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Strictly Confidential (FR) Class I FOMC

MONETARY POLICY ALTERNATIVES

Prepared for the Federal Open Market Committee

By the staff Board of Governors of the Federal Reserve System

Strictly Confidential (FR)
Class I - FOMC

January 27, 1995

MONETARY POLICY ALTERNATIVES

Recent Developments

(1) The federal funds rate averaged close to the intended level of 5-1/2 percent during the intermeeting period.[1] In the days approaching year-end, the Desk met heavy reserve demands by repeatedly arranging overlapping term System RPs. In the event, the federal funds rate averaged a little below 5-1/2 percent on the last trading day of the year, and year-end pressures in the money markets were not atypical. Reserve demands remained substantial into the first few days of the new year, and the Desk continued to arrange System RPs in size.

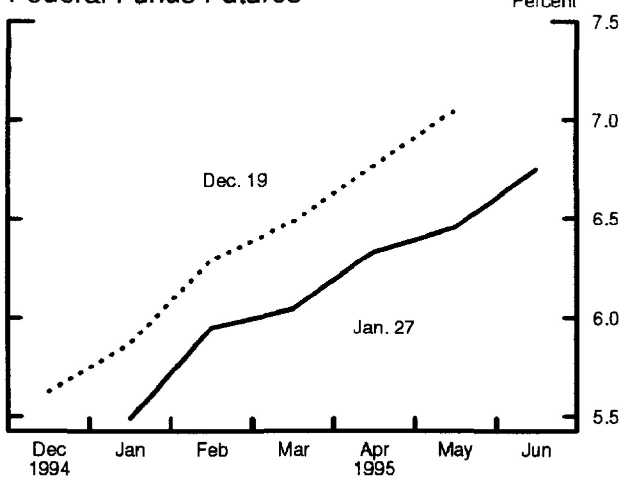
(2) Economic data released since the last FOMC meeting were broadly in line with market participants' expectations of high and rising levels of resource utilization and continued robust growth in output. However, some unexpected softening in indicators of final demand, surprisingly good price performance, and Mexico's difficulties prompted market participants to push back and trim somewhat the trajectory of expected monetary tightening, as shown in Chart 1. Consequently, many short- and long-term rates declined 15 to 20 basis points over the intermeeting period.[2] Nonetheless, markets continued to anticipate further substantial monetary tightening, and the

1. The allowance for adjustment and seasonal borrowing was reduced in two steps during the intermeeting period from $125 million to $75 million to accommodate seasonal declines in the demand for discount window credit. Actual borrowing averaged a little above its allowance during the intermeeting period.

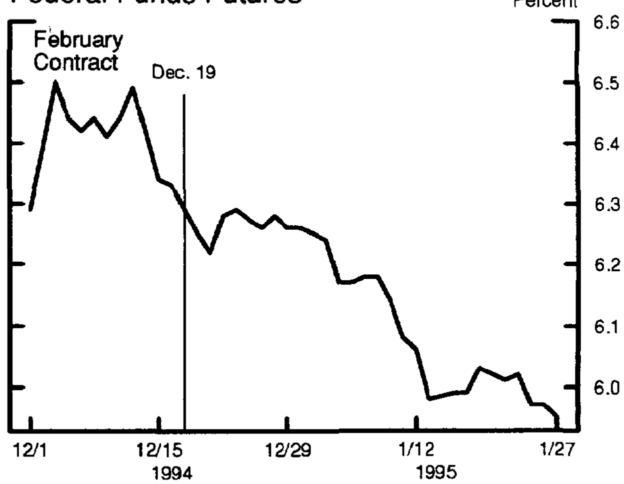
2. The rate on three-month Treasury bills jumped about 25 basis points over the period, partly reflecting the shifting "specialness" of bills as collateral in the RP market. In addition, with year-end premiums disappearing after the first of the year, rates on very short-term private paper fell 10 to 25 basis points over the intermeeting period.

Chart 1

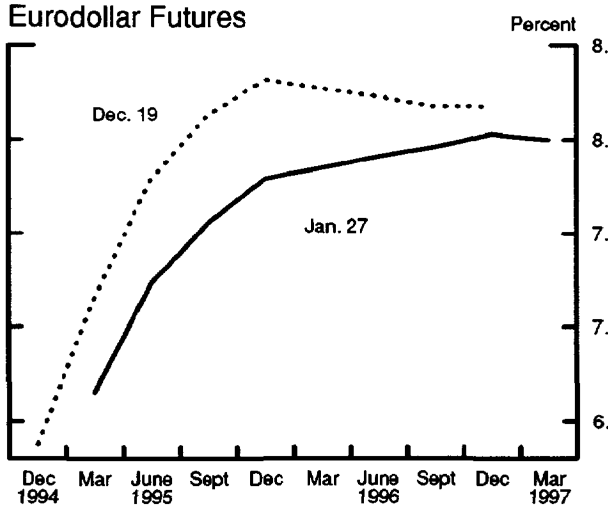
Federal Funds Futures



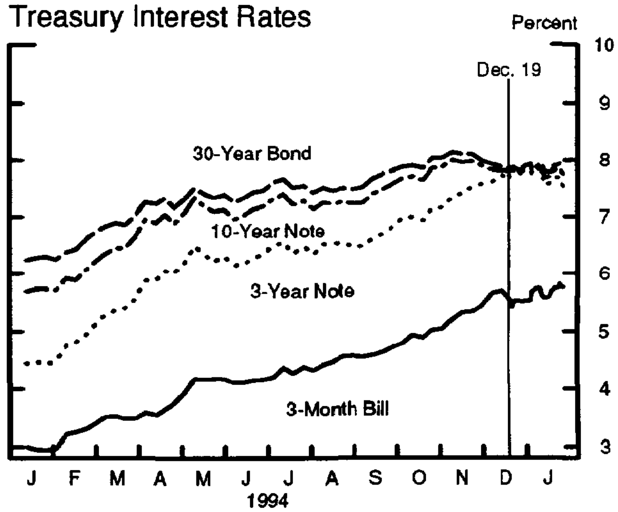
Federal Funds Futures



Eurodollar Futures

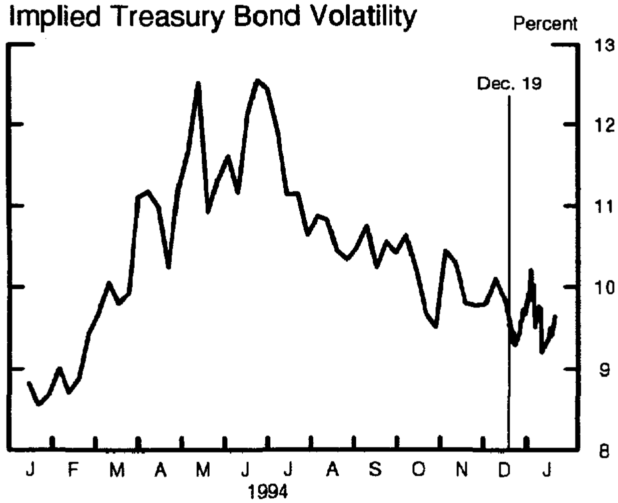


Treasury Interest Rates



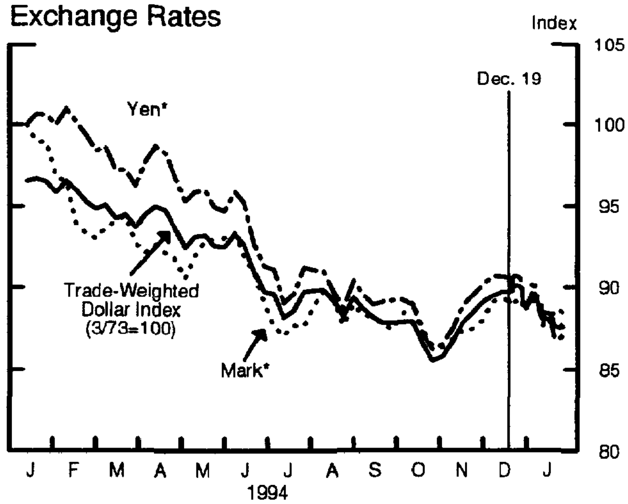
Weekly. Daily after Dec. 19.

Implied Treasury Bond Volatility



Weekly. Daily after Dec. 19.

Exchange Rates



* Index, Jan 1994=100
Weekly. Daily after Dec. 19.

yield curve remained steeply upward sloped through the first few years. Political discussion of sharp cuts in outlays to conform with the requirements of a balanced budget amendment appears to have had little effect to date in markets.

(3) Skittishness in domestic financial markets seemed to diminish during the intermeeting period. In the tax-exempt market, concerns waned about the implications of the Orange County problems for the financial condition of other municipal governments, abetting a considerable decline in tax-exempt yields. Some quality spreads on private paper had widened slightly before year-end as investors sought to move toward safer instruments in anticipation of the publication of their year-end financial statements; after the turn of the year, spreads retraced that movement, leaving them generally quite narrow. Spillover effects from Mexico's difficulties into U.S. financial markets to date have been quite limited. Outflows from emerging-market stock and bond mutual funds picked up for a while. But U.S. banks with exposure to Mexico generally have experienced little net change in their share prices and no unusual difficulties in raising funds on wholesale markets. Expected bond market volatility inferred from options prices fluctuated around the lower levels established late last fall; on balance, measures of volatility have rolled back most of their runup since February. Boosted by strong earnings reports for the fourth quarter, broad stock price indexes rose 2 to 5 percent over the intermeeting period, bringing most within a few percent of record highs.

(4) The dollar's weighted average exchange value against G-10 currencies declined 2-1/2 percent over the intermeeting period.

The dollar may have been held down by uncertainty about the implications for the U.S. economy of the Mexican economic and financial turmoil, perhaps including the possibility that the Federal Reserve would feel constrained in responding to U.S. inflation pressures. The dollar declined nearly 4 percent against the mark, which was also buoyed by safe-haven demand against weaker European currencies. Against the yen, the dollar depreciated only 1 percent, with the strength of the yen limited by the negative effects of the earthquake damage, which also sent Japanese stocks 6-1/2 percent lower. Interest rates in foreign industrial countries were little changed, on average. The Mexican peso depreciated about 40 percent against the U.S. dollar, Mexican interest rates soared, and the stock market declined 10 percent in peso terms; in Argentina and Brazil, equity indexes declined around 20 percent. The Canadian markets were also under pressure because of concerns about the fiscal situation and Quebec separatism: Canadian short- and long-term rates rose 125 and 20 basis points, respectively, as the Canadian dollar fell a further 1-3/4 percent against the U.S. dollar.

(5) The monetary data in this bluebook incorporate new benchmark and seasonal adjustments.[3] These data confirm that M2 grew 1.0 percent from 1993:Q4 to 1994:Q4, at the lower end of its 1-to-5 percent annual range.[4] M3 expanded 1.4 percent last year,

3. Data incorporating the new benchmark and seasonal adjustments are scheduled to be published in early February and are strictly confidential until that time. The revisions are discussed in appendix A.

4. M1 increased 2.3 percent during 1994, down sharply from the double-digit rates of expansion in the previous two years. Demand deposits were about flat last year, and other checkable deposits fell 2 percent. Both components were pulled down by substantial increases in their opportunity costs as short-term market rates rose. Demand

(Footnote continues on next page)

a little more than previously estimated, leaving this aggregate well within its 0-to-4 percent annual range. With both aggregates continuing to expand sluggishly relative to nominal income, their velocities increased substantially again in 1994. In contrast to the previous few years, the increase in velocities appears attributable primarily to rising opportunity costs resulting from the increases in short-term market rates rather than to portfolio shifts into bond and stock mutual funds. Over the year as a whole, flows into such funds were far smaller than in 1992 and 1993. With bond prices falling during the year, M2 plus the value of bond and stock mutual funds rose an estimated 1 percent in 1994, well below its average of 5-1/4 percent in the previous two years, and its velocity surged after exhibiting little change on balance over the previous several years.

(6) Growth in the monetary aggregates was stronger over December and January than had been anticipated at the time of the last FOMC meeting, with M2 and M3 expanding at 3-1/4 and 4-3/4 percent rates, respectively, over the two months.[5] Much of the pickup in M2, however, was in its most volatile components--demand deposits, overnight RPs, and overnight Eurodollars; no factors have been identified to explain these increases. Excluding the contribution from

(Footnote continued from previous page)
deposits were also restrained by declining mortgage refinancing activity, and other checkable deposits by the introduction of sweep account programs by two large regional bank holding companies. Together, these two factors are estimated to have depressed M1 growth by around 3 percentage points in 1994. Acting to strengthen M1 were continued strong demands from abroad for U.S. currency, which helped maintain overall currency growth at 1993's rate of 10-1/4 percent.

5. Monetary estimates for January are based on complete data through January 16 and sample figures through January 23.

those instruments, M2 eked out a 1-1/4 percent gain. Underlying patterns of monetary growth extended those seen over 1994. The more liquid accounts remained anemic, consistent with the very sluggish increases in their interest rates, while small time deposits expanded briskly.[6] Data on bond and stock funds, although difficult to interpret owing to large cash distributions around year end, suggest continued weakness in demand for these investment vehicles.[7] This weakness does not appear to have boosted the growth of the monetary aggregates, but rather was reflected in direct investment in market instruments, as indicated by continued strong noncompetitive tenders at Treasury auctions. Institution-only money funds jumped in January, contributing to the acceleration of M3. With the slow expansion in retail deposits, depository institutions continued to bid for wholesale funding to finance relatively robust growth of bank credit.

(7) As in much of 1994, the debt of nonfinancial sectors in recent months is estimated to have grown at a moderate pace--below that of nominal GDP--and borrowers have continued to rely significantly on shorter-term sources of funds. In the business sector, C&I loans have expanded at a brisk pace in each of the last two months, buoyed in part by lending to support merger and acquisition activity. Supply conditions for business credit at banks have become even more favorable: Senior loan officers at a significant number of banks reported a further easing of terms on business loans over the three months ending in December, although only a few institutions reduced

6. With transaction deposits depressed over the last two months, total reserves rose at an average rate of only 1 percent. Currency was unusually weak in December, perhaps reflecting shifting payment patterns during the holiday shopping season, but has snapped back this month. For the two-month period, the monetary base rose at a 6-1/2 percent rate.

7. M2 plus stock and bond funds is estimated to have contracted at a 1-1/2 percent rate on balance over December and January.

their standards further. Issuance of commercial paper has also stayed strong in the last two months. With longer-term rates near their recent peaks, however, gross offerings of corporate bonds have been light. Issuance of tax-exempt bonds has been slow and, and owing to sizable retirements, municipal debt outstanding appears to have contracted in the last two months. In the household sector, data on bank loans suggest that growth in consumer installment and mortgage credit was strong in December and January. With a lull in federal borrowing, overall domestic nonfinancial sector debt expanded at a 4 percent annual rate in December, bringing the increase for 1994 to 5-1/4 percent, in the lower half of the 4-to-8 percent monitoring range for this aggregate.

MONEY, CREDIT, AND RESERVE AGGREGATES
(Seasonally adjusted annual rates of growth)

	Dec.	Jan.	93:Q4 to 94:Q4	94:Q4 to Jan.
Money and credit aggregates[1]				
M1	0.4	2.1	2.3	1.1
M2	1.5	4.8	1.0	3.0
M3	3.2	6.4	1.4	4.6
Domestic nonfinancial debt	4.2	--	5.3	--
Federal	1.2	--	5.7	--
Nonfederal	5.3	--	5.1	--
Bank credit	9.5	8.8	6.9	8.2
Reserve measures[2]				
Nonborrowed reserves[3]	0.6	3.8	-2.1	2.0
Total reserves	-0.2	1.5	-1.9	0.1
Monetary base	4.1	8.7	8.3	7.1
Memo: (Millions of dollars)				
Adjustment plus seasonal borrowing	209	94	--	--
Excess reserves	1147	1203	--	--

1. The monetary data in this bluebook reflect new benchmarks and seasonal adjustments.
2. Monthly reserve measures, including excess reserves and borrowing, are calculated by prorating averages for two-week reserve maintenance periods that overlap months. Reserve data incorporate adjustments for discontinuities associated with changes in reserve requirements. Reserve figures for January assume excess reserves average $1 billion and adjustment and seasonal borrowings average $75 million in the maintenance period ending February 1.
3. Includes "other extended credit" from the Federal Reserve.

Long-Run Scenarios

(8) This section addresses several issues related to longer-run strategies for monetary policy and their interaction with underlying macroeconomic conditions. The first set of scenarios examines two alternative strategies for monetary policy. The strategies embed different assumptions about the economic outcomes that the Committee would find acceptable but assume the same underlying macroeconomic forces and relationships. The baseline strategy begins with the Greenbook's baseline projection for 1995 and 1996; it envisions a gradual rise in the unemployment rate to its natural rate by 2000 to cap inflation, which levels off at about 3-1/2 percent. The tighter strategy extends the Greenbook's "alternative simulation" and puts inflation on a downward path consistent with achieving price stability early in the next decade.[8] The next two sets of scenarios involve alternative assumptions about fiscal policy and the level of the natural rate of unemployment.

(9) A key assumption behind most of the scenarios, including the baseline, is a sharp turn toward fiscal restraint to put the budget in balance by the year 2002. Based on current-service projections that show the deficit rising above $300 billion early in the next decade, such a fiscal policy would require average incremental cuts of roughly $45 billion per year over the next seven years (we have assumed $20 billion in FY 1996 and slightly more than $45 billion

8. The charts show the federal funds rates, CPI (excluding food and energy) and unemployment rates that go with each strategy. The table below gives nominal and real GDP growth as well. The money growth projections were put together on the premise that as households complete their adjustments to the improved accessibility of bond and stock mutual funds, increasingly offered through banks themselves, money growth will gradually return to its traditional relationships with growth in income and changes in opportunity costs.

thereafter). The effect of this fiscal restraint is to trim equilibrium real interest rates over time by about 1-1/2 percentage points. In the baseline, the reduction in long-term rates in response to fiscal restraint occurs gradually over time, consistent with a view that the deficit reduction process will gain credibility only as cuts in outlays are actually legislated. Such an assumption is consistent with market uncertainty about the eventual ratification of the balanced budget amendment by the states or skepticism that adequate steps actually will be taken to implement it. Of course, it is possible that long-term rates might move sooner and by more in anticipation of substantial forthcoming fiscal restraint, with potential implications for the conduct of monetary policy that are discussed below.

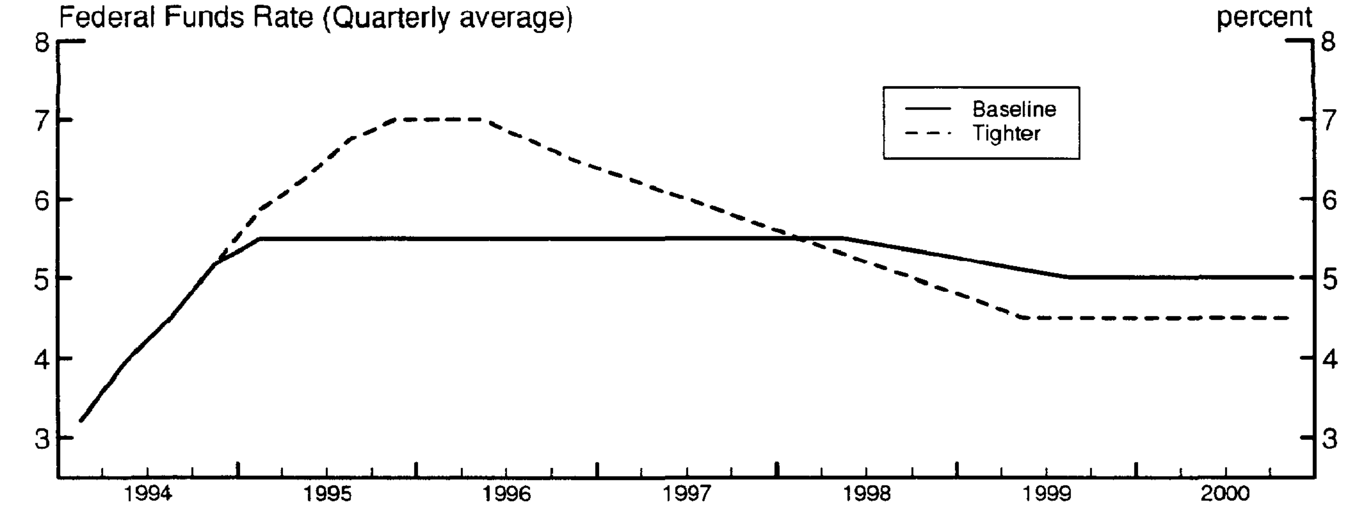
(10) The staff econometric model of the U.S. and foreign economies was used to derive the effects relative to the baseline of the differing assumptions about monetary policy, fiscal policy, and the labor market. That model embodies neither a productivity bonus in the long run from permanently reducing inflation nor forward-looking expectations. Thus, it does not allow for special effects from monetary or fiscal policy credibility. On the supply side of the model as well as in the baseline, the natural rate of unemployment is assumed to be 6 percent and the growth rate of potential GDP to be just under 2-1/2 percent. For each year unemployment exceeds its natural rate by one percentage point, the slack in the labor market tends to reduce the inflation rate by about 1/2 percentage point.

(11) Under the <u>baseline</u> strategy, the Committee maintains the federal funds rate at 5-1/2 percent until mid-1998 (Chart 2 and the table below). With the unemployment rate currently 1/2 percentage

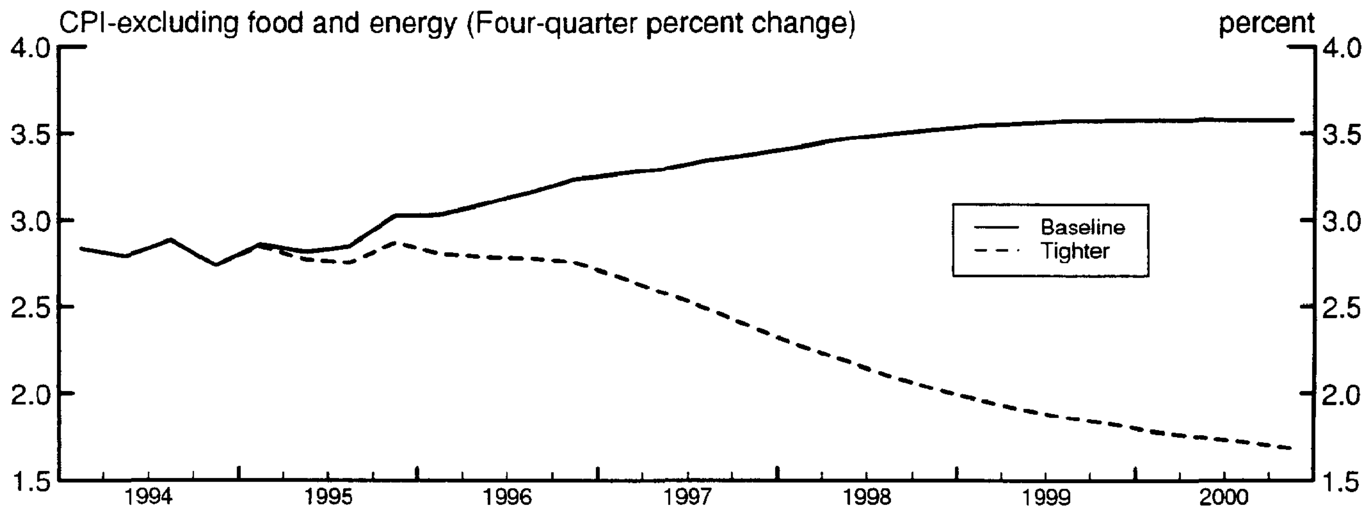
Chart 2

ALTERNATIVE STRATEGIES FOR MONETARY POLICY

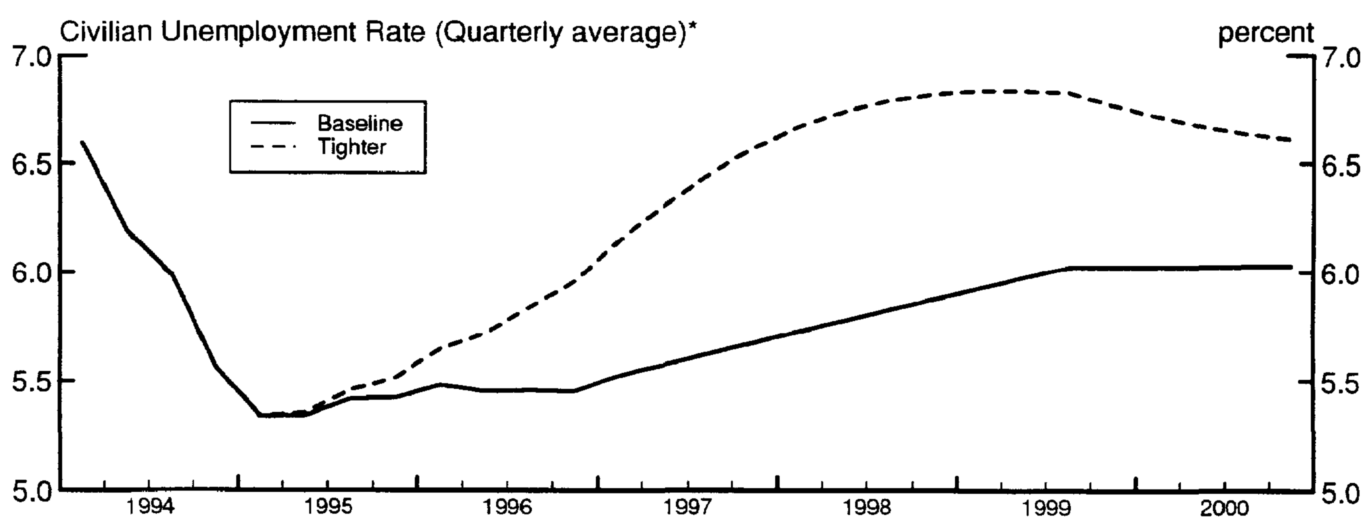
Federal Funds Rate (Quarterly average)



CPI-excluding food and energy (Four-quarter percent change)



Civilian Unemployment Rate (Quarterly average)*



*Data points are plotted in the midpoint of each period. Baseline uses final January 1995 Greenbook

point below its natural rate, the increases in inflation believed to be already in train would lower real short-term interest rates 75 basis points by mid-1998. But this decline in the real funds rate does not stimulate activity because the model's estimated equilibrium real rate falls even faster from the effects of ongoing deficit reduction. In the latter part of the simulation period, actual and equilibrium real rates move into rough alignment and the unemployment rate stabilizes at 6 percent. Meanwhile, the protracted overshoot of

	1994	1995	1996	1997	1998	1999	2000
			(QIV TO QIV percent change)				
CPI inflation--excluding food and energy							
baseline	2.8	3.2	3.3	3.4	3.6	3.6	3.6
tighter	2.8	3.0	2.9	2.4	2	1.8	1.7
Nominal GDP growth							
baseline	6.6	4.8	5	4.7	4.8	5.1	5.3
tighter	6.6	4.5	3.6	3	3.4	3.7	3.5
Real GDP growth							
baseline	4.1	2.2	2.5	2	2	2.2	2.4
tighter	4.1	1.9	1.4	1.2	2.1	2.7	2.6
			(fourth-quarter level, percent)				
Unemployment Rate (1994-survey basis)							
baseline	5.6	5.4	5.5	5.7	5.9	6.0	6.0
tighter	5.6	5.5	6	6.6	6.8	6.8	6.6
			(QIV to QIV percent change)				
M2							
baseline	1.0	2.5	3.5	4.0	4.2	5.2	5.7
tighter	1.0	1.5	2.0	2.8	3.5	4.2	4.2
			(fourth-quarter level, percent)				
Federal funds rate							
baseline	5.2	5.5	5.5	5.5	5.3	5	5
tighter	5.2	7	6.5	5.7	4.9	4.5	4.5

output beyond its potential pushes the inflation rate to 3-1/2 percent late in the decade. The drop in real interest rates lowers the foreign exchange value of the dollar, raising real net exports.[9] Should financial market participants come to be convinced of the ultimate scope of fiscal restraint more promptly than is assumed in the baseline, long-term interest rates could come under substantial downward pressure in the near term. Absent cutbacks by households and businesses in anticipation of prospective income losses, output would be boosted further beyond its potential and inflation would rise unless policy tightened.

(12) Progress toward price stability under the tighter policy involves raising the federal funds rate to 7 percent by 1995:Q3 and holding it there through the first half of 1996. This rise in the federal funds rate appears to be about what is built into the current term structure of market yields, but its effects on unemployment and inflation are greater than market participants appear to be anticipating. The relatively weaker economic activity reflects both the staff's assumption of tighter fiscal policy and its assessment of less strength in underlying private demands than appear to be embodied in market forecasts. Against the backdrop of these underlying forces, policy action raises the real federal funds rate substantially above its equilibrium level, producing sufficient slack in the economy to bring the inflation rate down toward price stability by the end of the simulation period. In an effort to limit overshooting, the Committee eases the nominal funds rate beginning in mid-1996 to keep pace with

9. However, the improvement in net exports comes to only a fraction of the reduction in government dissaving, as lower real interest rates also stimulate domestic fixed investment and discourage some private saving.

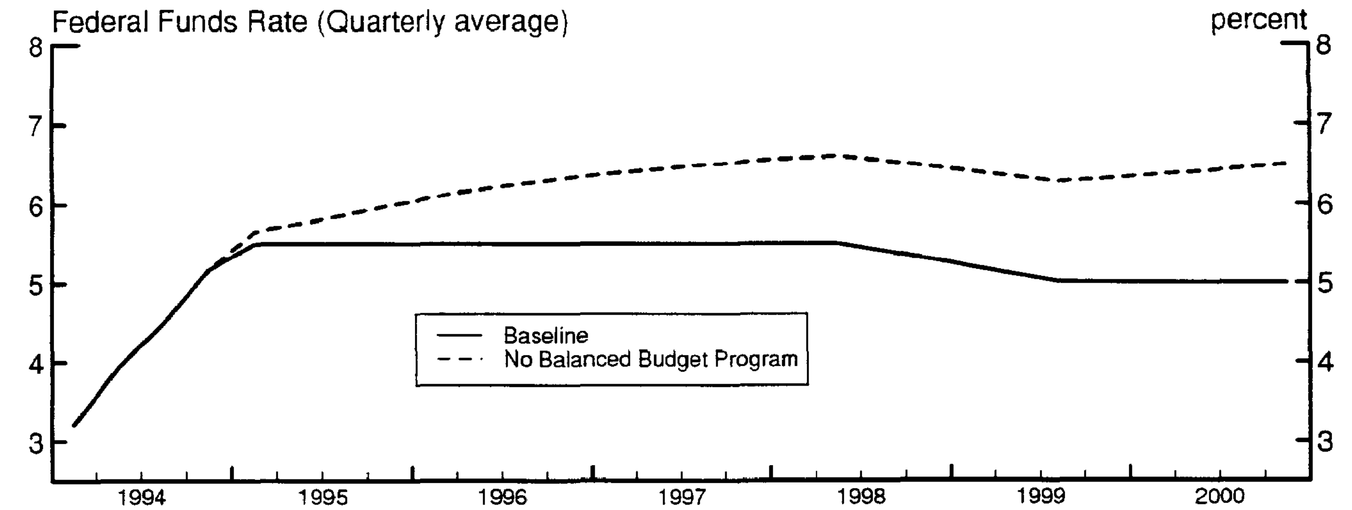
the decline in inflation and with the ongoing effects of fiscal contraction. By the end of the simulation period, the inflation rate has declined to 1-3/4 percent. The initial degree of tightening required to achieve this inflation outcome would have to be even greater if long-term rates tended to decline in anticipation of deficit reduction without offsetting decreases in private demands.

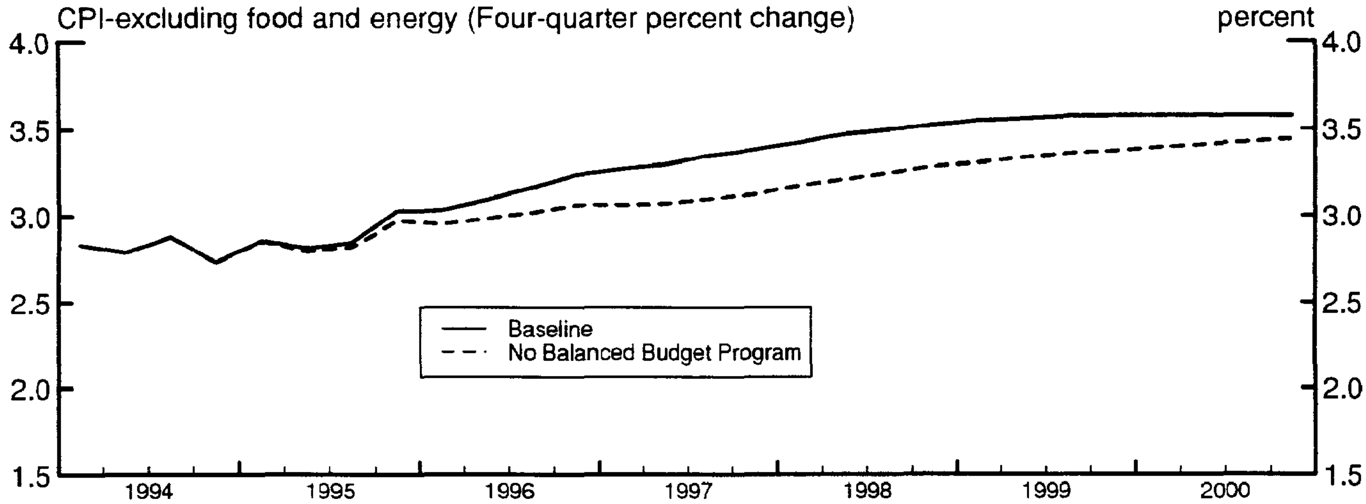
(13) The alternative scenario presented in Chart 3 considers some of the consequences if the fiscal restraint implied by the balanced-budget program never materializes. In these circumstances, the Committee would have to raise the federal funds rate about a percentage point over coming years just to keep the inflation rate from rising beyond the 3-1/2 percent endpoint of the baseline. Federal funds rates appreciably above 7 percent for a time would be required to make significant progress on inflation.

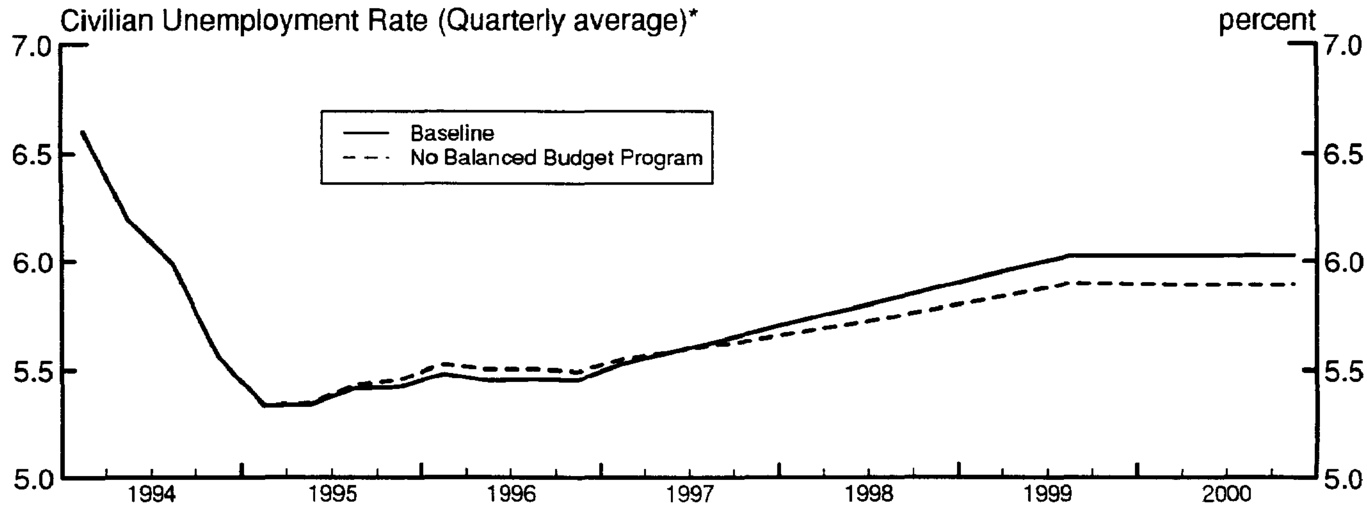
(14) The lack of a pickup of inflation yet, even though the unemployment rate has dropped to 5-1/2 percent, raises some question about whether the natural rate of unemployment is lower than 6 percent. Chart 4 considers the implications for monetary policy of a 5-1/2 percent natural rate of unemployment. In these circumstances the Committee can maintain a 5-1/2 percent funds rate for some time and still make as much progress toward price stability as with much higher interest rates when the natural rate is 6 percent. The higher level of aggregate supply implies that real interest rates don't have to be as high to restrain aggregate demand relative to the economy's potential. Consequently, a given degree of slack in the economy and pace of disinflation can be achieved with lower real interest rates.

Chart 3

RESPONSES TO ALTERNATIVE FISCAL POLICY ASSUMPTION





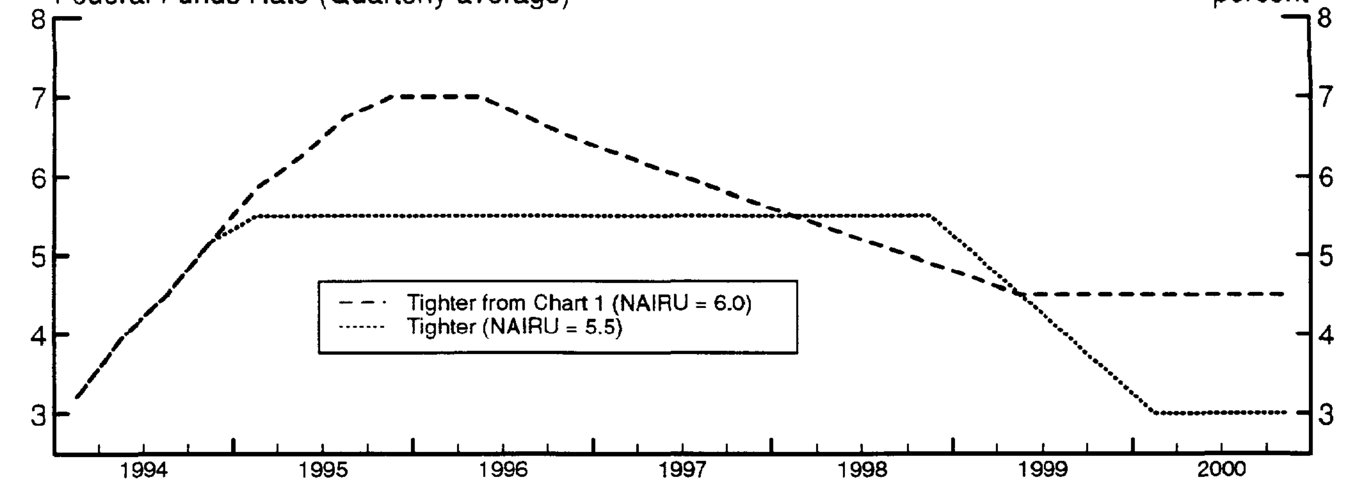


*Data points are plotted in the midpoint of each period. Baseline uses final January 1995 Greenbook

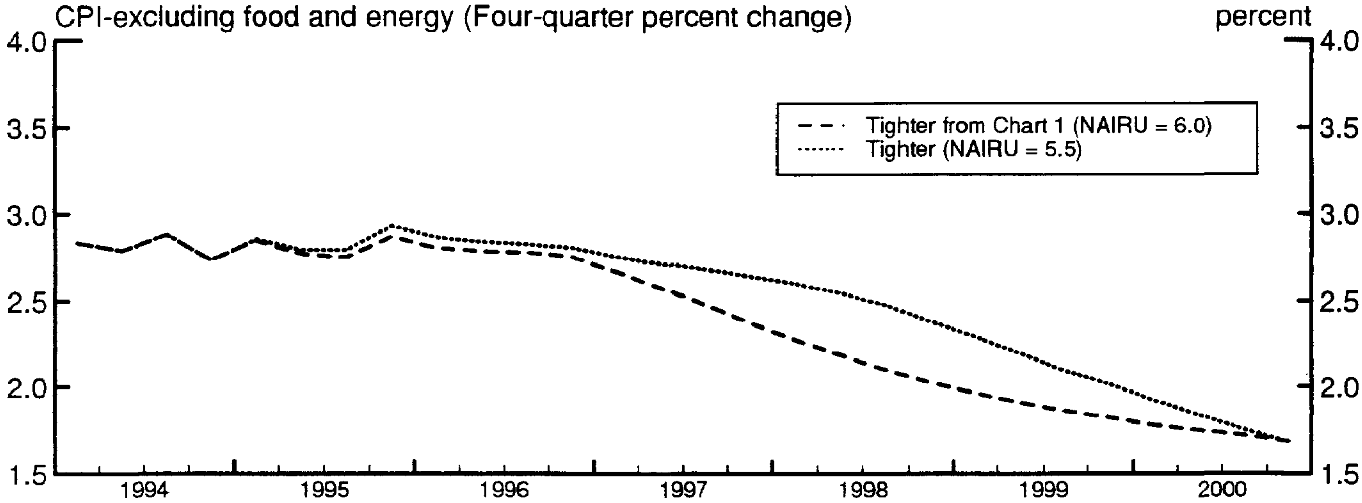
Chart 4

INFLUENCE OF A LOWER NAIRU ON MONETARY STRATEGIES

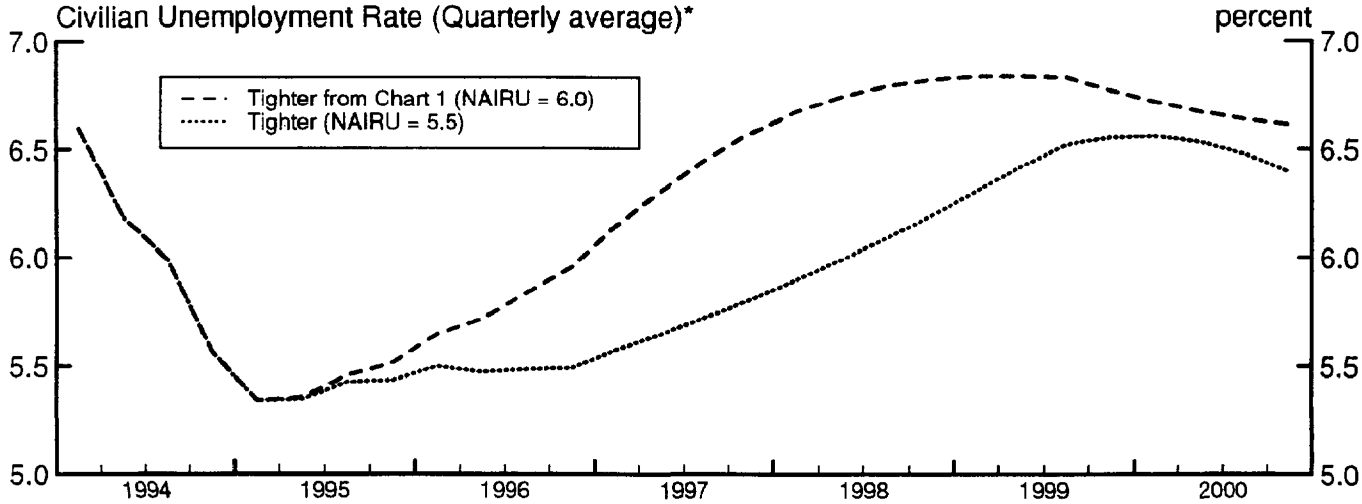
Federal Funds Rate (Quarterly average) percent



CPI-excluding food and energy (Four-quarter percent change) percent



Civilian Unemployment Rate (Quarterly average)* percent



*Data points are plotted in the midpoint of each period. Baseline uses final January 1995 Greenbook

Long-Run Ranges

(15) As background for discussion by the Committee of money and debt ranges for 1995, the table below presents staff projections of key money and debt aggregates and nominal GDP. Projections are given for both the Greenbook baseline forecast, which assumes no change in the federal funds rate through 1996, and for the Greenbook alternative simulation based on a 150 basis point increase in the federal funds rate by the end of the third quarter. These also correspond to the baseline strategy and the tighter strategy in the previous section of this bluebook.

		Staff Projections			
		1995		1996	
Growth rates (Q4 to Q4	Actual 1994	Baseline Strategy	Tighter Strategy	Baseline Strategy	Tighter Strategy
M2	1.0	2-1/2	1-1/2	3-1/2	2
M3	1.4	3	2-1/2	3-1/2	2-1/2
Debt	5.2	5-1/4	5	5-1/4	4-1/2
Nonfederal component	5.1	5-1/4	5	5-1/4	4-1/4
M1	2.3	1-1/2	0	3-1/2	1
Nominal GDP	6.4	4-3/4	4-1/2	5	3-1/2

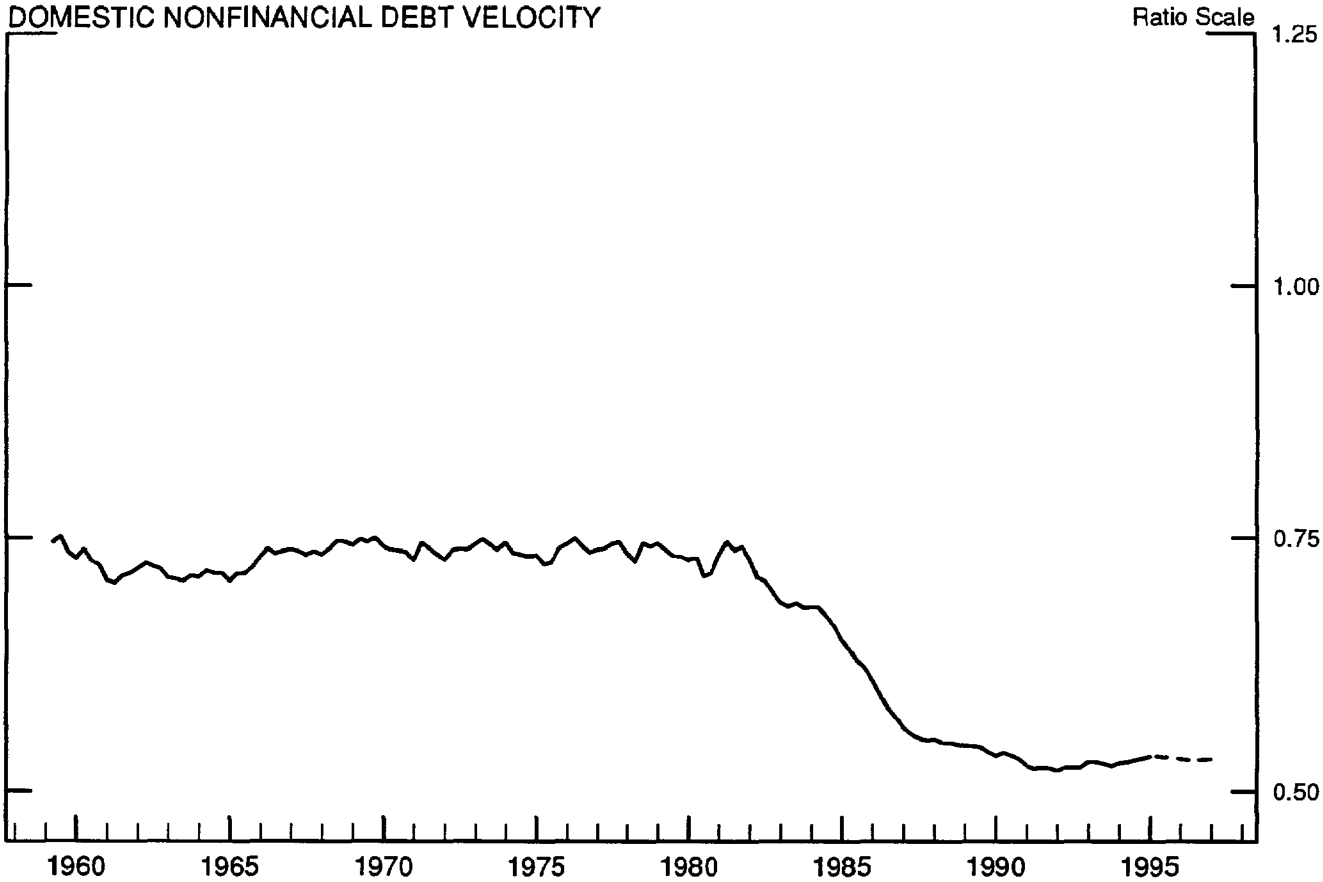
(16) Under either strategy the growth in nominal GDP moderates substantially in 1995. The higher short-term rates of the tighter strategy are associated with an elevated path for long-term rates as well, but much of their effects on spending is not felt until 1996. The different projections for interest rates in 1995 do have relatively larger effects on the composition of financial flows this year, and hence on some of the monetary aggregates under the two strategies.

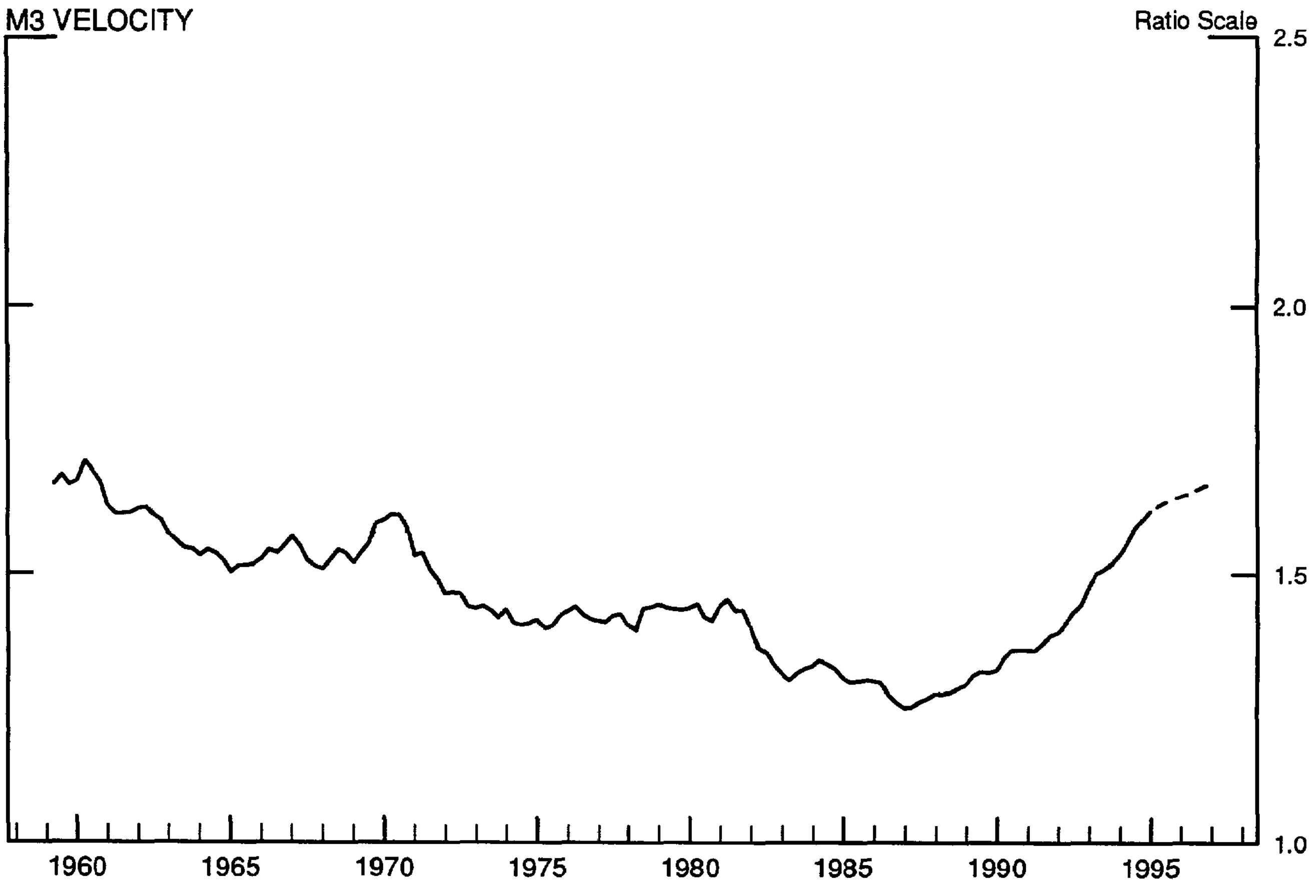
(17) Despite the appreciable slowing in nominal GDP, aggregate measures of nonfinancial debt are expected to increase at

roughly the same pace as in 1994 under the baseline forecast. Debt velocity would flatten after several years of small increases (chart 5). On the supply side, although competition to extend credit should remain intense given healthy lender capitalization, banks and other institutional lenders are not likely to continue to ease standards and shave already thin lending margins much further. Moreover, many administered rates, such as those on consumer loans, will continue to adjust higher in lagged response to earlier increases in market rates and rising retail deposit costs. This may contribute to a slackening in household borrowing, which will also be responding to sluggish housing activity and a slowdown in growth in purchases of consumer durables as a consequence of past increases in interest rates. But in the business sector, borrowing should be well maintained, as advances in capital outlays remain healthy while a flattening in profits constrains internal funds, and as stock retirements from mergers and acquisitions and share buy-back programs continue to be financed in part by debt. Even though bond issuance should pick up in 1995 as bond rates move lower under the baseline forecast, the financing needs of businesses are expected to remain focused on banks and the paper market. And growth in the debt of state and local governments should strengthen somewhat, owing primarily to fewer retirements of advance refunded bonds. Debt of the federal government is projected to grow about in line with that of nonfederal sectors as government spending cuts hold down the size of the deficit. The higher interest rates and moderation in spending associated with the tighter alternative should damp the growth of private debt and focus borrowing even more on short-term sources of funds. However, the federal government deficit

Chart 5

ACTUAL AND PROJECTED VELOCITY OF DEBT AND M3 *





*Projections are based on staff forecasts of GDP, money and debt.

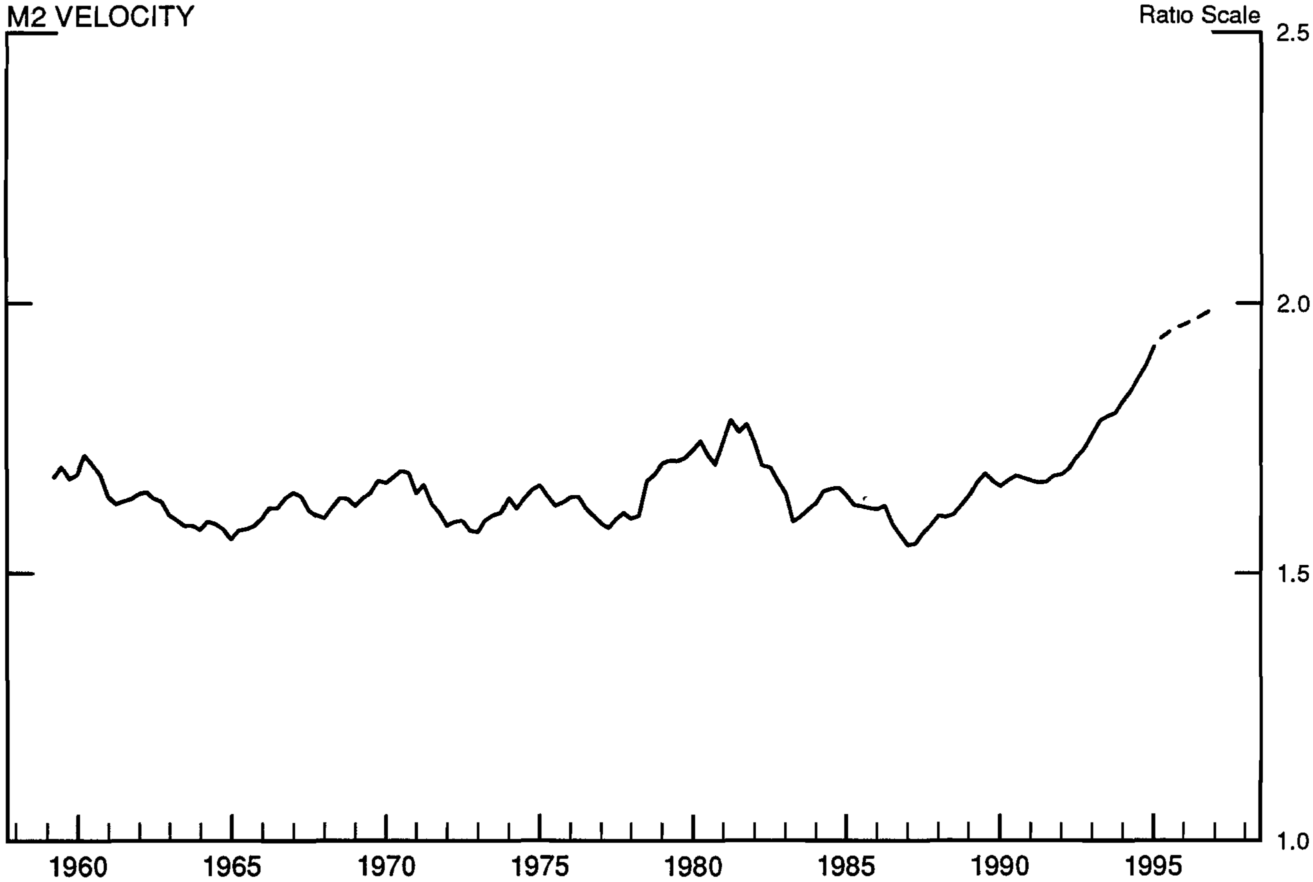
could be a little higher under this scenario, limiting the slowing of overall debt growth.

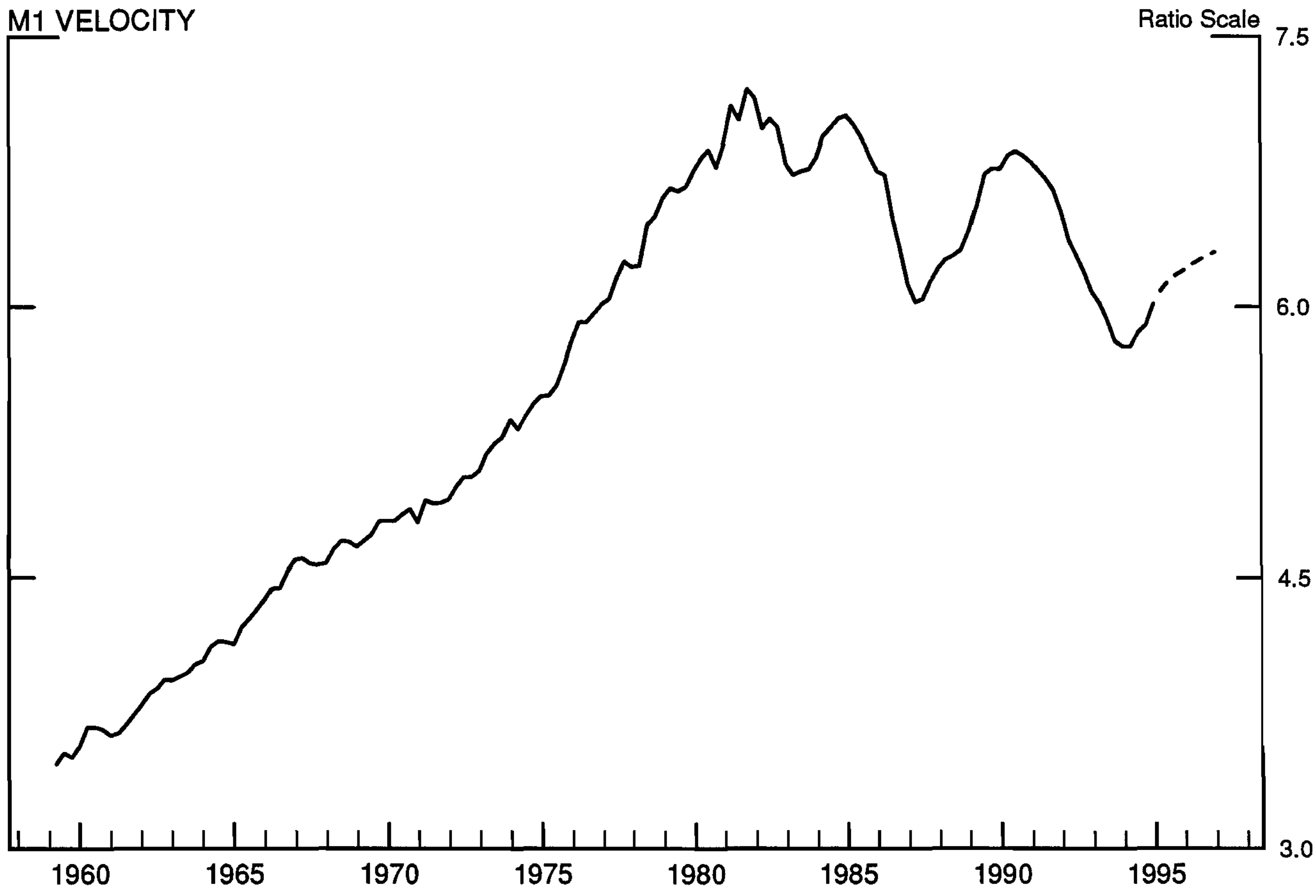
(18) Continued strong lending at commercial banks and a resumption of asset expansion at thrifts should show through to faster M3 growth in 1995 under the Greenbook baseline. Indeed, M3 is projected to grow 3 percent in 1995, its most rapid rate of expansion since 1989, producing the smallest rise in velocity since 1988. Reductions in FDIC insurance premiums for commercial banks should lead to lessened use of nondeposit funding sources outside M3, such as borrowing from foreign offices. Also acting to boost M3 under the baseline should be institution-only money funds, which are expected to expand after running off sharply in 1994 in the wake of rising market interest rates. Under the tighter alternative strategy, the increase in rates would cause these money funds to drop further, damping M3 growth. Moreover, as in 1994, rising rates may cause banks and thrifts again to rely more heavily on managed liabilities--including nondeposit sources of funds--though to a lesser extent than in 1994 owing in part to lower FDIC premiums. As a consequence, with growth in bank credit strong, growth in M3 would still strengthen from 1994--to about 2-1/2 percent.

(19) With regard to M2, the effects of slower growth in nominal spending are more than offset by a narrowing of opportunity costs in the baseline, and expansion of this aggregate is expected to pick up to 2-1/2 percent. Velocity would still increase, but at the slowest rate since 1991 (chart 6). The relative attractiveness of deposits should be enhanced by a continuing rise in their yields--in lagged response to the increase in market rates last year--while short-term market rates in 1995 hold steady. In an environment of

Chart 6

ACTUAL AND PROJECTED VELOCITY OF M2 AND M1 *





*Projections are based on staff forecasts of GDP and money stable or declining long-term rates and a still-steep yield curve under the baseline case, bond mutual funds will again become attractive investment options for some savers. After the experience of 1994, however, the staff would not expect a major shift into these instruments. Consequently, projected growth of M2 would be below the rates from conventional money demand models--but only by about a percentage point, far less than in the 1990-1993 period. The rising rates of the alternative scenario would significantly damp M2 demand, as returns on M2 assets continued to lag those available on market instruments. Under these conditions, M2 might increase only 1-1/2 percent in 1995, registering another sizeable increase in its velocity.

(20) M1 is forecast to grow only 1-1/2 percent in 1995 with flat short-term interest rates. The moderation of nominal income growth contributes to slower currency expansion as well as to damped demand for transactions balances. Opportunity costs on demand deposits and other checkable deposits remain high, and continued adjustment to this configuration restrains growth of M1 deposits relative to income. M1 velocity increases 3-1/4 percent in 1995, down from 4 percent last year. M1, of course, will be even weaker (about flat) and its velocity higher under the rising rates of the alternative strategy.

(21) Shown below for consideration by the Committee are three alternative sets of 1995 ranges for money and debt.[10] While the Committee has in recent years deemphasized the money and debt aggregates in its policy deliberations and public statements, choice of ranges may facilitate the Committee's efforts to communicate to the

10. Appendix B gives ranges and actual outcomes for money and debt in previous years.

public its expectations for financial conditions consistent with desired economic performance. The first, alternative I, contains the provisional ranges established last July. Alternative IA makes a technical upward adjustment to the provisional ranges to account for the more normal M3 behavior that seems to be evolving. Alternative II contains a lower range for M2 and maintain the provisional range for M3.

Alternative Money and Debt Ranges for 1995
(Percent)

	Alt. I (provisional ranges)	Alt. IA	Alt. II	Memo: Staff Projection Baseline	Memo: Staff Projection Tighter
M2	1 to 5	1 to 5	0 to 4	2-1/2	1-1/2
M3	0 to 4	1 to 5	0 to 4	3	2-1/2
Debt	3 to 7	3 to 7	3 to 7	5-1/4	5

(22) Under alternative I, staff baseline projections for growth of M2 and debt are reasonably well centered. The staff projection for M3, though, is in the upper end of its alternative I range. The Committee might wish to consider raising the M3 range for technical reasons. Now that the contraction in the thrift industry has ended and bank credit is displaying more typical behavior, M3 is no longer expected to grow less rapidly than M2, implying an M3 range more in line with that for M2. This is given as alternative IA.

(23) Being reasonably well centered on projected M2 growth under the baseline, the alternative I range allows for a good bit of unpredictability in M2 velocity, as might be implied particularly by uncertainties regarding the appeal of mutual funds, without breaching the upper or lower ends of the range. Moreover, this range contains a

fair amount of scope for the effects of a more restrictive policy stance; thus, it would accommodate some further policy tightening should the Committee find the upward drift in inflation in the staff economic forecast to be unacceptable. Taking a longer perspective, alternative I might provide a benchmark under the Federal Reserve Act for long-run growth of M2 "commensurate with the economy's long run potential to increase production so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" if it were believed that the unusual factors depressing M2 growth might be abating. This would imply a return to essentially trendless M2 velocity and growth of both M2 and nominal GDP averaging in the neighborhood of 3 percent over time. In these circumstances, selection of a lower range for M2 could well require a reversal later, with attendant possibilities for confusion on the part of market participants regarding the Committee's intentions.

(24) The lower ranges for M2 growth under alternative II would be better centered around the slower rate of expansion forecast by the staff under the tighter strategy. Thus, choice of this alternative might be favored if the Committee wished to underscore its commitment to resisting higher inflation in the near term and bringing inflation down over time. The experience of 1994--in particular, M2 growth of only 1 percent--suggests that considerable further policy tightening, along with some slowing of nominal income growth from the brisk pace of last year, could result in a shortfall from the 1 percent lower bound of the provisional M2 range. The M2 range of alternative II also would better accommodate substantial shortfalls in M2 demand relative to historical patterns, as have characterized a number of recent years.

<u>Short-Run Policy Alternatives</u>

(25) Two policy alternatives are presented below for consideration by the Committee. Under alternative B, federal funds would continue to trade around 5-1/2 percent, in association with keeping the allowance for adjustment plus seasonal borrowing at $75 million. Under the tighter alternative C, the federal funds rate would be raised 1/2 percentage point, to 6 percent, either by an equivalent rise in the discount rate to 5-1/4 percent with the same borrowing allowance or by an increase in the borrowing allowance to $125 million with the same discount rate.

(26) Choice of alternative B might be viewed as appropriate if the Committee desired additional readings on the extent of the economy's forward momentum and of underlying inflationary pressures to provide a firmer basis for judging whether incremental restraint will be required to damp aggregate demand sufficiently. In the staff economic forecast, real GDP growth slips below 2 percent in the second half of this year, even with an unchanged federal funds rate. Some recent signs of hesitancy in consumer spending and a considerable rise in inventories might be seen as pointing to a risk in the economic outlook that, especially with more monetary policy tightening, an undesirable degree of economic weakness could emerge later this year. Current levels of real short- and long-term interest rates are somewhat above secular averages and trend growth of money and debt has been relatively slow, suggesting that monetary policy restraint is already in place. Moreover, fiscal policy over the next few years may turn even more restrictive than the staff has built into its forecast, spurred on by political initiatives to make more visible progress toward balancing the federal budget early in the next century. The

effects on U.S. exports of the Mexican crisis, and its possible further spillover to other economies represent potential additional depressants on aggregate demand; the current situation could be exacerbated by another U.S. monetary policy tightening, which could render the currencies of those countries even less attractive to international investors. Postponing any action would allow time for the fiscal and Mexican situations to become clearer. Finally, the recent surprisingly quiescent U.S. price reports may also be signalling that pressures on domestic productive capacities are not as intense as conventionally estimated, so that a slowing in economic growth even along the lines projected by the staff could keep inflation in check.

(27) While market participants currently anticipate a 50 basis point increase in the federal funds rate at this meeting, their response to the Committee's selection of alternative B would depend on how the decision were interpreted. On the one hand, the market reaction could be muted if the decision were seen as only a delay in taking the inevitable next step, perhaps until the Mexican situation settles down somewhat. In that circumstance, delay might be seen as the prudent response to a potentially volatile situation, and little adverse concern about potential inflation would be engendered. Some edging lower of short-term interest rates might transpire, but bond yields and the value of the dollar could remain near recent quotes. On the other hand, the unexpected delay in policy tightening could create some confusion about the Federal Reserve's intentions and strategy. If market participants viewed the delay as unwarranted by the domestic economic situation and as signalling a possible change in Federal Reserve priorities, heightened inflation concerns could cause an adverse reaction in the fixed income and foreign exchange markets.

Such a reaction could be compounded by data suggesting continued strength in employment and a pickup in inflation--both of which are expected over the near term in the Greenbook forecast.

(28) Concern about the possibility of an adverse market reaction, combined with a view that the economic situation still pointed to significant risk of accelerating inflation, would argue for the 50 basis point firming in the federal funds rate associated with alternative C. In a situation in which the economy already has overshot its potential, the robust advance of economic activity through last quarter might well signify the likelihood that monetary policy still has not put in place sufficient restraint to slow the growth of future aggregate demand enough to forestall a sustained upward drift in inflation. Moving up the federal funds rate to 6 percent would more clearly place real short-term interest rates in a range that could be characterized as moderately restrictive. Even if slower real GDP growth emerges than in the staff economic forecast, which assumes unchanged short-term interest rates, such an outcome would aid in bringing resource use over time back to less potentially inflationary and, hence, more sustainable levels.

(29) The 1/2 percentage point rise in the federal funds rate embodied in alternative C, by matching current financial market expectations, would have few initial repercussions on market interest rates or exchange rates against our other G-10 trading partners. However, some strengthening of the dollar against the peso cannot be ruled out. Banks likely would hike the prime rate by a commensurate amount and might become somewhat more cautious in their other lending terms and standards as they saw a slowing in economic growth as more clearly in train.

(30) Projected growth of the monetary aggregates from January to June under the two alternatives is given in the table below, along with implied growth from the fourth quarter of last year. (More detailed data appear in the table and charts on the following pages.)

	Alt. B	Alt. C
Growth from January to June		
M2	2-1/4	1-1/2
M3	2-1/2	2
M1	1	-1/4
Growth from 1994:Q4 to June		
M2	2-1/2	2
M3	3	2-3/4
M1	1	1/4

(31) Under the unchanged federal funds rate of alternative B, M2 growth would be supported by some narrowing of its opportunity cost, as offering rates on retail deposits rise further in partial catch-up to earlier increases in short-term interest rates. Even so, this aggregate's expansion would remain well below that of nominal GDP--projected to grow at a 5-1/2 percent rate over the first half of the year--reflecting continued flows of saving into alternative investment outlets. The expected M2 growth of 2-1/4 percent from January to June would place this aggregate in the lower half of its

		M2		M3		M1	
		Alt. B	Alt. C	Alt. B	Alt. C	Alt. B	Alt. C
Levels in Billions							
Nov-94		3609.7	3609.7	4290.8	4290.8	1147.4	1147.4
Dec-94		3614.2	3614.2	4302.3	4302.3	1147.8	1147.8
Jan-95		3628.6	3628.6	4325.2	4325.2	1149.8	1149.8
Feb-95		3634.7	3633.2	4333.9	4333.0	1150.7	1150.2
Mar-95		3640.7	3636.5	4342.6	4340.0	1151.7	1150.1
Apr-95		3646.8	3640.2	4351.2	4347.3	1152.7	1149.9
May-95		3654.1	3645.2	4360.0	4354.7	1153.6	1149.3
Jun-95		3661.4	3650.6	4368.7	4362.2	1154.6	1148.9
Monthly Growth Rates							
Nov-94		0.5	0.5	1.8	1.8	-0.6	-0.6
Dec-94		1.5	1.5	3.2	3.2	0.4	0.4
Jan-95		4.8	4.8	6.4	6.4	2.1	2.1
Feb-95		2.0	1.5	2.4	2.2	1.0	0.4
Mar-95		2.0	1.1	2.4	1.9	1.0	-0.1
Apr-95		2.0	1.2	2.4	2.0	1.0	-0.2
May-95		2.4	1.7	2.4	2.0	1.0	-0.6
Jun-95		2.4	1.8	2.4	2.1	1.0	-0.5
Quarterly Averages							
94 Q3		0.8	0.8	2.0	2.0	2.4	2.4
94 Q4		-0.4	-0.4	1.7	1.7	-1.3	-1.3
95 Q1		2.7	2.4	3.9	3.8	1.0	0.8
95 Q2		2.1	1.4	2.4	2.0	1.0	-0.2
Growth Rate							
From	To						
Nov-94	Mar-95	2.6	2.2	3.6	3.6	1.1	1.1
Dec-94	Mar-95	2.9	2.5	3.7	3.5	1.4	0.8
Mar-95	Jun-95	2.3	1.6	2.4	2.0	1.0	-0.4
Jan-95	Jun-95	2.2	1.5	2.4	2.1	1.0	-0.2
93 Q4	Dec-94	1.0	1.0	1.5	1.5	2.2	2.2
94 Q4	Jan-95	3.0	3.0	4.6	4.6	1.1	1.1
94 Q4	Mar-95	2.5	2.1	3.5	3.3	1.0	0.6
94 Q4	Jun-95	2.4	1.9	3.0	2.8	1.0	0.2
91 Q4	92 Q4	2.0	2.0	0.5	0.5	14.3	14.3
92 Q4	93 Q4	1.7	1.7	1.0	1.0	10.5	10.5
93 Q4	94 Q4	1.0	1.0	1.4	1.4	2.3	2.3
94 Q4	95 Q2	2.4	1.9	3.1	2.9	1.0	0.3
1994 Target Ranges:		1.0 to 5.0		0.0 to 4.0			
1995 Target Ranges: (Tentative)		1.0 to 5.0		0.0 to 4.0			

Chart 7

ACTUAL AND TARGETED M2

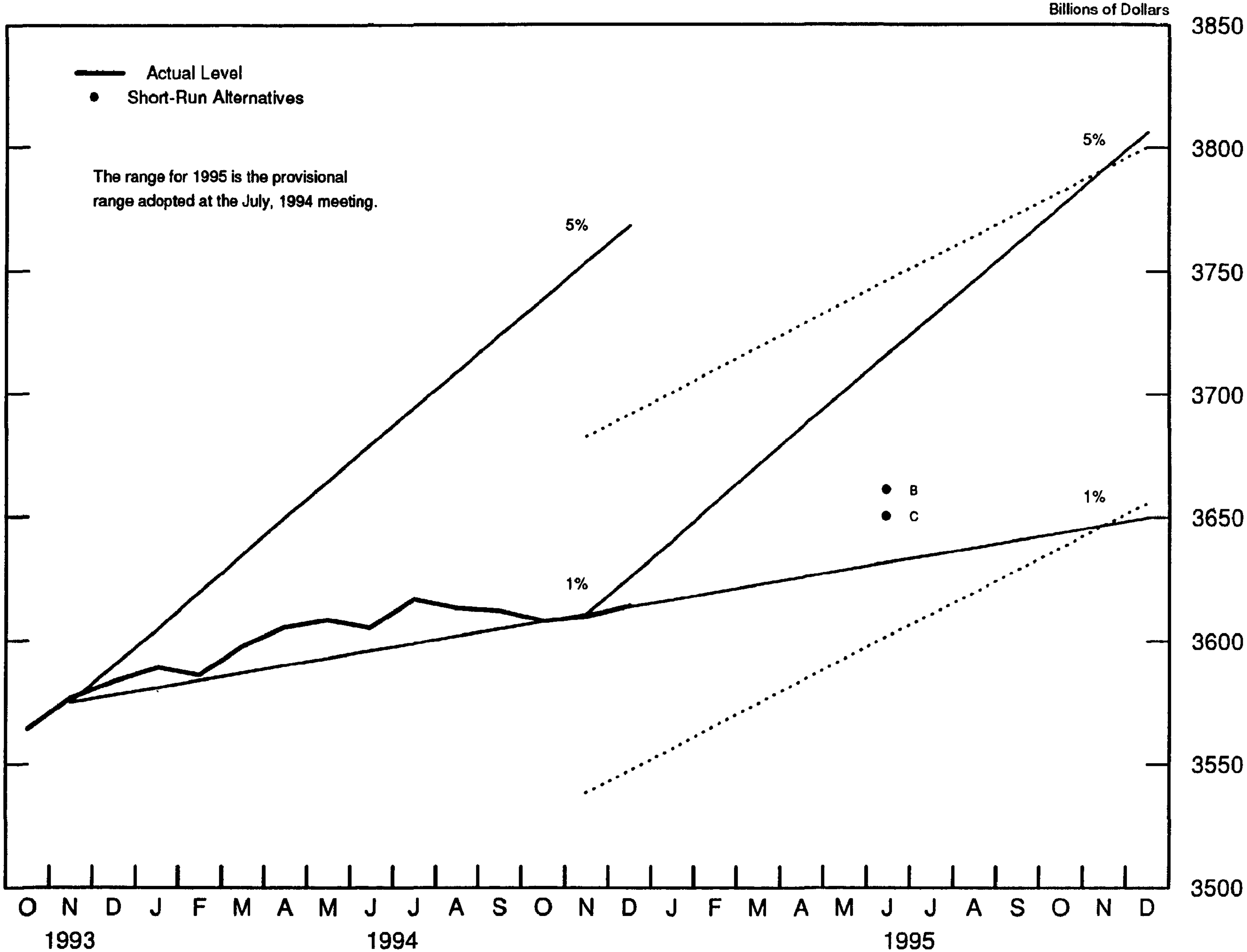


Chart 8

ACTUAL AND TARGETED M3

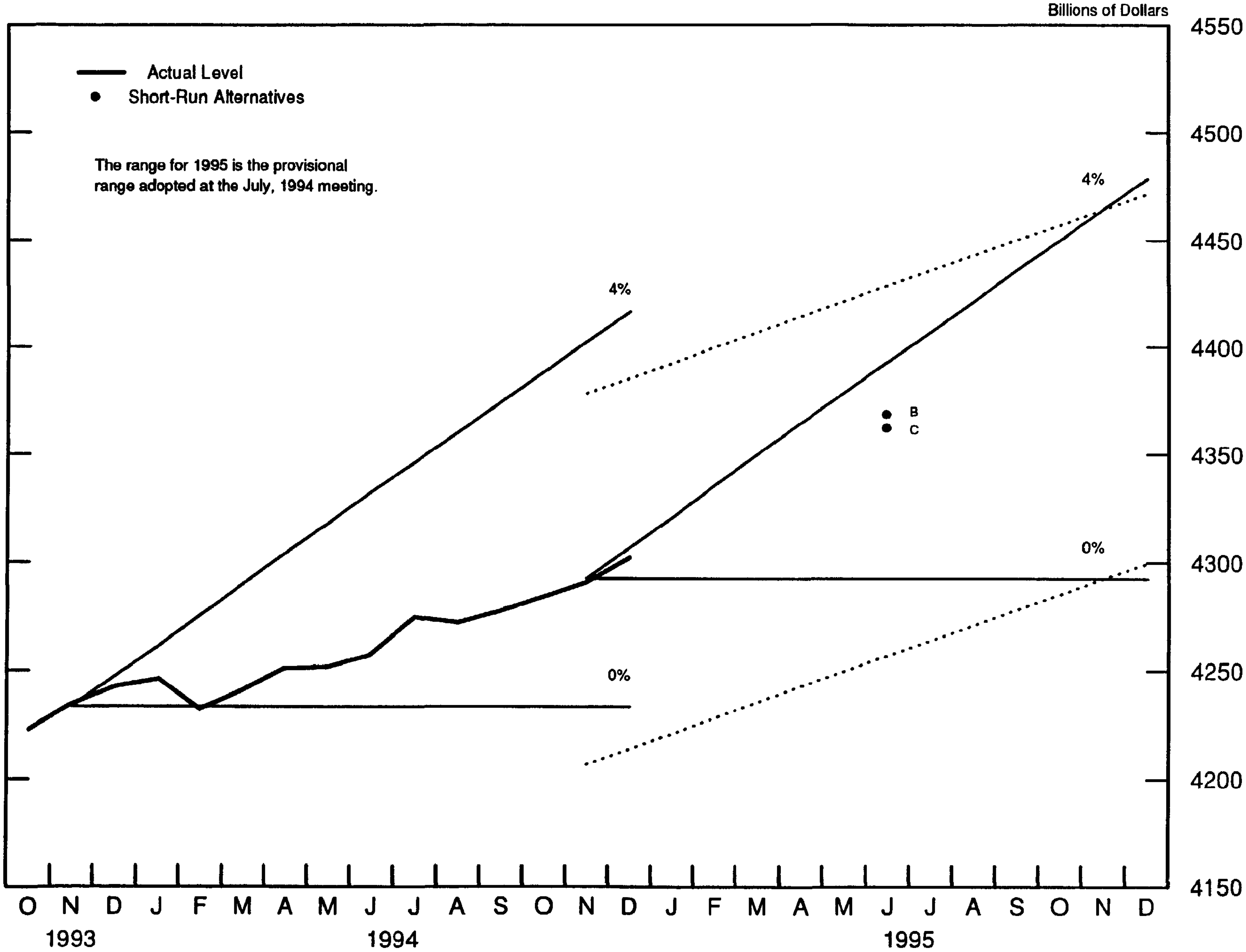
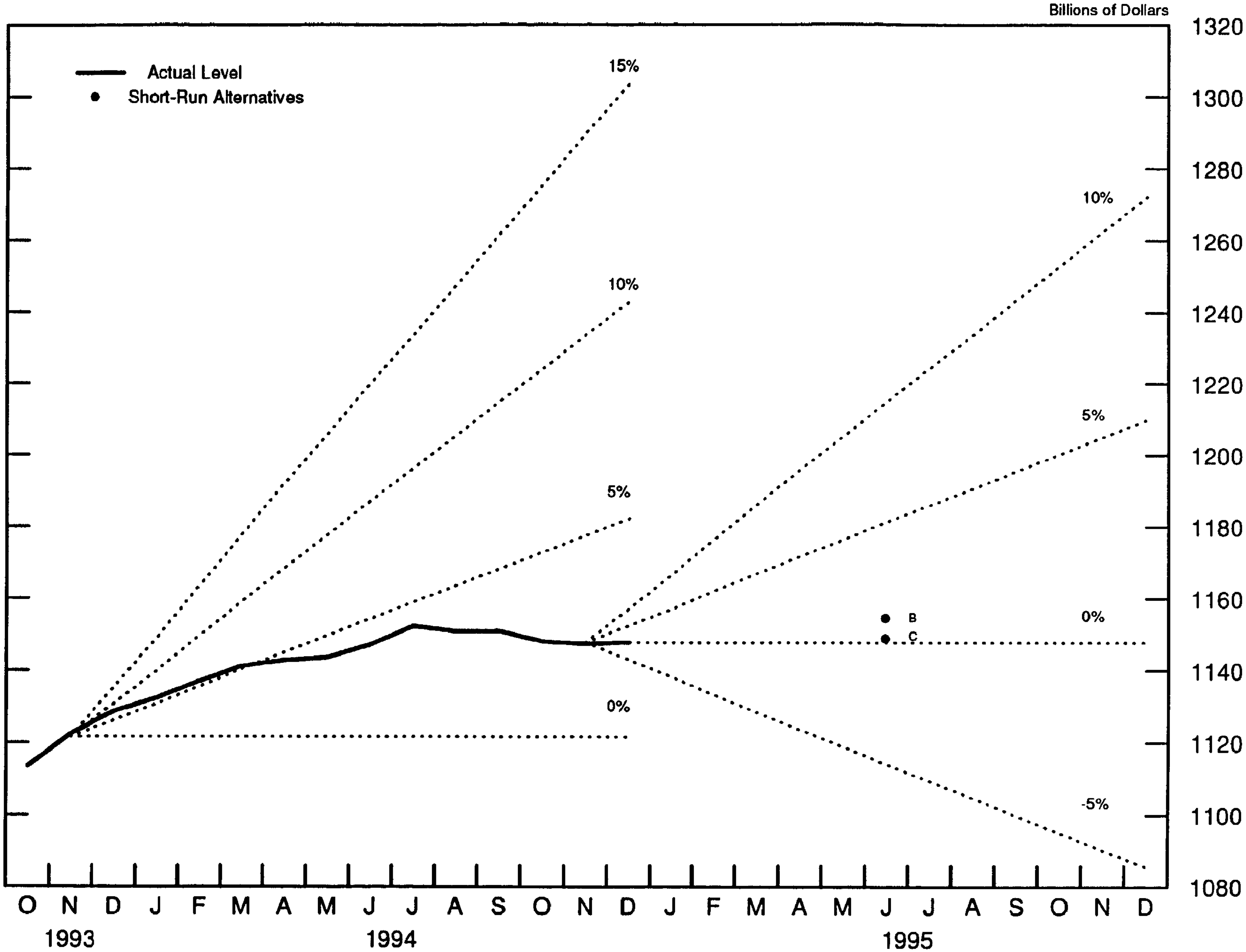


Chart 9

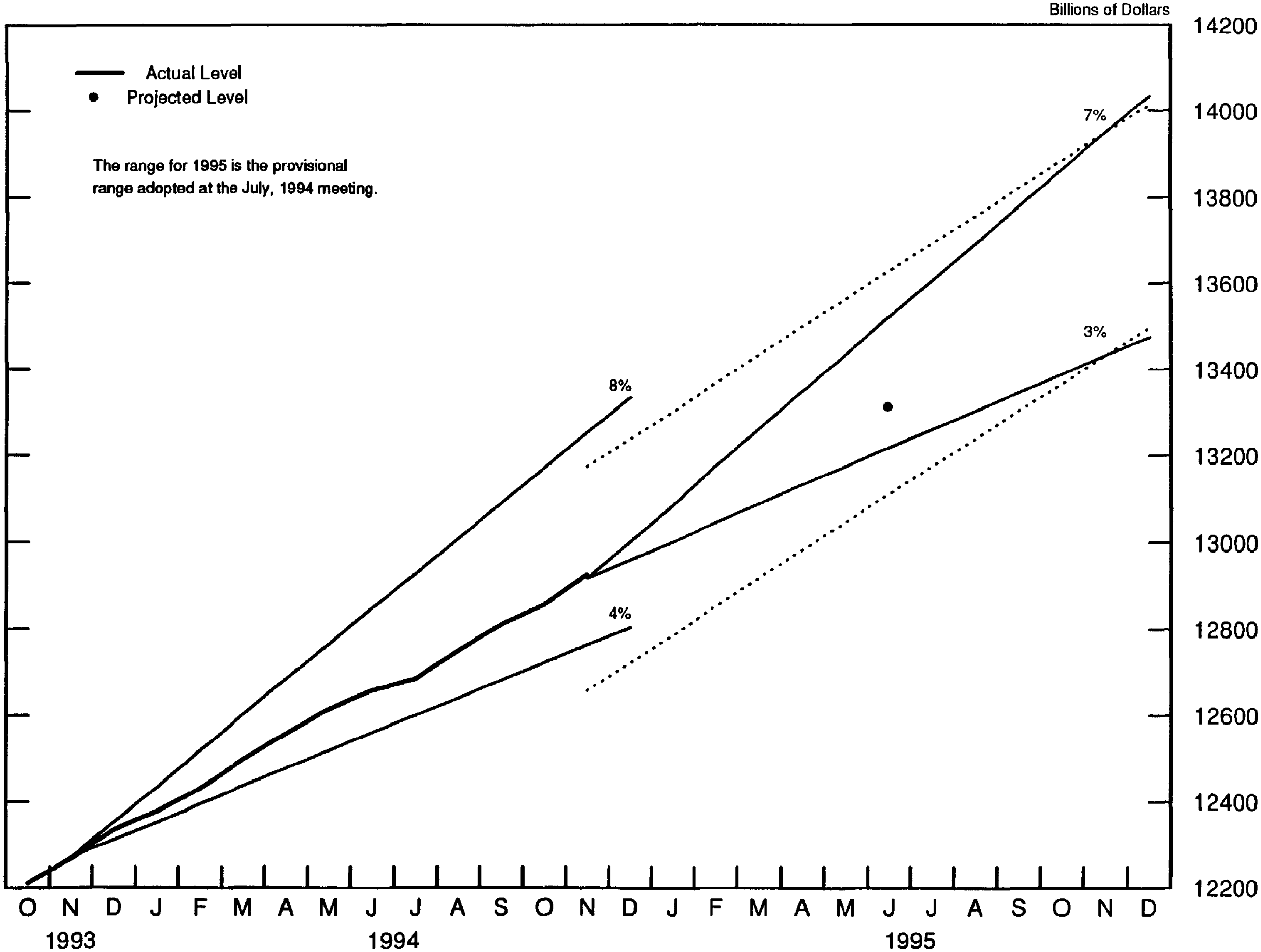
M1



Billions of Dollars
Actual Level
Short-Run Alternatives
15%
10%
5%
0%
10%
5%
0%
-5%
B
C
1320
1300
1280
1260
1240
1220
1200
1180
1160
1140
1120
1100
1080
O N D J F M A M J J A S O N D J F M A M J J A S O N D
1993
1994
1995

Chart 10

DEBT



provisional 1 to 5 percent growth range for 1995.[11] Growth in M3, forecast at a 2-1/2 percent rate from January to June under alternative B, would leave this aggregate above the midpoint of its tentative 0 to 4 percent 1995 range. Managed liabilities in the broader aggregate again would help to finance bank credit expansion, which is projected at a 5 percent rate over the same period. Paced by federal debt growth of 5-1/2 percent from December to June, domestic nonfinancial debt is foreseen as growing at a 5-1/4 percent rate over the six months, near the midpoint of its provisional 3 to 7 percent monitoring range for 1995. Nonfederal debt likely would continue to grow near the 5 percent pace of last year, with some slowdown in consumer credit expansion offsetting a probable cessation of the runoff of state and local debt.

(32) Under alternative C, the 1/2 percentage point higher funds rate would induce less rapid expansion of M2 and M3 than under alternative B as opportunity costs resumed their upward movement. Growth rates of 1-1/2 percent and 2 percent, respectively, from January to June are anticipated by the staff under alternative C.

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11. M1 growth is projected at 1 percent from January to June; the expansion of the monetary base would be at a 7-1/2 percent rate, with its total reserves component contracting at a 3-3/4 percent pace.

Directive Language

(33) Presented below for Committee consideration is draft wording relating to the Humphrey-Hawkins ranges for 1995 and the operating paragraph for the intermeeting period.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at THIS ~~its~~ meeting ~~in July~~ ~~reaffirmed the ranges it had~~ established RANGES ~~in February~~ for growth of M2 and M3 of ___ TO ___ ~~1 to 5~~ percent and ___ TO ___ ~~0 to 4~~ percent respectively, measured from the fourth quarter of 1994 ~~1993~~ to the fourth quarter of 1995 ~~1994~~. The Committee anticipated that ~~developments contributing to unusual velocity increases could persist during the year and that~~ money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was SET (LOWERED TO) ~~maintained~~ at ___ TO ___ ~~4 to 8~~ percent for the year. ~~For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995.~~ The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

OPERATIONAL PARAGRAPH

In the implementation of policy for the immediate future, the Committee seeks to DECREASE SOMEWHAT/maintain/INCREASE SOMEWHAT the existing degree of pressure on reserve positions, TAKING ACCOUNT OF A POSSIBLE INCREASE IN THE DISCOUNT RATE. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat (SLIGHTLY) greater reserve restraint would (MIGHT) or (SOMEWHAT) slightly lesser reserve restraint (WOULD) might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with MODERATE ~~modest~~ growth in M2 and M3 over coming months.

APPENDIX A

MONEY STOCK REVISIONS

Measures of the money stock have been revised to incorporate the results of the annual benchmark and seasonal factor review. The attached tables compare growth rates of the old and revised series. These data should be regarded as strictly confidential until their release to the public in early February.

Benchmark Revisions

Data for the monetary aggregates have been benchmarked using call reports through September 1994 and other sources. The benchmark and seasonal review revisions did not affect the annual growth rate of M2 over 1994. However, they lowered the 1994 growth rate of M1 by 0.1 percentage point and raised the 1994 growth rate of M3 by 0.2 percentage point.

The benchmark incorporates historical data for a number of money market mutual funds that began reporting for the first time during 1994, raising the levels of M2 and M3 over the years by amounts that cumulate to $15 billion and $22 billion respectively by late 1994. The benchmark also incorporates new estimates of large time deposits held by banks. (This item is one of several that are subtracted from gross large time deposits to measure the quantity of such time deposits held by the nonbank public.) As a result of the new estimates, this large time deposit netting item revised upward over the past thirteen years, by as much as $14 billion in the mid-1980s, thereby reducing the level of M3 by the same amount.

The benchmark also incorporates new estimates of money funds' holdings of both RPs and Eurodollars, which are netted out of the aggregates at both the M2 and M3 levels. These revisions, which extend back to 1984, shifted up the level of M2 by as much as $5 billion and the level of M3 by as much as $8 billion over the last decade. The benchmark includes other revisions as well, such as the incorporation of deposits data taken from the call reports of banks and thrifts that do not report on one of the more detailed deposits reports.

Seasonal Factor Revisions

Seasonal factors for the monetary aggregates have been revised using the X-11 ARIMA procedure applied to the benchmarked data through December 1994. The seasonal adjustment procedure used this year is identical to that employed for the past few years.

Overall, the revisions to seasonal factors slightly shifted the growth of M1 and M3--but not of M2--from the second half to the first half of the year 1994. The growth rates for the first half of 1994 were raised 0.2 percentage point for M1 and 0.1 percentage point for M3, with corresponding downward revisions in the second half of the year.

Appendix Table A.1

Comparison of Revised and Old M1 Growth Rates
(percent changes at annual rates)

	Revised (1)	Old (2)	Difference (1) - (2) (3)	Difference due to Benchmark (4)	Difference due to Seasonals (5)
Monthly					
1993--Oct.	9.6	9.0	0.6	0.1	0.5
Nov.	9.6	9.7	-0.1	-0.4	0.3
Dec.	6.6	6.4	0.2	0.0	0.2
1994--Jan.	4.1	5.4	-1.3	-0.5	-0.8
Feb.	4.8	5.3	-0.5	0.1	-0.6
Mar.	4.3	4.0	0.3	-0.1	0.4
Apr.	1.8	-1.3	3.1	0.1	3.0
May	0.7	1.8	-1.1	0.2	-1.3
June	3.7	3.7	0.0	0.1	-0.1
July	5.4	7.1	-1.7	0.0	-1.7
Aug.	-1.5	-2.2	0.7	0.0	0.7
Sept.	0.1	0.9	-0.8	0.2	-1.0
Oct.	-3.0	-3.5	0.5	-0.2	0.7
Nov.	-0.6	-0.9	0.3	0.0	0.3
Dec.	0.4	0.0	0.4	0.0	0.4
1995--Jan.	2.1	3.0	-0.9	0.0	-0.9
Quarterly					
1993--QIV	9.7	9.4	0.3	0.1	0.2
1994--QI	5.5	6.0	-0.5	-0.2	-0.3
QII	2.6	1.9	0.7	0.1	0.6
QIII	2.4	3.0	-0.6	0.1	-0.7
QIV	-1.3	-1.4	0.1	-0.1	0.2
Semi-Annual					
1994--QIV '93 to QII '94	4.1	3.9	0.2	0.0	0.2
QII '94 to QIV '94	0.6	0.8	-0.2	0.0	-0.2
Annual (QIV TO QIV)					
1993	10.5	10.5	0.0	0.0	0.0
1994	2.3	2.4	-0.1	0.0	-0.1

Appendix Table A.2

Comparison of Revised and Old M2 Growth Rates
(percent changes at annual rates)

	Revised	Old	Difference (1) - (2)	Difference due to Benchmark	Difference due to Seasonals
	(1)	(2)	(3)	(4)	(5)
Monthly					
1993--Oct.	1.8	1.3	0.5	0.3	0.2
Nov.	4.2	4.2	0.0	-0.1	0.1
Dec.	2.3	2.6	-0.3	0.2	-0.5
1994--Jan.	1.8	2.4	-0.6	-0.5	-0.1
Feb.	-1.0	-0.9	-0.1	-0.2	0.1
Mar.	3.8	4.1	-0.3	0.0	-0.3
Apr.	2.6	2.4	0.2	0.1	0.1
May	1.0	1.2	-0.2	0.4	-0.6
June	-1.1	-2.1	1.0	0.2	0.8
July	3.8	5.2	-1.4	-0.4	-1.0
Aug.	-1.1	-1.9	0.8	0.0	0.8
Sept.	-0.4	-0.4	0.0	-0.1	0.1
Oct.	-1.3	-1.7	0.4	-0.1	0.5
Nov.	0.5	0.5	0.0	0.0	0.0
Dec.	1.5	1.9	-0.4	0.0	-0.4
1995--Jan.	4.8	4.8	0.0	0.0	0.0
Quarterly					
1993--QIV	2.7	2.4	0.3	0.2	0.1
1994--QI	1.8	2.1	-0.3	-0.2	-0.1
QII	1.7	1.7	0.0	0.1	-0.1
QIII	0.8	0.9	-0.1	-0.1	0.0
QIV	-0.4	-0.5	0.1	0.0	0.1
Semi-Annual					
1994--QIV '93 to QII '94	1.8	1.9	-0.1	0.0	-0.1
QII '94 to QIV '94	0.2	0.2	0.0	0.0	0.0
Annual (QIV TO QIV)					
1993	1.7	1.4	0.3	0.3	0.0
1994	1.0	1.0	0.0	-0.1	0.1

Appendix Table A.3

Comparison of Revised and Old M3 Growth Rates
(percent changes at annual rates)

	Revised	Old	Difference (1) - (2)	Difference due to Benchmark	Difference due to Seasonals
	(1)	(2)	(3)	(4)	(5)
Monthly					
1993--Oct.	2.4	2.2	0.2	0.7	-0.5
Nov.	3.3	3.9	-0.6	-0.4	-0.2
Dec.	2.3	3.7	-1.4	-0.4	-1.0
1994--Jan.	1.0	1.8	-0.8	0.3	-1.1
Feb.	-3.9	-7.1	3.2	0.6	2.6
Mar.	2.5	2.1	0.4	0.0	0.4
Apr.	2.9	2.6	0.3	0.3	0.0
May	0.2	-0.2	0.4	0.5	-0.1
June	1.5	0.4	1.1	0.8	0.3
July	5.0	6.4	-1.4	-0.3	-1.1
Aug.	-0.7	-1.9	1.2	0.4	0.8
Sept.	1.5	1.4	0.1	0.4	-0.3
Oct.	1.9	2.5	-0.6	0.1	-0.7
Nov.	1.8	2.1	-0.3	-0.1	-0.2
Dec.	3.2	4.3	-1.1	0.1	-1.2
1995--Jan.	6.4	7.6	-1.2	0.0	-1.2
Quarterly					
1993--QIV	2.5	2.6	-0.1	0.1	-0.2
1994--QI	0.6	0.5	0.1	0.1	0.0
QII	1.3	0.5	0.8	0.4	0.4
QIII	2.0	1.9	0.1	0.3	-0.2
QIV	1.7	1.9	-0.2	0.2	-0.4
Semi-Annual					
1994--QIV '93 to QII '94	0.9	0.5	0.4	0.2	0.2
QII '94 to QIV '94	1.9	1.9	0.0	0.2	-0.2
Annual (QIV TO QIV)					
1993	1.0	0.7	0.3	0.4	-0.1
1994	1.4	1.2	0.2	0.2	0.0

Appendix Table A.4

Revisions to the Monetary Aggregates
(4th quarter-to-4th quarter growth rates)
(in percent)

	M1 seasonally adjusted			M2 seasonally adjusted			M3 seasonally adjusted		
	Old	Revised	Diff	Old	Revised	Diff	Old	Revised	Diff
1980	7.4	7.4	0.0	8.9	8.9	0.0	9.6	9.6	0.0
1981	5.4	5.4	0.0	9.3	9.4	0.1	12.4	12.4	0.0
1982	8.8	8.8	0.0	9.2	9.1	-0.1	9.9	9.8	-0.1
1983	10.4	10.4	0.0	12.2	12.2	0.0	9.9	9.5	-0.4
1984	5.5	5.5	0.0	8.1	8.1	0.0	10.9	10.9	0.0
1985	12.0	12.0	0.0	8.7	8.8	0.1	7.6	7.7	0.1
1986	15.5	15.5	0.0	9.3	9.3	0.0	8.9	9.0	0.1
1987	6.3	6.3	0.0	4.3	4.3	0.0	5.7	5.9	0.2
1988	4.3	4.3	0.0	5.3	5.3	0.0	6.3	6.3	0.0
1989	0.6	0.6	0.0	4.8	4.9	0.1	3.8	3.9	0.1
1990	4.2	4.2	0.0	4.0	4.0	0.0	1.7	1.7	0.0
1991	7.9	7.9	0.0	2.9	2.9	0.0	1.2	1.2	0.0
1992	14.3	14.3	0.0	1.9	2.0	0.1	0.5	0.5	0.0
1993	10.5	10.5	0.0	1.4	1.7	0.3	0.7	1.0	0.3
1994	2.4	2.3	-0.1	1.0	1.0	0.0	1.2	1.4	0.2

Appendix B

ADOPTED LONGER-RUN GROWTH RATE RANGES FOR THE MONETARY AND CREDIT AGGREGATES
(percent annual rates)

	M1		M2		M3		Domestic Non-financial Debt[1]	
QIV 1979 - QIV 1980	4 - 6.5	(7.3)[2,3]	6 - 9	(9.8)	6.5 - 9.5	(9.9)	6 - 9	(7.9)
QIV 1980 - QIV 1981	3.5 - 6	(2.3)[2,4]	6 - 9	(9.4)	6.5 - 9.5	(11.4)	6 - 9	(8.8)[5]
QIV 1981 - QIV 1982	2.5 - 5.5	(8.5)[2]	6 - 9	(9.2)	6.5 - 9.5	(10.1)	6 - 9[6]	(7.1)[5]
QIV 1982 - QIV 1983	5 - 9[7]	(7.2)	7 - 10[8]	(8.3)	6.5 - 9.5	(9.7)	8.5 - 11.5	(10.5)
QIV 1983 - QIV 1984	4 - 8[9]	(5.2)	6 - 9	(7.7)	6 - 9	(10.5)	8 - 11	(13.4)
QIV 1984 - QIV 1985	3 - 8	(12.7)	6 - 9	(8.6)	6 - 9.5	(7.4)	9 - 12	(13.5)
QIV 1985 - QIV 1986	3 - 8	(15.2)	6 - 9	(8.9)	6 - 9	(8.8)	8 - 11	(12.9)
QIV 1986 - QIV 1987	n.s. [10]	(6.2)	5.5 - 8.5	(4.0)	5.5 - 8.5	(5.4)	8 - 11	(9.6)
QIV 1987 - QIV 1988	n.s.	(4.3)	4 - 8	(5.3)	4 - 8	(6.2)	7 - 11	(8.7)
QIV 1988 - QIV 1989	n.s.	(0.6)	3 - 7	(4.6)	3.5 - 7.5	(3.3)	6.5 - 10.5	(8.1)
QIV 1989 - QIV 1990	n.s.	(4.2)	3 - 7	(3.9)	1 - 5[11]	(1.8)	5 - 9	(6.9)
QIV 1990 - QIV 1991	n.s.	(8.0)	2.5 - 6.5	(2.8)	1 - 5	(1.2)	4.5 - 8.5	(4.5)
QIV 1991 - QIV 1992	n.s.	(14.3)	2.5 - 6.5	(2.0)	1 - 5	(0.5)	4.5 - 8.5	(4.6)
QIV 1992 - QIV 1993	n.s.	(10.5)	1 - 5[12]	(1.4)	0 - 4[12]	(0.6)	4 - 8[12]	(4.9)
QIV 1993 - QIV 1994	n.s.	(2.3)	1 - 5	(1.0)	0 - 4	(1.4)	4 - 8	(5.2)

NOTE: Numbers in parentheses are actual growth rates as reported at end of policy period in February Monetary Policy Report to Congress. Subsequent revisions to historical data (not reflected above) have altered growth rates by up to a few tenths of a percent.

n.s.--not specified.

Footnotes on following page

1. Targets are for bank credit until 1983; from 1983 onward targets are for domestic nonfinancial sector debt.

2. The figures shown reflect target and actual growth of M1-B in 1980 and shift-adjusted M1-B in 1981. M1-B was relabelled M1 in January 1982. The targeted growth for M1-A was 3-1/2 to 6 percent in 1980 (actual growth was 5.0 percent); in 1981 targeted growth for shift-adjusted M1-A was 3 to 5-1/2 percent (actual growth was 1.3 percent).

3. When these ranges were set, shifts into other checkable deposits in 1980 were expected to have only a limited effect on growth of M1-A and M1-B. As the year progressed, however, banks offered other checkable deposits more actively, and more funds than expected were directed to these accounts. Such shifts are estimated to have decreased M1-A growth and increased M1-B growth each by at least 1/2 percentage point more than had been anticipated.

4. Adjusted for the effects of shifts out of demand deposits and savings deposits. At the February FOMC meeting, the target ranges for observed M1-A and M1-B in 1981 on an unadjusted basis, expected to be consistent with the adjusted ranges, were -4-1/2 to -2 and 6 to 8-1/2 percent, respectively. Actual M1-B growth (not shift adjusted) was 5.0 percent.

5. Adjusted for shifts of assets from domestic banking offices to International Banking Facilities.

6. Range for bank credit is annualized growth from the December 1981-January 1982 average level through the fourth quarter of 1982.

7. Base period, adopted at the July 1983 FOMC meeting, is QII'83. At the February 1983 meeting, the FOMC had adopted a QIV'82 to QIV'83 target range for M1 of 4 to 8 percent.

8. Base period is the February-March 1983 average.

9. Base period, adopted at the July 1985 FOMC meeting, is QII'85. At the February 1985 meeting, the FOMC had adopted a QIV'84 to QIV'85 target range for M1 of 4 to 7 percent.

10. No range for M1 has been specified since the February 1987 FOMC meeting because of uncertainties about its underlying relationship to the behavior of the economy and its sensitivity to economic and financial circumstances.

11. At the February 1990 meeting, the FOMC specified a range of 2-1/2 to 6-1/2 percent. This range was lowered to 1 to 5 percent at the July 1990 meeting.

12. At the February 1993 meeting, the FOMC specified a range of 2 to 6 percent for M2, 1/2 to 4-1/2 percent for M3, and 4-1/2 to 8-1/2 percent for domestic nonfinancial debt. These ranges were lowered to 1 to 5 percent for M2, 0 to 4 percent for M3, and 4 to 8 percent for domestic nonfinancial debt at the July 1993 meeting.

1/27/95 (MARP)

SELECTED INTEREST RATES
(percent)

	Short-Term								Long-Term							
	federal funds	Treasury bills secondary market			CDs secondary market	comm. paper	money market mutual fund	bank prime loan	U.S. government constant maturity yields			corporate A-utility recently offered	municipal Bond Buyer	conventional home mortgages		
														secondary market	primary market	
		3-month	6-month	1-year	3-month	1-month			3-year	10-year	30-year			fixed-rate	fixed-rate	ARM
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
93 -- High	3.24	3.12	3.27	3.48	3.36	3.44	2.92	6.00	5.06	6.73	7.46	8.28	6.44	8.17	8.14	5.36
-- Low	2.87	2.82	2.94	3.07	3.06	3.07	2.59	6.00	4.07	5.24	5.83	6.79	5.41	6.72	6.74	4.14
94 -- High	5.85	5.70	6.26	6.73	6.31	6.11	5.12	8.50	7.79	8.00	8.13	9.05	7.37	9.57	9.25	6.79
-- Low	2.97	2.94	3.12	3.35	3.11	3.11	2.68	6.00	4.44	5.70	6.25	7.16	5.49	7.02	6.97	4.12
Monthly																
Jan 94	3.05	2.98	3.15	3.39	3.15	3.14	2.71	6.00	4.48	5.75	6.29	7.24	5.54	7.12	7.06	4.21
Feb 94	3.25	3.25	3.43	3.69	3.43	3.39	2.73	6.00	4.83	5.97	6.49	7.45	5.65	7.35	7.15	4.20
Mar 94	3.34	3.50	3.78	4.11	3.77	3.63	2.86	6.06	5.40	6.48	6.91	7.82	6.16	7.96	7.68	4.55
Apr 94	3.56	3.68	4.09	4.57	4.01	3.81	3.03	6.45	5.99	6.97	7.27	8.20	6.48	8.55	8.32	4.96
May 94	4.01	4.14	4.60	5.03	4.51	4.28	3.29	6.99	6.34	7.18	7.41	8.37	6.46	8.78	8.60	5.46
Jun 94	4.25	4.14	4.55	4.98	4.52	4.36	3.61	7.25	6.27	7.10	7.40	8.30	6.38	8.62	8.40	5.45
Jul 94	4.26	4.33	4.75	5.17	4.73	4.49	3.75	7.25	6.48	7.30	7.58	8.45	6.48	8.82	8.61	5.52
Aug 94	4.47	4.48	4.88	5.25	4.81	4.65	3.95	7.51	6.50	7.24	7.49	8.36	6.44	8.82	8.51	5.53
Sep 94	4.73	4.62	5.04	5.43	5.03	4.90	4.15	7.75	6.69	7.46	7.71	8.62	6.55	8.93	8.64	5.54
Oct 94	4.76	4.95	5.39	5.75	5.51	5.02	4.30	7.75	7.04	7.74	7.94	8.80	6.83	9.25	8.93	5.78
Nov 94	5.29	5.29	5.72	6.13	5.79	5.40	4.62	8.15	7.44	7.96	8.08	8.95	7.27	9.43	9.17	6.10
Dec 94	5.45	5.60	6.21	6.67	6.29	6.08	5.00	8.50	7.71	7.81	7.87	8.78	7.07	9.51	9.20	6.66
Weekly																
Oct 12 94	4.62	4.93	5.35	5.68	5.55	5.13	4.29	7.75	6.99	7.71	7.90	8.73	6.73	9.12	8.93	5.77
Oct 19 94	4.72	4.89	5.31	5.69	5.45	4.99	4.31	7.75	6.94	7.64	7.85	8.87	6.81	9.29	8.85	5.77
Oct 26 94	4.72	5.02	5.47	5.85	5.52	4.97	4.35	7.75	7.15	7.85	8.03	8.85	6.95	9.30	9.03	5.88
Nov 2 94	4.77	5.04	5.48	5.85	5.56	5.01	4.40	7.75	7.16	7.88	8.03	9.05	7.16	9.43	9.05	5.91
Nov 9 94	4.74	5.19	5.62	5.98	5.69	5.18	4.41	7.75	7.36	8.00	8.13	9.00	7.23	9.38	9.19	6.01
Nov 16 94	5.22	5.32	5.73	6.12	5.75	5.39	4.50	7.96	7.41	7.95	8.10	9.00	7.37	9.52	9.19	6.12
Nov 23 94	5.53	5.33	5.79	6.23	5.87	5.59	4.77	8.50	7.52	7.98	8.10	8.80	7.32	9.37	9.25	6.35
Nov 30 94	5.85	5.44	5.87	6.34	5.95	5.62	4.84	8.50	7.58	7.89	7.99	8.81	7.18	9.57	9.23	6.47
Dec 7 94	5.47	5.67	6.15	6.57	6.26	6.07	4.91	8.50	7.62	7.82	7.92	8.78	7.17	9.50	9.15	6.56
Dec 14 94	5.48	5.70	6.26	6.73	6.31	6.11	4.97	8.50	7.72	7.81	7.88	8.79	7.02	9.47	9.25	6.75
Dec 21 94	5.56	5.51	6.20	6.64	6.26	6.09	5.04	8.50	7.69	7.80	7.85	8.75	6.99	9.53	9.18	6.79
Dec 28 94	5.45	5.51	6.22	6.73	6.30	6.05	5.12	8.50	7.79	7.81	7.83	8.78	6.97	9.50	9.18	6.75
Jan 4 95	5.40	5.57	6.25	6.72	6.39	5.96	5.18	8.50	7.80	7.84	7.88	8.77	6.94	9.57	9.22	6.83
Jan 11 95	5.53	5.72	6.31	6.75	6.28	5.79	5.18	8.50	7.80	7.85	7.88	8.70	6.87	9.33	9.19	6.87
Jan 18 95	5.45	5.63	6.16	6.56	6.16	5.73	5.16	8.50	7.63	7.73	7.81	8.81	6.78	9.41	9.05	6.82
Jan 25 95	5.42	5.76	6.21	6.57	6.24	5.90	5.17	8.50	7.67	7.81	7.89	8.69	6.78	9.31	9.13	6.75
Daily																
Jan 20 95	5.37	5.75	6.21	6.59	6.22	5.87	--	8.50	7.70	7.82	7.90	--	--	--	--	--
Jan 26 95	5.53	5.77	6.16	6.46	6.22	5.96	--	8.50	7.54	7.76	7.85	--	--	--	--	--
Jan 27 95	5.65p	5.76	6.13	6.39	6.19	5.98	--	8.50	7.46	7.66	7.75	--	--	--	--	--

NOTE: Weekly data for columns 1 through 11 are statement week averages. Data in column 7 are taken from Donoghue's Money Fund Report. Columns 12, 13 and 14 are 1-day quotes for Friday, Thursday or Friday, respectively, following the end of the statement week. Column 13 is the Bond Buyer revenue index. Column 14 is the FNMA purchase yield, plus loan servicing fee, on 30-day mandatory delivery commitments. Column 15 is the average contract rate on new commitments for fixed-rate mortgages (FRMs) with 80 percent loan-to-value ratios at major institutional lenders. Column 16 is the average initial contract rate on new commitments for 1-year, adjustable-rate mortgages (ARMs) at major institutional lenders offering both FRMs and ARMs with the same number of discount points.

p - preliminary data

Strictly Confidential (FR)-
Class II FOMC

JANUARY 30, 1995

Money and Credit Aggregate Measures

Seasonally adjusted

Period	Money stock measures and liquid assets						Bank credit	Domestic nonfinancial debt[1]		
	M1	M2	nontransactions components: In M2	nontransactions components: In M3 only	M3	L	total loans and investments[1]	U.S. government[2]	other[2]	total[2]
	1	2	3	4	5	6	7	8	9	10
Annual growth rates(%):										
Annually (Q4 to Q4)										
1992	14.3	1.9	-2.4	-6.3	0.5	1.4	3.7	10.7	2.8	4.7
1993	10.5	1.4	-2.3	-3.3	0.7	1.1	4.9	8.5	4.1	5.2
1994	2.4	1.0	0.4	2.1	1.2		6.9			
Quarterly Average										
1994-1st QTR.	6.0	2.1	0.3	-7.9	0.5	2.6	8.7	7.3	4.6	5.3
1994-2nd QTR.	1.9	1.7	1.6	-5.6	0.5	1.3	7.1	5.4	5.6	5.6
1994-3rd QTR.	3.0	0.9	-0.0	7.3	1.9	1.3	7.0	3.9	4.6	4.4
1994-4th QTR.	-1.4	-0.5	-0.1	15.1	1.9		3.9			
Monthly										
1994-JAN.	5.4	2.4	0.9	-1.3	1.8	5.2	14.2	3.7	4.5	4.3
FEB.	5.3	-0.9	-3.8	-40.3	-7.1	-2.5	4.2	6.0	4.5	4.9
MAR.	4.0	4.1	4.1	-9.4	2.1	-0.4	9.7	8.8	5.4	6.3
APR.	-1.3	2.4	4.1	3.8	2.6	4.9	10.4	3.9	6.3	5.7
MAY	1.8	1.2	1.0	-8.3	-0.2	1.4	2.1	4.2	6.1	5.6
JUNE	3.7	-2.1	-4.7	14.8	0.4	-2.2	4.6	4.9	3.7	4.0
JULY	7.1	5.2	4.3	12.5	6.4	6.3	13.5	1.0	3.2	2.6
AUG.	-2.2	-1.9	-1.8	-2.2	-1.9	-1.6	3.9	6.1	6.3	6.2
SEP.	0.9	-0.4	-1.1	11.7	1.4	-1.2	3.5	6.0	5.5	5.7
OCT.	-3.5	-1.7	-0.7	25.0	2.5	6.6	2.6	5.4	4.2	4.5
NOV.	-0.9	0.5	1.3	10.6	2.1	2.8	3.5	8.5	5.0	5.9
DEC.	0.0	1.9	2.8	17.1	4.3		9.5			
1995-JAN. pe	3	5	6	23	8					
Levels ($Billions):										
Monthly										
1994-AUG.	1151.0	3598.9	2447.9	647.0	4245.9	5182.1	3270.9	3436.7	9312.5	12749.1
SEP.	1151.9	3597.6	2445.6	653.3	4250.9	5176.9	3280.5	3454.0	9355.5	12809.5
OCT.	1148.5	3592.6	2444.1	666.9	4259.6	5205.5	3287.7	3469.4	9388.3	12857.8
NOV.	1147.6	3594.2	2446.7	672.8	4267.0	5217.8	3297.2	3494.0	9427.5	12921.5
DEC.	1147.6	3600.0	2452.5	682.4	4282.4		3323.4			
Weekly										
1994-DEC. 5	1150.0	3598.9	2448.9	669.6	4268.6					
12	1148.3	3594.8	2446.5	681.2	4275.9					
19	1147.0	3593.9	2446.9	688.4	4282.3					
26	1147.9	3606.0	2458.1	683.4	4289.3					
1995-JAN. 2	1141.8	3606.1	2464.2	686.1	4292.2					
9 p	1146.1	3607.7	2461.6	683.4	4291.0					
16 p	1151.1	3615.9	2464.7	699.2	4315.1					

1. Adjusted for breaks caused by reclassifications.
2. Debt data are on a monthly average basis, derived by averaging end-of-month levels of adjacent months, and have been adjusted to remove discontinuities.

p preliminary
pe preliminary estimate

Strictly Confidential (FR)-
Class II FOMC

Components of Money Stock and Related Measures

Seasonally adjusted unless otherwise noted

JANUARY 30, 1995

Period	Currency	Demand deposits	Other checkable deposits	Overnight RPs and Euro-dollars NSA[1]	Savings deposits[2]	Small denomi-nation time deposits[3]	Money market mutual funds		Large denomi-nation time deposits[5]	Term RP's NSA[1]	Term Euro-dollars NSA[1]	Savings bonds	Short-term Treasury securities	Commercial paper[1]	Bankers acceptan-ces
							general purpose and broker/ dealer[4]	Institutions only							
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Levels ($Billions):															
Annually (4th Qtr.)															
1992	289.7	337.1	380.1	81.2	1177.9	882.9	354.0	206.5	365.3	80.9	47.0	154.4	327.7	366.3	20.5
1993	319.5	382.1	411.9	90.8	1212.1	790.4	346.7	195.4	340.0	96.1	47.0	170.9	326.1	385.2	15.4
1994	352.2	384.2	403.1	115.2	1159.6	807.2	368.6	175.8	358.5	102.4	54.6				
Monthly															
1993-DEC.	321.4	384.8	414.3	92.3	1215.5	785.7	348.8	197.0	339.0	96.8	47.0	171.7	329.9	386.8	14.6
1994-JAN.	325.2	388.3	412.0	95.1	1220.3	779.7	349.3	192.7	341.8	92.9	46.0	172.7	339.8	391.6	14.9
FEB.	329.2	390.3	411.2	93.5	1220.9	775.1	345.8	176.9	336.5	91.5	48.1	173.4	341.5	403.0	15.3
MAR.	332.4	390.0	411.9	98.6	1221.9	772.2	348.2	177.4	332.2	94.0	47.2	174.1	344.8	389.6	15.7
APR.	334.8	388.9	409.3	97.1	1220.7	770.0	359.4	177.0	332.3	97.9	47.5	174.8	361.9	384.9	14.2
MAY	337.6	385.7	411.2	100.4	1215.9	770.9	361.9	169.3	335.5	97.1	48.7	175.7	364.5	391.0	11.5
JUNE	340.3	386.5	411.4	104.7	1207.2	772.8	356.3	169.5	336.2	101.1	51.3	176.6	351.8	392.6	10.6
JULY	343.2	389.1	412.5	109.9	1202.5	774.8	361.7	170.9	338.5	102.2	52.1	177.5	355.3	392.7	10.8
AUG.	345.4	387.5	409.7	111.6	1194.8	779.8	361.1	169.3	341.0	100.6	52.5	178.4	359.5	387.0	11.3
SEP.	347.4	388.0	408.2	113.1	1186.6	785.3	360.5	167.9	346.7	101.6	53.2	179.0	344.1	391.0	12.0
OCT.	350.0	385.8	404.3	114.9	1173.4	795.7	363.3	175.3	353.0	101.4	54.1	179.4	346.8	407.8	11.9
NOV.	352.9	383.4	402.8	113.6	1159.8	807.9	368.1	175.6	359.0	102.1	55.9	179.9	354.3	405.9	10.7
DEC.	353.6	383.3	402.3	117.2	1145.5	818.1	374.5	176.6	363.6	103.6	53.7				

1. Net of money market mutual fund holdings of these items.
2. Includes money market deposit accounts.
3. Includes retail repurchase agreements. All IRA and Keogh accounts at commercial banks and thrift institutions are subtracted from small time deposits.
4. Excludes IRA and Keogh accounts.
5. Net of large denomination time deposits held by money market mutual funds, depository institutions, U.S. government, and foreign banks and official institutions.

p preliminary

January 27, 1995

STRICTLY CONFIDENTIAL (FR)
CLASS II-FOMC

NET CHANGES IN SYSTEM HOLDINGS OF SECURITES[1]
Millions of dollars, not seasonally adjusted

Period	Treasury bills			Treasury coupons						Federal agencies redemptions (-)	Net change outright holdings total[4]	Net RPs[5]
	Net purchases[2]	Redemptions (-)	Net change	Net purchases[3]				Redemptions (-)	Net Change			
				within 1 year	1-5	5-10	over 10					
1992	13,086	1,600	11,486	1,096	13,118	2,818	2,333	---	19,365	632	30,219	-13,215
1993	17,717	---	17,717	1,223	10,350	4,168	3,457	767	18,431	774	35,374	5,974
1994	17,484	---	17,484	1,238	9,168	3,818	3,606	2,337	15,493	1,002	31,975	-7,412
1993 ---Q1	---	---	---	279	1,441	716	705	---	3,141	289	2,851	-461
---Q2	7,749	---	7,749	244	2,490	1,147	1,110	---	4,990	91	12,648	10,624
---Q3	1,268	---	1,268	511	3,700	1,297	817	298	6,028	228	7,067	-8,644
---Q4	8,700	---	8,700	189	2,719	1,008	826	468	4,273	166	12,807	4,455
1994 ---Q1	2,164	---	2,164	147	1,413	1,103	618	616	2,665	411	4,418	-11,663
---Q2	6,639	---	6,639	364	2,817	1,117	896	440	4,754	307	11,086	4,179
---Q3	1,610	---	1,610	151	2,530	938	840	302	4,157	114	5,654	-8,530
---Q4	7,071	---	7,071	575	2,408	660	1,252	979	3,916	169	10,818	8,602
1994 January	---	---	---	---	---	---	---	616	-616	202	-817	-7,757
February	1,264	---	1,264	---	---	---	---	---	---	102	1,163	-3,946
March	900	---	900	147	1,413	1,103	618	---	3,281	108	4,073	40
April	1,101	---	1,101	209	2,817	1,117	896	440	4,599	180	5,520	-5,332
May	1,395	---	1,395	155	---	---	---	---	155	70	1,480	5,441
June	4,143	---	4,143	---	---	---	---	---	---	58	4,085	4,070
July	---	---	---	---	---	---	---	302	-302	20	-322	-5,023
August	1,610	---	1,610	---	---	---	---	---	---	63	1,547	2,793
September	---	---	---	151	2,530	938	840	---	4,459	31	4,428	-6,301
October	518	---	518	450	---	---	---	979	-529	62	-72	819
November	6,109	---	6,109	---	200	---	---	---	200	70	6,239	4,718
December	444	---	444	125	2,208	660	1,252	---	4,245	37	4,652	3,066
Weekly												
October 26	---	---	---	---	---	---	---	---	---	18	-18	221
November 2	572	---	572	450	---	---	---	---	450	---	1,022	-602
9	212	---	212	---	---	---	---	---	---	---	212	-629
16	4,716	---	4,716	---	---	---	---	---	---	---	4,716	380
23	480	---	480	---	---	---	---	---	---	---	480	2,526
30	648	---	648	---	200	---	---	---	200	70	778	524
December 7	---	---	---	125	2,208	660	1,252	---	4,245	---	4,245	-11,064
14	---	---	---	---	---	---	---	---	---	30	-30	5,940
21	444	---	444	---	---	---	---	---	---	---	444	3,624
28	---	---	---	---	---	---	---	---	---	7	-7	1,419
January 4	---	---	---	---	---	---	---	---	---	---	---	3,084
11	---	---	---	---	---	---	---	---	---	27	-27	-6,919
18	---	---	---	---	---	---	---	---	---	---	---	3,849
25	---	---	---	---	---	---	---	621	-621	64	-685	-10,071
Memo: LEVEL (bil. $)[6]												
January 25			185.4	209.6	90.2	26.6	34.8		361.2		375.5	-10.7

1. Change from end-of-period to end-of-period.
2. Outright transactions in market and with foreign accounts.
3. Outright transactions in market and with foreign accounts, and short-term notes acquired in exchange for maturing bills. Excludes maturity shifts and rollovers of maturing issues.
4. Reflects net change in redemptions (-) of Treasury and agency securities.
5. Includes change in RPs (+), matched sale-purchase transactions (-), and matched purchase sale transactions (+).
6. The levels of agency issues were as follows:

	within 1 year	1-5	5-10	over 10	total
January 25	1.6	1.4	0.5	0.0	3.5