96.153	
	2	1387.174	8667.178	7667.286		8990.338	859.394	94.440	
	3	1417.516	8763.332	7745.460		9084.945	892.824	117.901	
	4	1531.037	8980.018	8022.401		9439.970	1430.738	620.373	
2009	1	1566.477	9403.715	8273.322		9337.750	1663.079	820.761	
	2	1612.012	9555.747	8329.718		9308.185	1763.776	917.203	
	3	1654.439	9583.029	8331.603		9195.745	1747.155	895.367	
	4	1684.005	9552.748	8387.378		9078.211	2012.405	1145.948	
2007	Dec	1373.009	8124.214	7438.839		8843.454	847.454	91.758	
2008	Jan	1377.414	8204.131	7488.190		8926.168	851.405	95.043	
	Feb	1380.574	8403.584	7565.327		8965.333	856.964	96.211	
	Mar	1383.330	8544.761	7628.973		9035.353	860.532	97.205	
	Apr	1383.980	8614.811	7650.054		8976.564	855.222	94.350	
	May	1383.770	8671.288	7669.845		9001.601	859.920	95.142	
	Jun	1393.771	8715.434	7681.958		8992.851	863.041	93.827	
	Jul	1409.317	8766.530	7726.867		9021.507	870.771	97.074	
	Aug	1391.659	8736.351	7699.561		9038.214	871.530	96.736	
	Sep	1451.572	8787.114	7809.953		9195.113	936.171	159.892	
	Oct	1474.699	8830.304	7929.177		9541.168	1142.202	347.655	
	Nov	1523.164	8945.365	7982.133		9406.200	1480.759	674.088	
	Dec	1595.249	9164.385	8155.894		9372.542	1669.252	839.377	
2009	Jan	1576.451	9339.366	8235.858		9337.104	1730.461	870.224	
	Feb	1559.675	9394.505	8258.690		9347.561	1590.256	758.678	
	Mar	1563.305	9477.273	8325.417		9328.584	1668.519	833.381	
	Apr	1592.773	9464.524	8272.198		9266.851	1787.813	949.452	
	May	1595.462	9583.611	8342.627		9338.100	1799.379	946.291	
	Jun	1647.802	9619.107	8374.329		9319.603	1704.135	855.866	
	Jul	1653.592	9615.856	8356.628		9249.622	1693.704	841.448	
	Aug	1649.848	9551.975	8305.242		9210.442	1728.092	879.513	
	Sep	1659.877	9581.256	8332.939		9127.172	1819.670	965.141	
	Oct	1673.921	9567.102	8359.907		9047.561	1975.378	1122.170	
	Nov	1688.659	9556.202	8391.894		9105.315	2044.552	1182.198	
	Dec	1689.435	9534.941	8410.334		9081.758	2017.284	1133.475	

Note: All values are given in billions of dollars. *See table of contents for changes to the series.

**We will not update the MSI series until we revise the code to accommodate the discontinuation of M3.

	Federal Funds	Primary Credit Rate	Prime Rate	3-mo CDs	Treasury Yields 3-mo	3-yr	10-yr	Corporate Aaa Bonds	Municipal Aaa Bonds	Conventional Mortgage
2005	3.21	4.19	6.19	3.51	3.21	3.93	4.29	5.23	4.28	5.86
2006	4.96	5.96	7.96	5.15	4.85	4.77	4.79	5.59	4.15	6.41
2007	5.02	5.86	8.05	5.27	4.47	4.34	4.63	5.56	4.13	6.34
2008	1.93	2.39	5.09	2.97	1.39	2.24	3.67	5.63	4.58	6.04
2009	0.16	0.50	3.25	0.56	0.15	1.43	3.26	5.31	4.27	5.04
2007 1	5.26	6.25	8.25	5.31	5.12	4.68	4.68	5.36	3.91	6.22
2	5.25	6.25	8.25	5.32	4.87	4.76	4.85	5.58	4.13	6.37
3	5.07	5.93	8.18	5.42	4.42	4.41	4.73	5.75	4.27	6.55
4	4.50	5.02	7.52	5.02	3.47	3.50	4.26	5.53	4.24	6.23
2008 1	3.18	3.67	6.21	3.23	2.09	2.17	3.66	5.46	4.39	5.88
2	2.09	2.33	5.08	2.76	1.65	2.67	3.89	5.60	4.43	6.09
3	1.94	2.25	5.00	3.06	1.52	2.63	3.86	5.65	4.50	6.31
4	0.51	1.31	4.06	2.82	0.30	1.48	3.25	5.82	5.02	5.87
2009 1	0.18	0.50	3.25	1.08	0.22	1.27	2.74	5.27	4.64	5.06
2	0.18	0.50	3.25	0.62	0.17	1.49	3.31	5.51	4.43	5.03
3	0.16	0.50	3.25	0.30	0.16	1.56	3.52	5.27	4.11	5.16
4	0.12	0.50	3.25	0.22	0.06	1.39	3.46	5.20	3.91	4.92
2007 Dec	4.24	4.83	7.33	5.02	3.07	3.13	4.10	5.49	4.25	6.10
2008 Jan	3.94	4.48	6.98	3.84	2.82	2.51	3.74	5.33	4.13	5.76
Feb	2.98	3.50	6.00	3.06	2.17	2.19	3.74	5.53	4.42	5.92
Mar	2.61	3.04	5.66	2.79	1.28	1.80	3.51	5.51	4.63	5.97
Apr	2.28	2.49	5.24	2.85	1.31	2.23	3.68	5.55	4.45	5.92
May	1.98	2.25	5.00	2.66	1.76	2.69	3.88	5.57	4.34	6.04
Jun	2.00	2.25	5.00	2.76	1.89	3.08	4.10	5.68	4.50	6.32
Jul	2.01	2.25	5.00	2.79	1.66	2.87	4.01	5.67	4.44	6.43
Aug	2.00	2.25	5.00	2.79	1.75	2.70	3.89	5.64	4.44	6.48
Sep	1.81	2.25	5.00	3.59	1.15	2.32	3.69	5.65	4.61	6.04
Oct	0.97	1.81	4.56	4.32	0.69	1.86	3.81	6.28	5.05	6.20
Nov	0.39	1.25	4.00	2.36	0.19	1.51	3.53	6.12	4.83	6.09
Dec	0.16	0.86	3.61	1.77	0.03	1.07	2.42	5.05	5.17	5.33
2009 Jan	0.15	0.50	3.25	1.02	0.13	1.13	2.52	5.05	4.64	5.06
Feb	0.22	0.50	3.25	1.16	0.30	1.37	2.87	5.27	4.56	5.13
Mar	0.18	0.50	3.25	1.07	0.22	1.31	2.82	5.50	4.74	5.00
Apr	0.15	0.50	3.25	0.89	0.16	1.32	2.93	5.39	4.48	4.81
May	0.18	0.50	3.25	0.57	0.18	1.39	3.29	5.54	4.26	4.86
Jun	0.21	0.50	3.25	0.39	0.18	1.76	3.72	5.61	4.56	5.42
Jul	0.16	0.50	3.25	0.35	0.18	1.55	3.56	5.41	4.36	5.22
Aug	0.16	0.50	3.25	0.30	0.17	1.65	3.59	5.26	4.17	5.19
Sep	0.15	0.50	3.25	0.25	0.12	1.48	3.40	5.13	3.81	5.06
Oct	0.12	0.50	3.25	0.24	0.07	1.46	3.39	5.15	3.85	4.95
Nov	0.12	0.50	3.25	0.21	0.05	1.32	3.40	5.19	3.99	4.88
Dec	0.12	0.50	3.25	0.22	0.05	1.38	3.59	5.26	3.89	4.93

Note: All values are given as a percent at an annual rate.

		M1	MZM	M2	M3*
Percent change at an annual rate					
	2005	2.03	2.10	4.22	5.97
	2006	0.19	4.33	5.04	4.95
	2007	-0.08	9.05	5.76	
	2008	4.07	13.98	6.87	
	2009	14.01	9.49	7.50	
2007	1	0.16	7.49	5.85	
	2	2.04	9.82	5.78	
	3	-1.43	13.65	5.54	
	4	1.26	16.85	5.81	
2008	1	1.37	16.70	8.36	
	2	1.95	13.50	5.63	
	3	8.75	4.44	4.08	
	4	32.03	9.89	14.30	
2009	1	9.26	18.87	12.51	
	2	11.63	6.47	2.73	
	3	10.53	1.14	0.09	
	4	7.15	-1.26	2.68	
2007	Dec	-1.71	9.95	5.43	
2008	Jan	3.85	11.80	7.96	
	Feb	2.75	29.17	12.36	
	Mar	2.40	20.16	10.10	
	Apr	0.56	9.84	3.32	
	May	-0.18	7.87	3.10	
	Jun	8.67	6.11	1.90	
	Jul	13.38	7.04	7.02	
	Aug	-15.04	-4.13	-4.24	
	Sep	51.66	6.97	17.20	
	Oct	19.12	5.90	18.32	
	Nov	39.44	15.64	8.01	
	Dec	56.79	29.38	26.12	
2009	Jan	-14.14	22.91	11.77	
	Feb	-12.77	7.08	3.33	
	Mar	2.79	10.57	9.70	
	Apr	22.62	-1.61	-7.67	
	May	2.03	15.10	10.22	
	Jun	39.37	4.44	4.56	
	Jul	4.22	-0.41	-2.54	
	Aug	-2.72	-7.97	-7.38	
	Sep	7.29	3.68	4.00	
	Oct	10.15	-1.77	3.88	
	Nov	10.57	-1.37	4.59	
	Dec	0.55	-2.67	2.64	

*See table of contents for changes to the series.

Definitions

M1: The sum of currency held outside the vaults of depository institutions, Federal Reserve Banks, and the U.S. Treasury; travelers checks; and demand and other checkable deposits issued by financial institutions (except demand deposits due to the Treasury and depository institutions), minus cash items in process of collection and Federal Reserve float.

MZM (money, zero maturity): M2 minus small-denomination time deposits, plus institutional money market mutual funds (that is, those included in M3 but excluded from M2). The label MZM was coined by William Poole (1991); the aggregate itself was proposed earlier by Motley (1988).

M2: M1 plus savings deposits (including money market deposit accounts) and small-denomination (under $100,000) time deposits issued by financial institutions; and shares in retail money market mutual funds (funds with initial investments under $50,000), net of retirement accounts.

M3: M2 plus large-denomination ($100,000 or more) time deposits; repurchase agreements issued by depository institutions; Eurodollar deposits, specifically, dollar-denominated deposits due to nonbank U.S. addresses held at foreign offices of U.S. banks worldwide and all banking offices in Canada and the United Kingdom; and institutional money market mutual funds (funds with initial investments of $50,000 or more).

Bank Credit: All loans, leases, and securities held by commercial banks.

Domestic Nonfinancial Debt: Total credit market liabilities of the U.S. Treasury, federally sponsored agencies, state and local governments, households, and nonfinancial firms. End-of-period basis.

Adjusted Monetary Base: The sum of currency in circulation outside Federal Reserve Banks and the U.S. Treasury, deposits of depository financial institutions at Federal Reserve Banks, and an adjustment for the effects of changes in statutory reserve requirements on the quantity of base money held by depositories. This series is a spliced chain index; see Anderson and Rasche (1996a,b, 2001, 2003).

Adjusted Reserves: The sum of vault cash and Federal Reserve Bank deposits held by depository institutions and an adjustment for the effects of changes in statutory reserve requirements on the quantity of base money held by depositories. This spliced chain index is numerically larger than the Board of Governors' measure, which excludes vault cash not used to satisfy statutory reserve requirements and Federal Reserve Bank deposits used to satisfy required clearing balance contracts; see Anderson and Rasche (1996a, 2001, 2003).

Monetary Services Index: An index that measures the flow of monetary services received by households and firms from their holdings of liquid assets; see Anderson, Jones, and Nesmith (1997). Indexes are shown for the assets included in M2, with additional data at research.stlouisfed.org/msi/index.html.

Note: M1, M2, M3, Bank Credit, and Domestic Nonfinancial Debt are constructed and published by the Board of Governors of the Federal Reserve System. For details, see *Statistical Supplement to the Federal Reserve Bulletin*, tables 1.21 and 1.26. MZM, Adjusted Monetary Base, Adjusted Reserves, and Monetary Services Index are constructed and published by the Research Division of the Federal Reserve Bank of St. Louis.

Notes

Page 3: Readers are cautioned that, since early 1994, the level and growth of M1 have been depressed by retail sweep programs that reclassify transactions deposits (demand deposits and other checkable deposits) as savings deposits overnight, thereby reducing banks' required reserves; see Anderson and Rasche (2001) and research.stlouisfed.org/aggreg/swdata.html. **Primary Credit Rate**, **Discount Rate,** and **Intended Federal Funds Rate** shown in the chart **Reserve Market Rates** are plotted as of the date of the change, while the **Effective Federal Funds Rate** is plotted as of the end of the month. Interest rates in the table are monthly averages from the Board of Governors H.15 Statistical Release. The **Treasury Yield Curve** and **Real Treasury Yield Curve** show constant maturity yields calculated by the U.S. Treasury for securities 5, 7, 10, and 20 years to maturity. **Inflation-Indexed Treasury Yield Spreads** are a measure of inflation compensation at those horizons, and it is simply the nominal constant maturity yield less the real constant maturity yield. Daily data and descriptions are available at research.stlouisfed.org/fred2/. See also *Statistical Supplement to the Federal Reserve Bulletin*, table 1.35. The 30-year constant maturity series was discontinued by the Treasury as of February 18, 2002.

Page 5: **Checkable Deposits** is the sum of demand and other checkable deposits. **Savings Deposits** is the sum of money market deposit accounts and passbook and statement savings. **Time Deposits** have a minimum initial maturity of 7 days. **Retail Money Market Mutual Funds** are included in M2. **Institutional** money market funds are not included in M2.

Page 6: **Excess Reserves plus RCB (Required Clearing Balance) Contracts** equals the amount of deposits at Federal Reserve Banks held by depository institutions but not applied to satisfy statutory reserve requirements. (This measure excludes the vault cash held by depository institutions that is not applied to satisfy statutory reserve requirements.) **Consumer Credit** includes most short- and intermediate-term credit extended to individuals. See *Statistical Supplement to the Federal Reserve Bulletin*, table 1.55.

Page 7: Data are reported in the Senior Loan Officer Opinion Survey on Bank Lending Practices.

Page 8: **Inflation Expectations** measures include the quarterly Federal Reserve Bank of Philadelphia *Survey of Professional Forecasters*, the monthly University of Michigan Survey Research Center's *Surveys of Consumers*, and the annual Federal Open Market Committee (FOMC) range as reported to the Congress in the February testimony that accompanies the Monetary Policy Report to the Congress. Beginning February 2000, the FOMC began using the personal consumption expenditures (PCE) price index to report its inflation range; the FOMC then switched to the PCE chain-type price index excluding food and energy prices ("core") beginning July 2004. Accordingly, neither are shown on this graph. **CPI Inflation** is the percentage change from a year ago in the consumer price index for all urban consumers. **Real Interest Rates** are ex post measures, equal to nominal rates minus year-over-year CPI inflation.

From 1991 to the present the source of the long-term PCE inflation expectations data is the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters*. Prior to 1991, the data were obtained from the Board of Governors of the Federal Reserve System. Realized (actual) inflation is the annualized rate of change for the 40-quarter period that corresponds to the forecast horizon (the expectations measure). For example, in 1965:Q1, annualized PCE inflation over the next 40 quarters was expected to average 1.7 percent. In actuality, the average annualized rate of change measured 4.8 percent from 1965:Q1 to 1975:Q1. Thus, the vertical distance between the two lines in the chart at any point is the forecast error.

Page 9: **FOMC Intended Federal Funds Rate** is the level (or midpoint of the range, if applicable) of the federal funds rate that the staff of the FOMC expected to be consistent with the desired degree of pressure on bank reserve positions. In recent years, the FOMC has set an explicit target for the federal funds rate.

Page 10: **Federal Funds Rate and Inflation Targets** shows the observed federal funds rate, quarterly, and the level of the funds rate implied by applying Taylor's (1993) equation

$$f_t^* = 2.5 + \pi_{t-1} + (\pi_{t-1} - \pi^*)/2 + 100 \times (y_{t-1} - y_{t-1}^P)/2$$

to five alternative target inflation rates, $\pi^* = 0, 1, 2, 3, 4$ percent, where f_t^* is the implied federal funds rate, π_{t-1} is the previous period's inflation rate (PCE) measured on a year-over-year basis, y_{t-1} is the log of the previous period's level of real gross domestic product (GDP), and y_{t-1}^P is the log of an estimate of the previous period's level of potential output. **Potential Real GDP** is estimated by the Congressional Budget Office (CBO). Since the July 2009 NIPA revision, there is a discrepancy between real GDP (in billions of chained 2005 dollars) and CBO real potential GDP (in billions of chained 2000 dollars). We have multiplied each quarterly observation of CBO real potential GDP by a factor of 1.14. This scaling factor is the average of the ratio of real GDP in billions of chained 2005 dollars to real GDP in billions of chained 2000 dollars for the four quarters of 2005.

Monetary Base Growth and Inflation Targets shows the quarterly growth of the adjusted monetary base implied by applying McCallum's (2000, p. 52) equation

$$\Delta b_t = \Delta x_t^* - \Delta v_t^a + \lambda\,(\Delta x_t^* - \Delta x_{t-1}),$$
$$\Delta x_t^* = \pi^* + \Delta y_t^*$$

to five alternative target inflation rates, $\pi^* = 0, 1, 2, 3, 4$ percent, where Δb_t is the implied growth rate of the adjusted monetary base, Δy_t^* is the 10-year moving average growth in real GDP, Δv_t^α is the average base velocity growth (calculated recursively), Δx_{t-1} is the lag growth rate of nominal GDP, and $\lambda = 0.5$.

Page 11: **Implied One-Year Forward Rates** are calculated by this Bank from Treasury constant maturity yields. Yields to maturity, $R(m)$, for securities with $m = 1,\ldots, 10$ years to maturity are obtained by linear interpolation between reported yields. These yields are smoothed by fitting the regression suggested by Nelson and Siegel (1987),

$$R(m) = a_0 + (a_1 + a_2)(1 - e^{-m/50})/(m/50) - a_2 \times e^{-m/50},$$

and forward rates are calculated from these smoothed yields using equation (a) in table 13.1 of Shiller (1990),

$$f(m) = [D(m)R(m) - D(m-1)] \,/\, [D(m) - D(m-1)],$$

where duration is approximated as $D(m) = (1 - e^{-R(m)\times m})/R(m)$. These rates are linear approximations to the true instantaneous forward rates; see Shiller (1990). For a discussion of the use of forward rates as indicators of inflation expectations, see Sharpe (1997). **Rates on 3-Month Eurodollar Futures** and **Rates on Selected Federal Funds Futures Contracts** trace through time the yield on three specific contracts. **Rates on Federal Funds Futures on Selected Dates** displays a single day's snapshot of yields for contracts expiring in the months shown on the horizontal axis. **Inflation-Indexed Treasury Securities and Yield Spreads** are those plotted on page 3. **Inflation-Indexed 10-Year Government Notes** shows the yield of an inflation-indexed note that is scheduled to mature in approximately (but not greater than) 10 years. The current French note has a maturity date of 7/25/2015, the current U.K. note has a maturity date of 8/16/2013, and the current U.S. note has a maturity date of 1/15/2018. **Inflation-Indexed Treasury Yield Spreads** and **Inflation-Indexed 10-Year Government Yield Spreads** equal the difference between the yields on the most recently issued inflation-indexed securities and the unadjusted security yields of similar maturity.

Page 12: **Velocity** (for MZM and M2) equals the ratio of GDP, measured in current dollars, to the level of the monetary aggregate. **MZM** and **M2 Own Rates** are weighted averages of the rates received by households and firms on the assets included in the aggregates. Prior to 1982, the 3-month T-bill rates are secondary market yields. From 1982 forward, rates are 3-month constant maturity yields.

Page 13: **Real Gross Domestic Product** is GDP as measured in chained 2000 dollars. The **Gross Domestic Product Price Index** is the implicit price deflator for GDP, which is defined by the Bureau of Economic Analysis, U.S. Department of Commerce, as the ratio of GDP measured in current dollars to GDP measured in chained 2005 dollars.

Page 14: **Investment Securities** are all securities held by commercial banks in both investment and trading accounts.

Page 15: **Inflation Rate Differentials** are the differences between the foreign consumer price inflation rates and year-over-year changes in the U.S. all-items Consumer Price Index.

Page 17: **Treasury Yields** are Treasury constant maturities as reported in the Board of Governors of the Federal Reserve System's H.15 release.

Sources

Agence France Trésor: French note yields.

Bank of Canada: Canadian note yields.

Bank of England: U.K. note yields.

Board of Governors of the Federal Reserve System:
Monetary aggregates and components: H.6 release. Bank credit and components: H.8 release. Consumer credit: G.19 release. Required reserves, excess reserves, clearing balance contracts, and discount window borrowing: H.4.1 and H.3 releases. Interest rates: H.15 release. Nonfinancial commercial paper: Board of Governors website. Nonfinancial debt: Z.1 release. M2 own rate. Senior Loan Officer Opinion Survey on Bank Lending Practices.

Bureau of Economic Analysis: GDP.

Bureau of Labor Statistics: CPI.

Chicago Board of Trade: Federal funds futures contract.

Chicago Mercantile Exchange: Eurodollar futures.

Congressional Budget Office: Potential real GDP.

Federal Reserve Bank of Philadelphia: Survey of Professional Forecasters inflation expectations.

Federal Reserve Bank of St. Louis: Adjusted monetary base and adjusted reserves, monetary services index, MZM own rate, one-year forward rates.

Organization for Economic Cooperation and Development: International interest and inflation rates.

Standard & Poor's: Stock price-earnings ratio, stock price composite index.

University of Michigan Survey Research Center: Median expected price change.

U.S. Department of the Treasury: U.S. security yields.

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Note: *Available on the Internet at research.stlouisfed.org/publications/review/.