

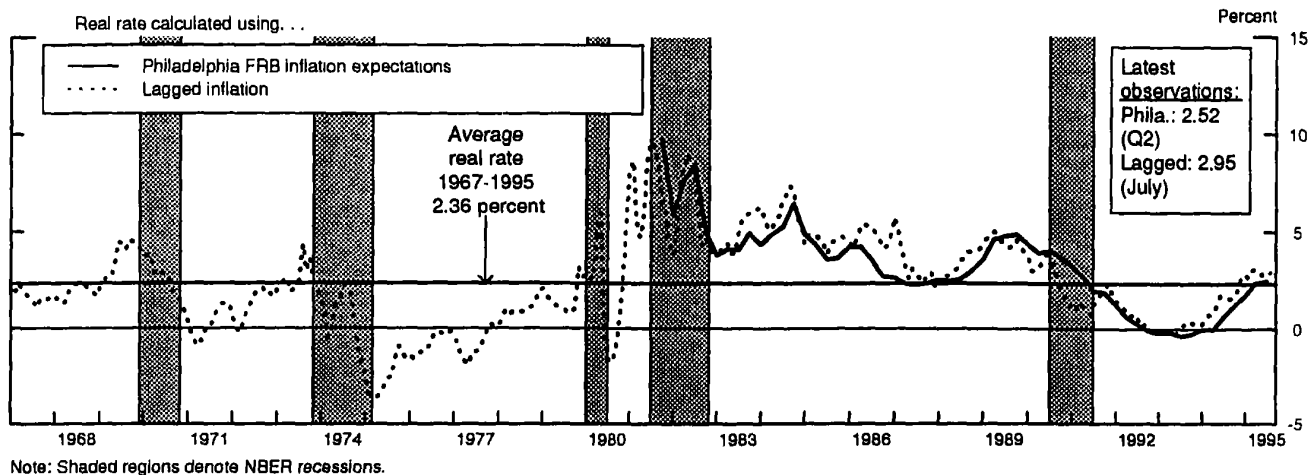
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
DIVISION OF MONETARY AFFAIRS

Date: August 23, 1995
To: Federal Open Market Committee
From: Don Kohn
Subject: Real 3-month Bill Rate

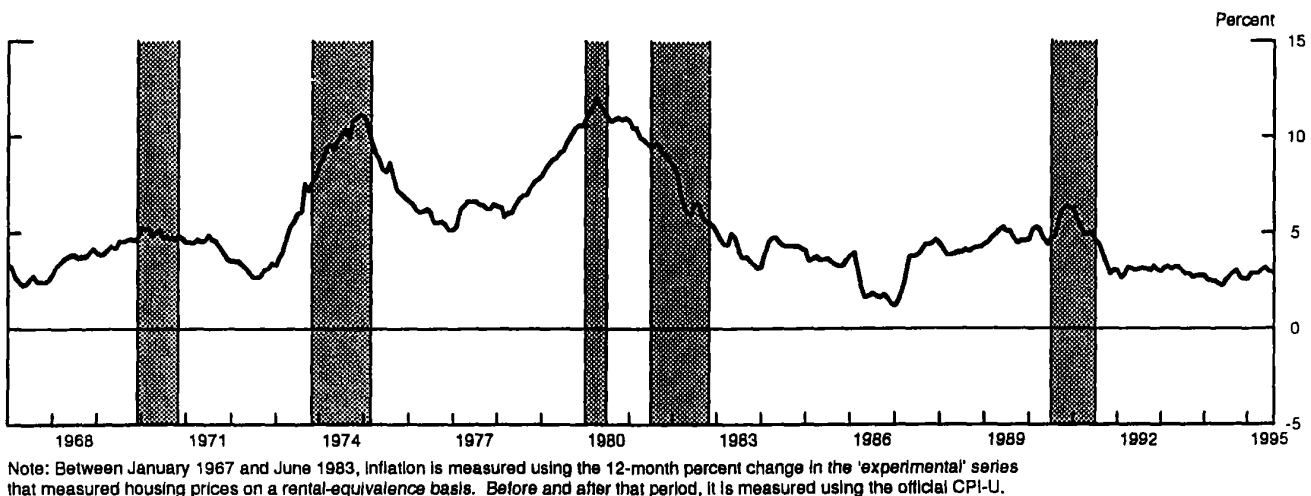
The attached charts were prepared in response to Governor Blinder's question at yesterday's Committee meeting. The first is the chart on the real federal funds rate distributed at the meeting, but including in the upper panel the most recent observations plotted. The second and third charts go through the same exercises for the 3-month bill rate--the second with the rate on a coupon-equivalent basis (the preferred method) and the third using rates on the more familiar bank discount basis.

As noted at the meeting, the bill rate averages below the funds rate, even after the former is grossed up to a coupon-equivalent basis; apparently the lower risk and more favorable state tax treatment of the Treasury bill more than outweigh any liquidity premium going from overnight to three months. In July, the real federal funds rate calculated using 12-month lagged inflation was 59 basis points above its long-run average; the Treasury bill coupon equivalent on the same basis was 77 basis points above its average. The nominal funds rate in July averaged 5.85 percent, so that on the basis of the current 5.75 percent intended funds rate, the real funds rate now would be about 50 basis points above its long-run average; the coupon equivalent bill rate this morning is right at its July level, so it would remain about 75 basis points above its long-run average.

Two Measures of the Real Federal Funds Rate



Consumer Price Inflation

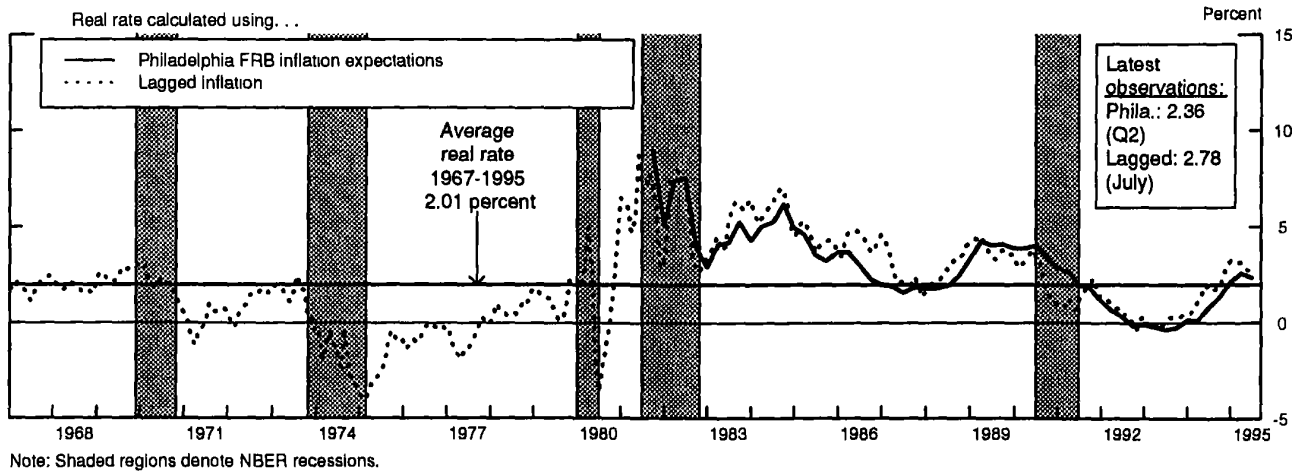


Average Real Federal Funds Rate

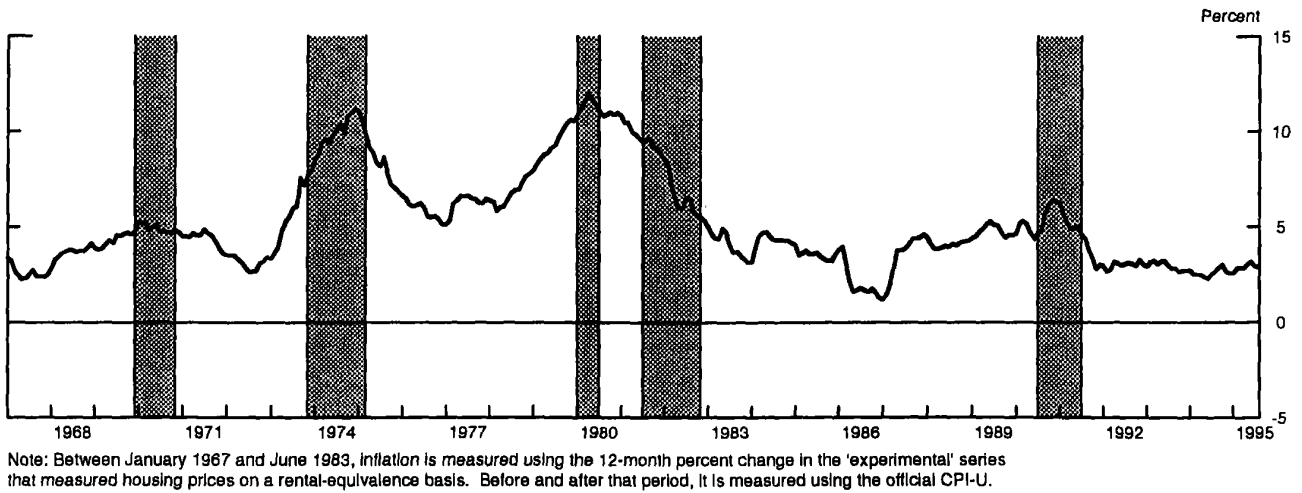
	<u>1954-95</u>	<u>1967-95</u>	<u>1954-60</u>	<u>1960-69</u>	<u>1970-79</u>	<u>1980-89</u>	<u>1990-95</u>
Average real fed funds rate (percent)	2.1	2.4	.9	2.0	.6	4.6	1.4
<i>memo:</i>							
Change in inflation over the period (percentage points)	2.6	-0.3	1.3	3.7	5.7	-6.3	-1.7

Calculated using the 3-month bill rate, coupon-equivalent yield

Two Measures of the Real Interest Rate



Consumer Price Inflation

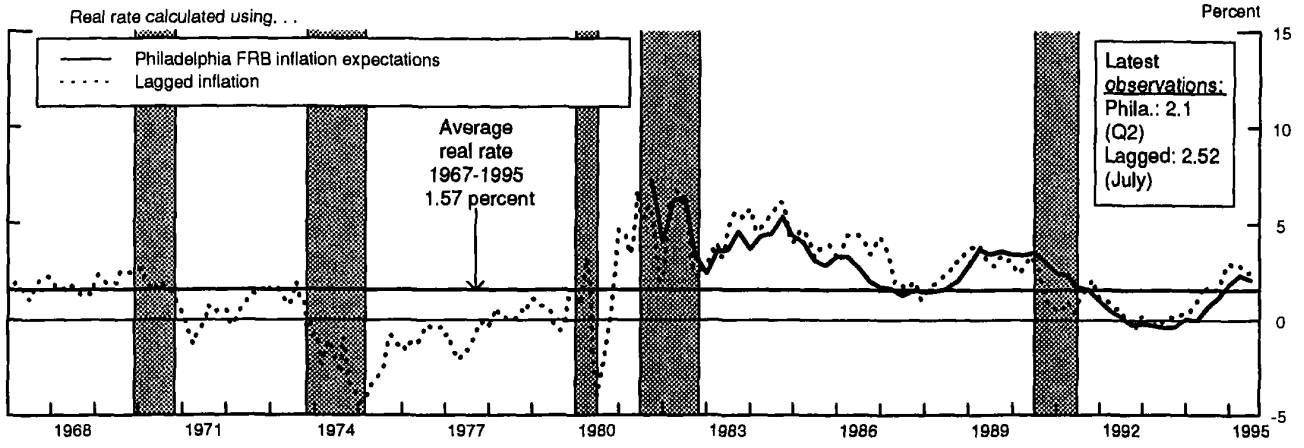


Average Real Interest Rate

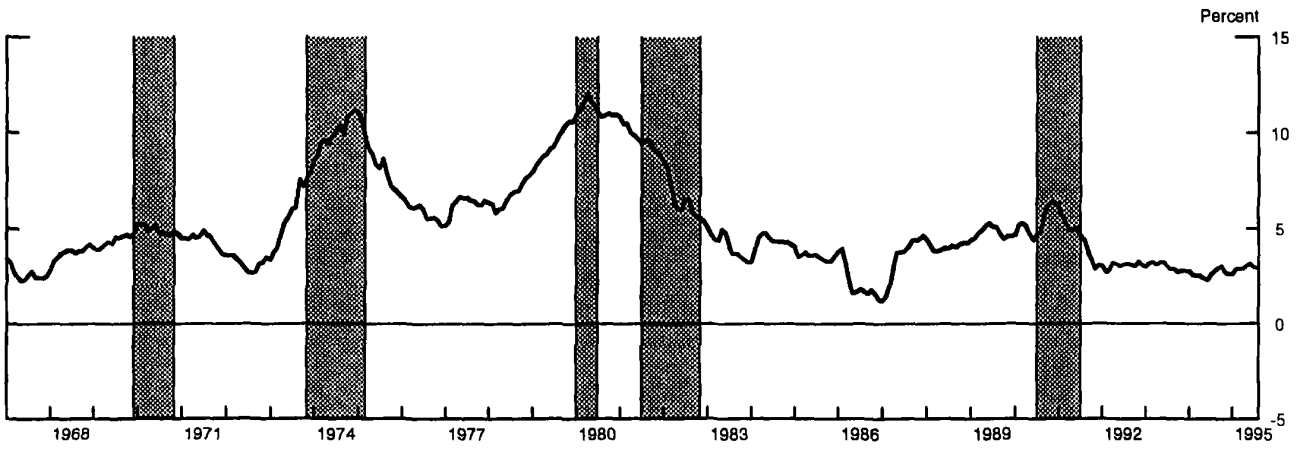
	<u>1954-95</u>	<u>1967-95</u>	<u>1954-60</u>	<u>1960-69</u>	<u>1970-79</u>	<u>1980-89</u>	<u>1990-95</u>
Average real interest rate (percent)	1.9	2.0	1.0	2.0	.1	4.2	1.4
<i>memo:</i> Change in inflation over the period (percentage points)	2.6	-0.3	1.3	3.7	5.7	-6.3	-1.7

Calculated using the 3-month bill rate, bank discount basis

Two Measures of the Real Interest Rate



Consumer Price Inflation



Average Real Interest Rate

	1954-95	1967-95	1954-60	1960-69	1970-79	1980-89	1990-95
Average real interest rate (percent)	1.5	1.6	.9	1.8	-.2	3.5	1.2
<i>memo:</i>							
Change in inflation over the period (percentage points)	2.6	-0.3	1.3	3.7	5.7	-6.3	-1.7