Prefatory Note

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Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

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[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Content last modified 5/26/2009.

Strictly Confidential (F.R.) **May 1, 2003**
Class II – FOMC

MONETARY POLICY ALTERNATIVES

Recent Developments

(1) Favorable developments regarding the war in Iraq and disappointing economic data releases produced notable crosscurrents in financial markets over the intermeeting period. The rapid military gains, as well as the associated substantial decline in oil prices, appear to have led to an unwinding of previous flight-to-quality flows and tended to brighten the economic outlook, working to boost Treasury yields and equity prices.[1] That impetus has been offset, however, by soft economic data that were read by investors as indicating that the economic upturn may be a bit more delayed than previously anticipated. On balance, the two-year Treasury yield has declined 15 basis points, but longer-dated Treasury yields are little changed since the March meeting (Chart 1). Broad equity indexes, which have also benefited from better-than-expected corporate earnings reports, have risen about 6 percent.[2] Inflation compensation implied by the spread of the nominal over the inflation-indexed ten-year Treasury yield has declined 15 basis points, probably spurred in part by the considerable drop in oil prices, although a survey-based measure of households' long-term inflation expectations has remained around 2¾ percent.

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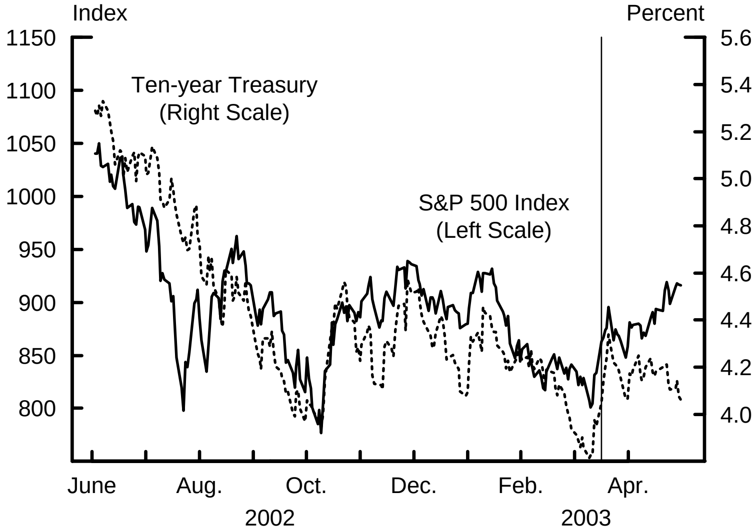
[1] See the box on page 2 on the effects of war-related news on Treasury yields.

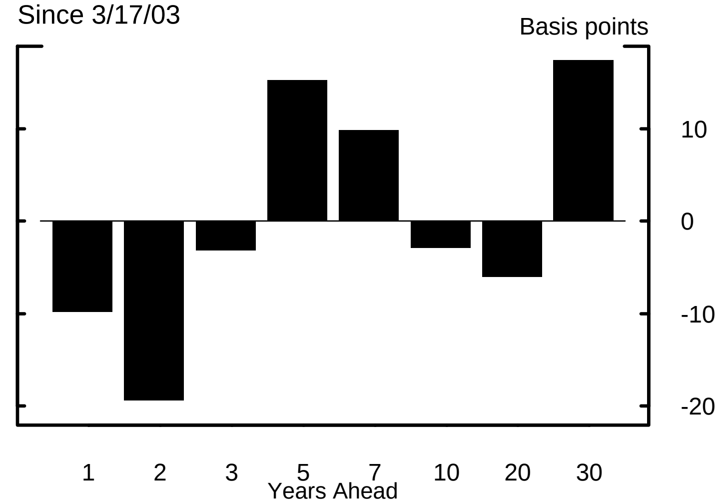
[2] These changes in Treasury yields and equity prices followed sharp increases in the run-up to the March meeting after questions about the timing of the onset of the war were largely resolved. Since March 12 (the day the previous Greenbook closed) broad equity indexes have gained about 14 percent and Treasury coupon yields have risen 6 to 24 basis points.

Chart 1
Financial Market Indicators

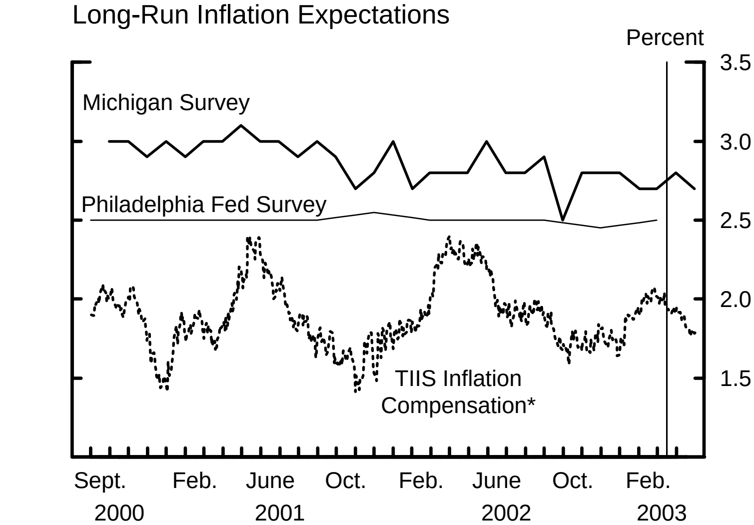
S&P 500 and the Ten-year Treasury



Change in One-Year Treasury Forward Rates Since 3/17/03

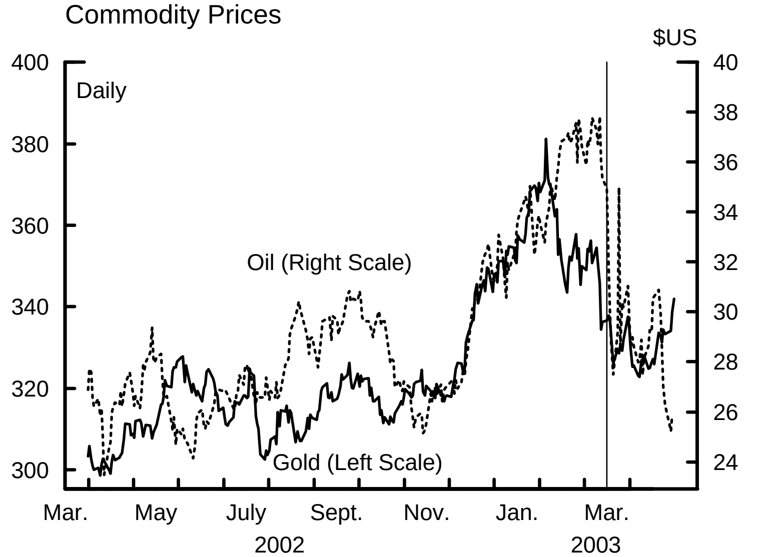


Long-Run Inflation Expectations



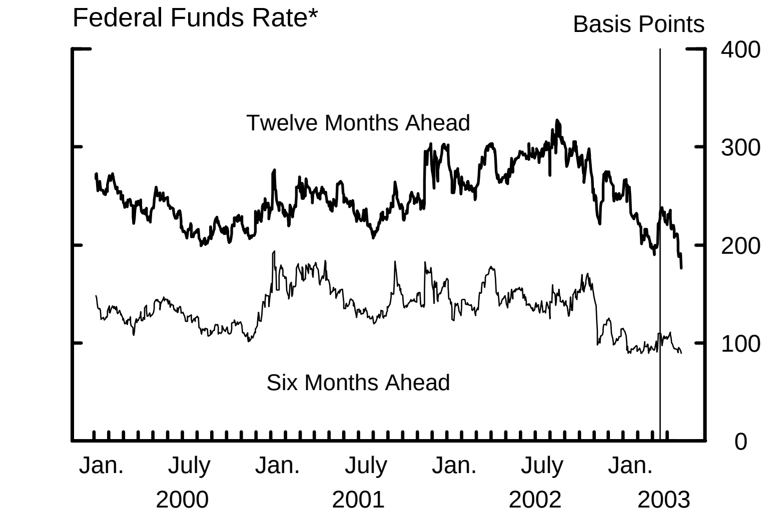
*The inflation rate that equalizes the price of the January 2012 TIIS and the value of a portfolio of nominal securities with the same payments.

Commodity Prices



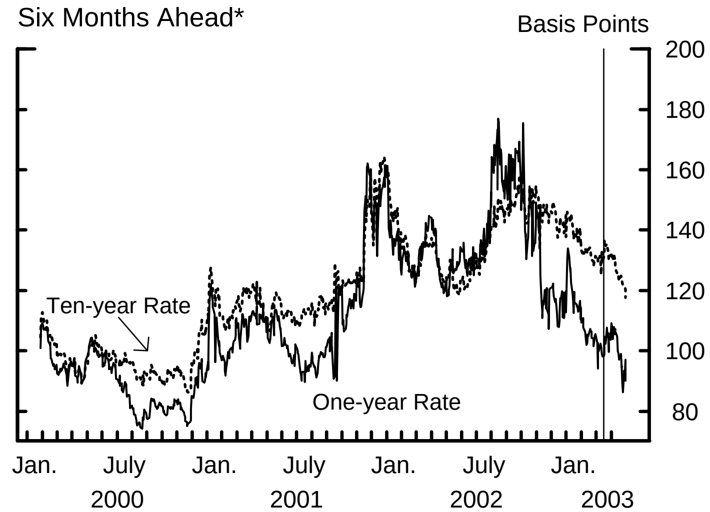
Note. Oil data are through April 30, 2003.

Market Uncertainty Regarding the Federal Funds Rate*



*Width of 90 percent confidence interval computed from futures rates and implied volatility. Data are through April 30, 2003.

Market Uncertainty Regarding Swap Rates Six Months Ahead*



*Width of 90 percent confidence interval computed from swap rates and implied volatility.

Note: Solid vertical lines indicate March 17, 2003.

The Effects of War-Related News on Treasury Yields

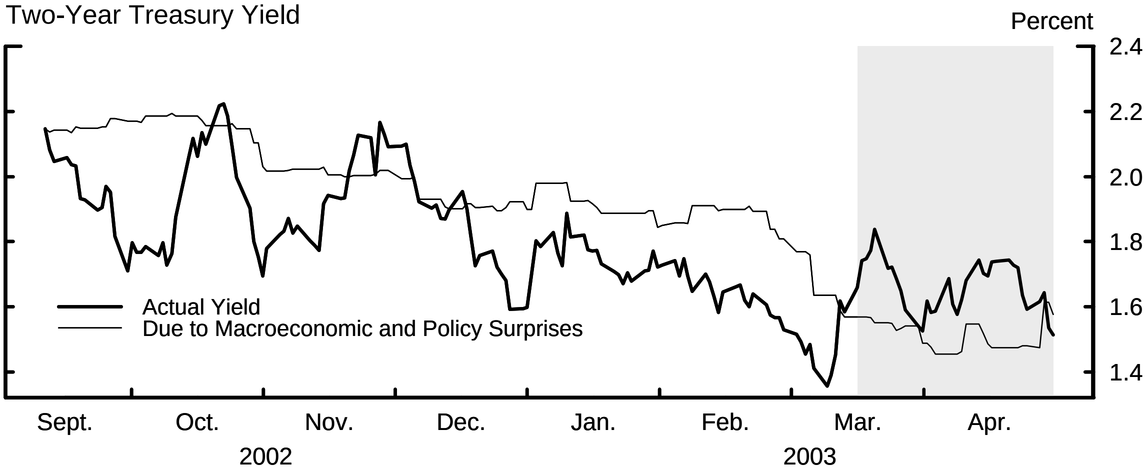
On balance, the yield on the two-year Treasury note (the thick line in the upper panel of Chart 2) has fallen 63 basis points since September 11, 2002, the day before President Bush's speech at the U.N. General Assembly that first called on the world to disarm Iraq. Financial market commentary suggests that some of the movements in the yield (and other asset prices) during this period were driven by changing views regarding the prospect for war with Iraq and, in the event, by its relatively quick resolution. Presumably, the channels of such influence on Treasury yields include effects on investors' outlook for economic activity and inflation, the attendant consequences for monetary policy, and changes in the perception of and attitude toward bearing risk.

Quantifying these effects, and the extent to which they have unwound, is complicated because other factors also have left their imprint on Treasury yields. To control for the systematic effect of macroeconomic information, daily changes in the two-year Treasury yield over the past 15 years were regressed on the surprise component of 15 data releases, where the surprises were measured using the median expectation from surveys conducted by Money Market Services. According to this regression, incoming news since the fall of last year have pulled down the two-year yield about 60 basis points (the thin line in the upper panel). The unexplained portion of the yield movements varied quite a bit over this period and, on net, left the yield little changed (the dotted line in the middle panel).

By no means is war-related news likely to account for all these unexplained movements. Indeed, before mid-December, the words "Iraq" or "war" were mentioned only occasionally in the Credit Markets column of the *Wall Street Journal* (the bottom panel). Beginning in December, however, mention of war with Iraq as an explanation of Treasury yield movements stepped up considerably. From September 11, 2002, to March 5, 2003, the nadir of most Treasury yields, the two-year note rate fell about 70 basis points, with most of that decline attributable to the unexplained component on days in which war news was prominent. Similarly, the rebound in that yield since then is mainly accounted for by influences other than the predictable responses to economic data surprises on days when financial reporters, at least, were focusing on the war, with the most dramatic move occurring in the run-up to the March 18th FOMC meeting. Over the intermeeting period itself, a diminution of war effects apparently offset some, but not all, of the drag on yields associated with mostly softer economic data.

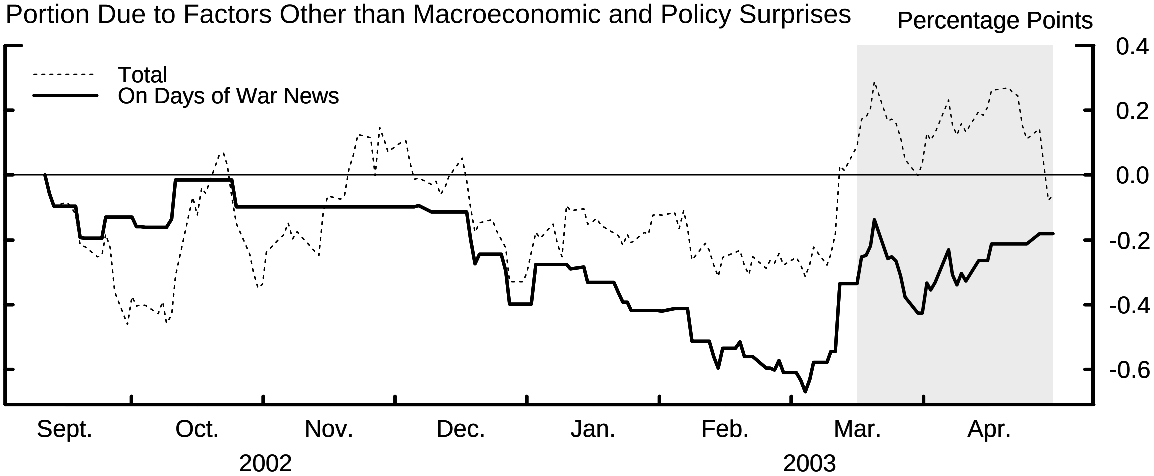
Chart 2

Two-Year Treasury Yield

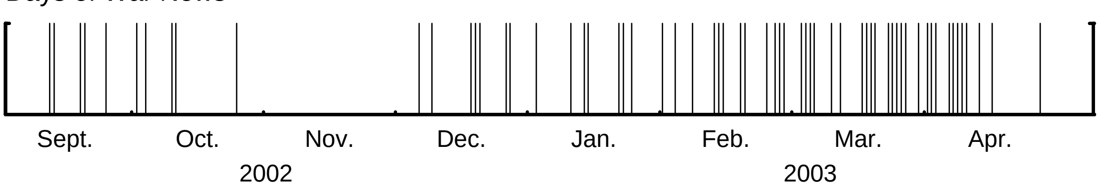


Note: The portion due to macroeconomic and policy surprises is indexed to equal the actual yield on 9/11/02.

Portion Due to Factors Other than Macroeconomic and Policy Surprises



Days of War News*



*Days on which "war" or "Iraq" was mentioned in Wall Street Journal Credit Markets column.

(2) The abatement of war-related risks has been reflected in sizable declines in forward-looking measures of uncertainty in short- and long-term interest rates, exchange rates, and oil and equity prices (Charts 1 and 3). Risk spreads on corporate debt securities have narrowed across the credit quality spectrum–probably pulled down also in part by expectations of improved default and recovery rates–and flows into high-yield bond mutual funds have been substantial. The spread between the forward earnings-price ratio and the real longer-term Treasury yield, a measure of the equity premium, has narrowed only slightly, but there have been sizable flows into equity mutual funds of late.

(3) The decision to leave policy on hold at the March meeting was mostly anticipated by market participants, and interest rates edged higher on the afternoon of the announcement.[3] The FOMC's decision not to characterize the balance of risks and to mention "heightened surveillance" in the announcement was apparently read as indicating that the Committee was poised to react quickly to evolving economic news and global events, elevating market participants' expectation of the possibility of an intermeeting action. Indeed, at one point in late March, futures prices suggested a significant chance of an ease sometime before May 6th. As time passed and the speed and extent of military success in Iraq became evident, such expectations unwound. On net, the term structure of money market futures rates has rotated since the March meeting, with the expected path for the target federal funds rate revised upward through the summer but downward thereafter in light of the downbeat economic news. The current configuration of futures rates suggests that market participants

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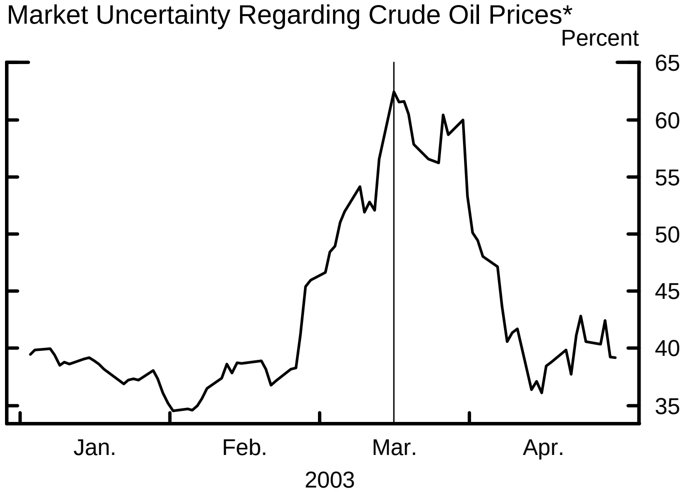
[3] Over the intermeeting period, the federal funds rate averaged close to its 1¼ percent target. The Desk has purchased $7.6 billion of Treasury securities in outright operations: $5.3 billion of Treasury coupon securities and bills in the market and $2.3 billion of bills from foreign official institutions. The outstanding volume of long-term System RPs was unchanged, on net, at $16 billion.

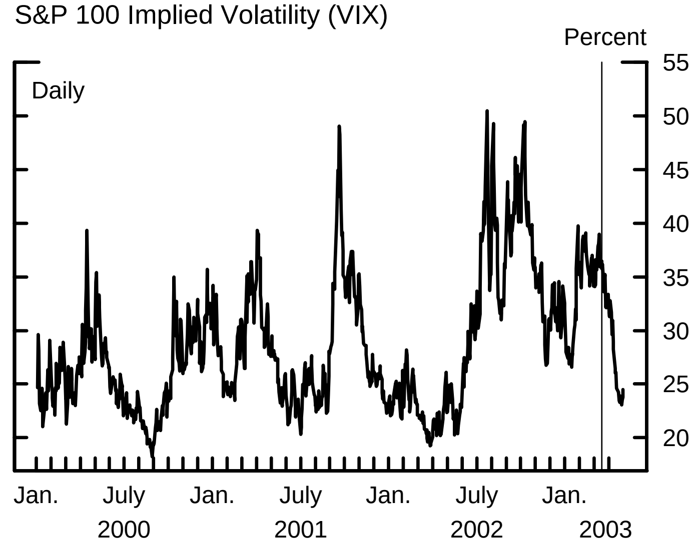
Chart 3
Financial Market Indicators

Market Uncertainty Regarding Crude Oil Prices*

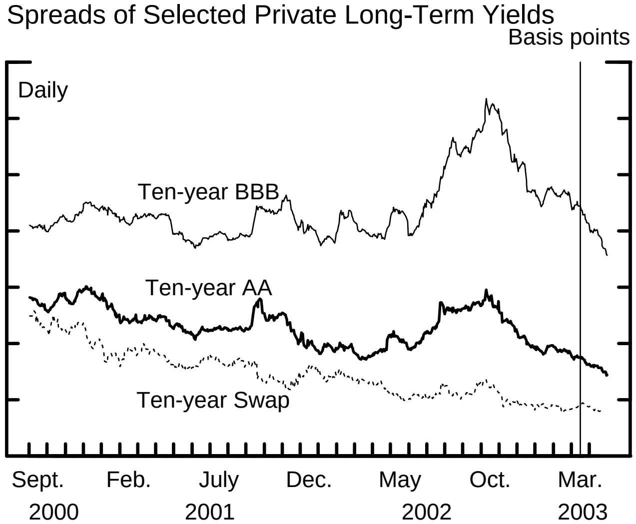


*Implied by options on West Texas Intermediate Crude Oil futures contracts expiring in June 2003.

S&P 100 Implied Volatility (VIX)

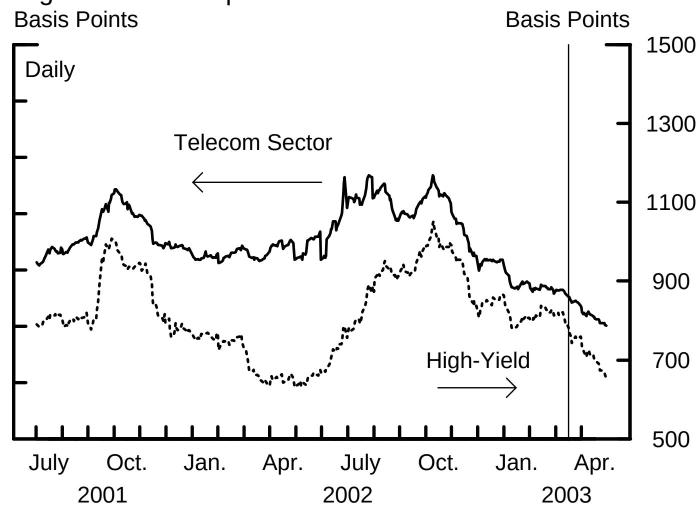


Spreads of Selected Private Long-Term Yields



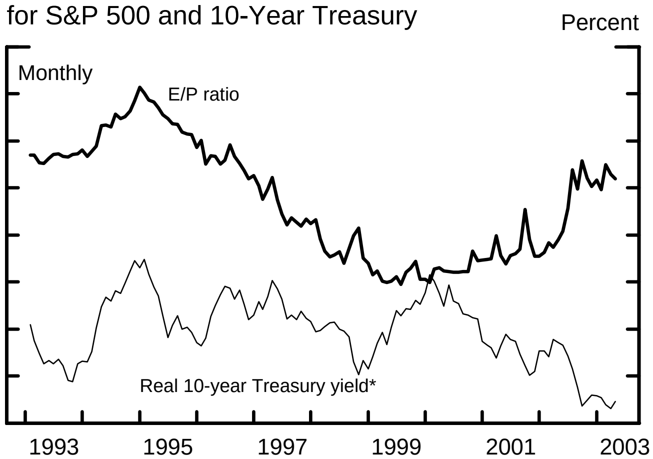
Note: Spreads measured over ten-year Treasury.

High-Yield Debt Spreads



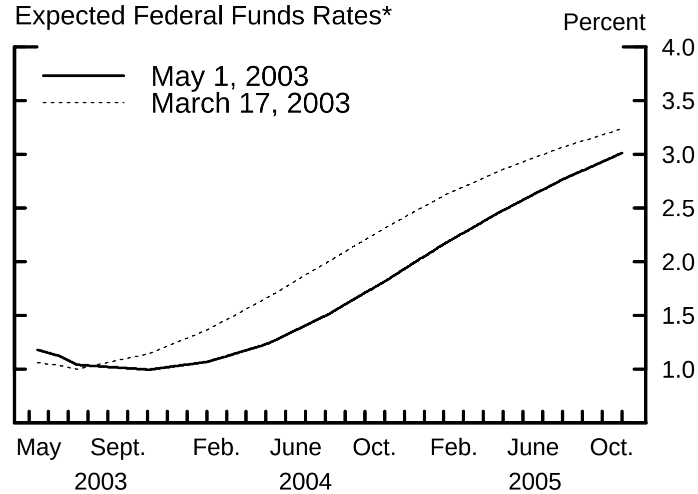
Note: Spreads measured over five-year Treasury. Telecom shown through April 30. Source: Merrill Lynch.

12-Month Forward Earnings-Price Ratio
for S&P 500 and 10-Year Treasury



* 10-year Treasury yield minus Philadelphia Fed 10-year expected inflation.

Expected Federal Funds Rates*



*Estimates from federal funds and eurodollar futures

Note: Solid vertical lines indicate March 17, 2003.

now place about one-in-three odds on a 25-basis-point cut in the target federal funds rate at the upcoming meeting and that the expected amount of policy tightening by the end of next year has been trimmed about 50 basis points, placing the expected funds rate then at about 1¾ percent.

(4) After recording a sharp rise in the days just before the March FOMC meeting in anticipation of the start of military operations in Iraq, the dollar fluctuated widely during the first half of the intermeeting period, driven largely by news from the battlefield and other global trouble spots (Chart 4). Following the capture of Baghdad in early April, the dollar came under downward pressure that has intensified in recent days. On balance, the dollar has lost about 3¾ percent against an index of major foreign currencies since the March FOMC meeting.[4] The dollar fell particularly steeply—about 5¾ percent—against the euro, but it also declined 4½ percent versus the Canadian dollar. The Bank of Canada raised its overnight interest rate 25 basis points on April 15, citing inflationary pressures, although it also acknowledged the possibility of some near-term weakness in the economy. Much as was the case in U.S. markets, stock prices in most major foreign markets benefited from the reduction of geopolitical uncertainty and from some better-than-anticipated earnings reports, while yields on most foreign long-term government securities rose slightly. In Japan, by contrast, the ten-year government bond yield slumped to a record low of 57 basis points, stock prices moved essentially sideways, and the yen was unchanged against the dollar over the period.

(5) Since the March FOMC meeting, the dollar has depreciated 2¾ percent against the currencies of our other important trading partners. The

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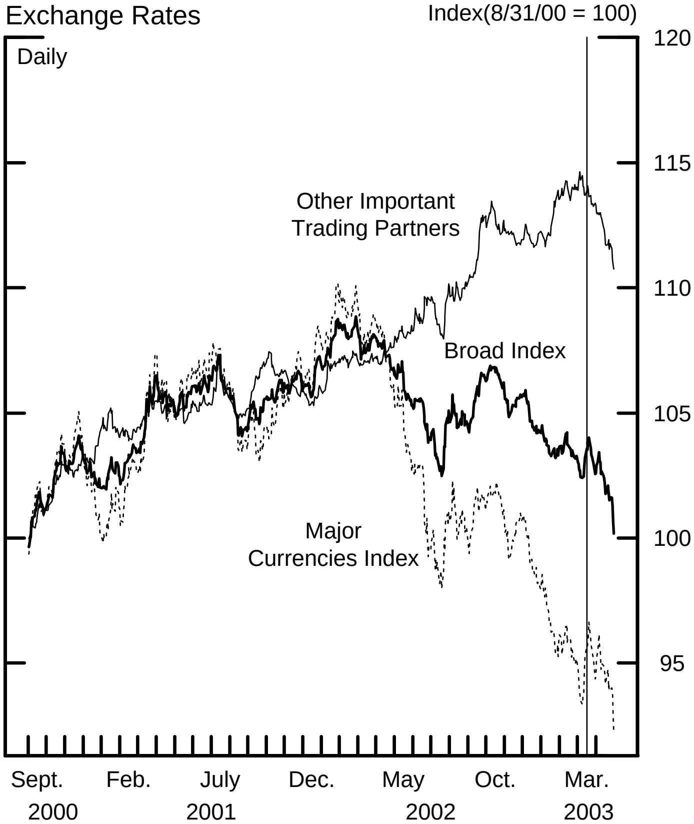
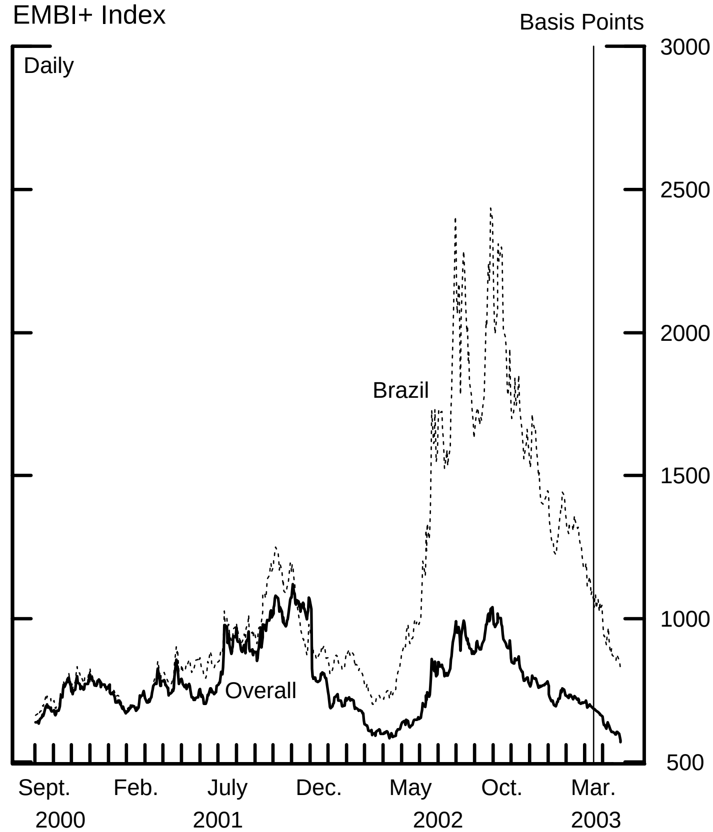
[4] . The Desk did not intervene during the period for the account of the System or Treasury.

Chart 4
Financial Market Indicators

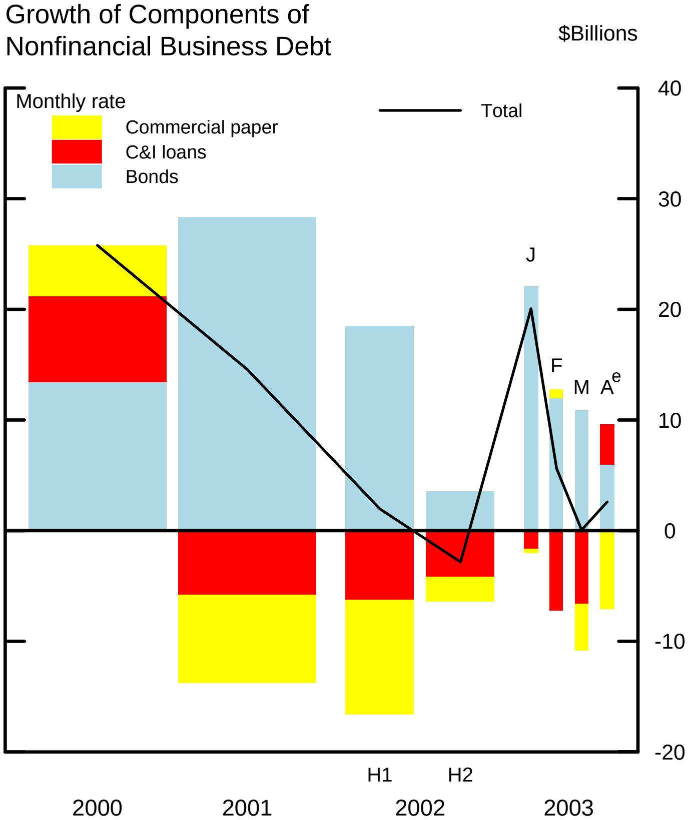
Nominal Trade-Weighted Dollar Exchange Rates



EMBI+ Index



Growth of Components of Nonfinancial Business Debt



Net New Cash Inflows to Mutual Funds
($ billions, at monthly rates, NSA)

	Equity Funds	Bond Funds: Govt.	Bond Funds: Other	Memo: Money Funds*
2001	2.8	2.3	4.0	37.7
2002	-2.2	5.0	5.4	-1.6
2002 Q3	-23.9	10.9	6.1	-12.6
2002 Q4	-3.0	2.6	4.9	30.8
2003 Jan.	-0.4	4.1	8.7	19.9
2003 Feb.	-11.1	6.0	11.9	-32.8
2003 Mar.	0.2	2.0	8.8	-35.3
2003 Apr.[e]	17.5	0.7	12.2	-81.9

* Net change. April number is actual.
e = estimate.

Note: Solid vertical lines indicate March 17, 2003.

Mexican peso gained about 6 percent as the Bank of Mexico tightened policy again near the end of March. Favorable developments in Brazil, including an announcement that the primary budget surplus in 2002 exceeded its target and some progress on fiscal and pension reform, buoyed financial markets there. Extending recent trends, the *real* appreciated almost 17 percent, Brazilian stocks moved up 15 percent, and Brazil's EMBI+ spread narrowed 230 basis points. Markets in some Asian countries were buffeted noticeably by news about the SARS epidemic and menacing rhetoric from North Korea. The most visible market reaction to SARS was in Hong Kong, where stock prices declined sharply midway through the period but recouped much of that loss in recent days. For a time, Korean markets were supported by building optimism that diplomatic progress would be made on the impasse with North Korea, but those gains were knocked back somewhat when such hopes waned in recent days.

(6) Despite improvements in market conditions, domestic business demands for credit have remained sluggish in recent months, owing importantly to a continuing narrow gap between capital expenditures and internal sources of funds. Gross issuance of corporate bonds slowed somewhat in the past couple of months from its relatively robust pace earlier in the year, and borrowers continued to use much of the proceeds to pay down other debt, especially commercial paper and C&I loans. Indeed, according to responses to the April Senior Loan Officer Opinion Survey, demand for C&I loans has weakened further over the past three months. However, a notably smaller net percentage of banks reported tightening loan terms and standards than in recent surveys. Household debt is estimated to have grown 9½ percent in the first quarter, only a touch below the average pace in 2002, propelled by continued rapid growth of mortgage debt that has been fueled by record levels of refinancing activity. Consumer credit expanded moderately in the first quarter, at about the same

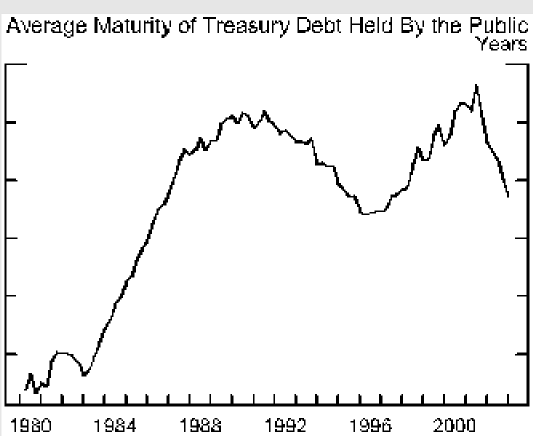
rate as last year, but consumer loans at banks are estimated to have weakened in April. Facing growing financing needs, the Treasury announced yesterday additional changes to its auction schedule. (See the box on the next page on Treasury debt management developments.)

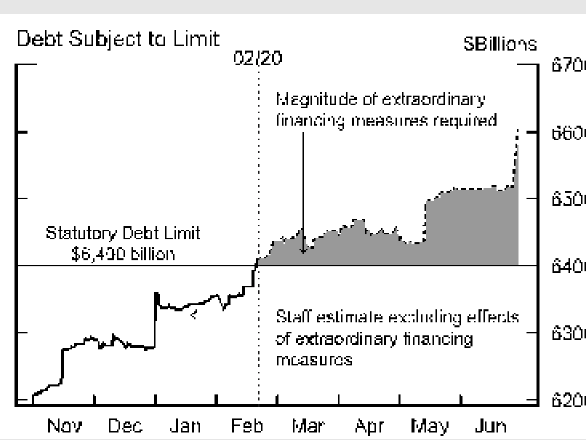
(7) M2 growth slowed over March and April, but most of the deceleration appeared to be attributable to tax-related factors. A shift toward earlier electronic filing pushed refund distributions into February, thereby weakening the level of M2 in March. In addition, final tax payments by individuals in April ran below the average of recent years, and the resulting buildup of deposits in anticipation of tax payments was lower than what was incorporated in seasonal factors. M2 growth may also have been held down somewhat in recent months by substantial net flows to capital market mutual funds. In the first quarter, M2 velocity continued to fall roughly in line with movements in opportunity costs.

Treasury Debt Management Developments

The average maturity of Treasury debt held by the public has been falling since late 2001, nearly reversing an uptrend that had started in the mid-1990s. This decline is partly attributable to the expectation of Treasury debt managers that the surge in federal borrowing in late 2001 and early 2002 would be short-lived and thus better accommodated through increased offerings of short-term securities. As deficits have apparently become more persistent, the Treasury has announced measures to increase its borrowing capacity in longer-dated securities in recent quarterly refunding statements. For instance, quarterly auctions of three-year notes will be reintroduced next week with the primary purpose of allowing the Treasury to reduce its borrowing in bills and two-year notes. In addition, the Treasury announced at yesterday's quarterly refunding press conference that, starting in August, it will issue five-year notes on a monthly basis, introduce regular reopenings of the ten-year note (to take place about a month after each refunding auction) and increase the number of ten-year indexed note auctions from three to four times a year. In total, the Treasury will sell $58 billion of notes at the upcoming quarterly refunding auctions—the largest refunding offering since 1996.

Given that the Congress has not yet taken action to raise the Treasury's statutory borrowing limit of $6.4 trillion, the Treasury has been engaging in extraordinary measures to keep its statutory debt under the limit and avoid any disruptions to the May refunding auctions. On April 4, the Treasury invoked its authority to suspend issuing debt to the Civil Service Retirement and Disability Fund until July 11, 2003. In addition, the Treasury has been underinvesting two other trust funds: the Thrift Savings Plan of Federal Retirement Thrift Investment Board (the "G-fund") and the Exchange Stabilization Fund. Yesterday, the Treasury indicated that these measures will allow it to stay within its statutory debt limit only until the second half of May.





Policy Alternatives

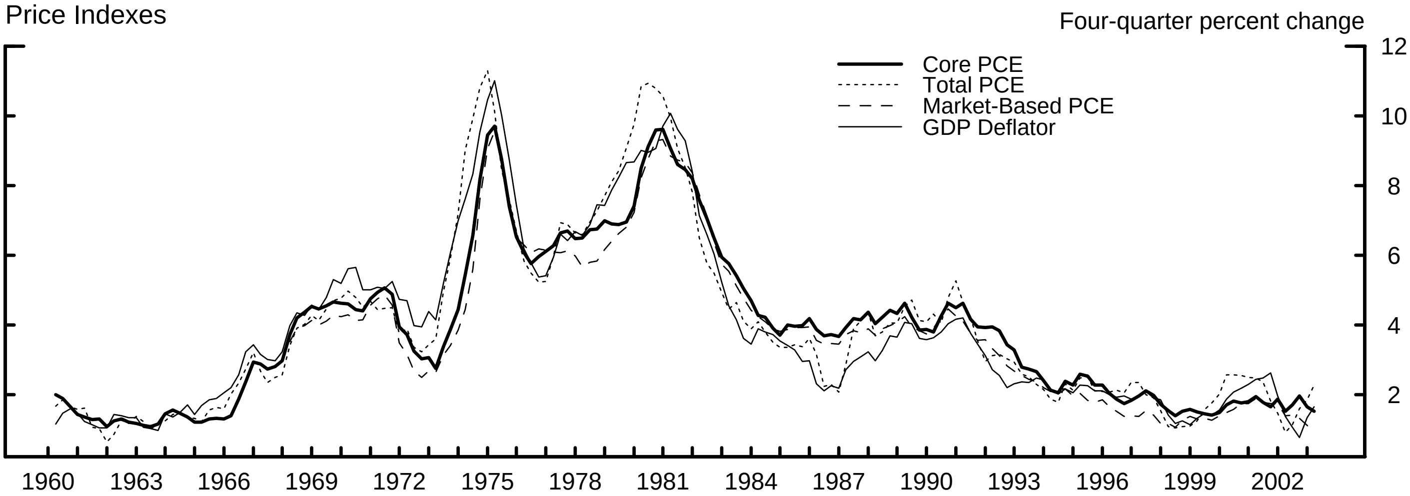
(8) The contours of the staff outlook for this meeting are generally similar to those in the previous few projections in that near-term sluggishness in economic growth is anticipated to give way to more vigorous expansion over the balance of the forecast period. This time round, projected growth in economic activity is a bit weaker in the near term in light of generally disappointing economic data released in the past seven weeks and slightly stronger next year, given a higher track for wealth and more fiscal stimulus than anticipated in March. The projection is again premised on the assumption that the FOMC keeps the target federal funds rate flat at 1¼ percent through the end of next year. While yields on longer-term Treasuries are expected to edge up slightly over the next few quarters, those on lower-tier investment-grade and speculative-grade securities fall further as the expansion gains firmer footing. Equity prices again are anticipated to rise steadily, but from a base that is considerably higher than in the March Greenbook. These financial conditions are projected to spur business investment, which, together with a bit larger and more front-loaded fiscal stimulus than assumed in the March Greenbook, contributes to a gradual acceleration in overall activity, with real GDP growth reaching 4¾ percent over next year. Still, with productivity rising briskly, the unemployment rate edges up over the next several quarters, peaking just above 6 percent before beginning to slip lower in the second quarter of next year. Reflecting the persistent slack in product and labor markets, core consumer price inflation is expected to continue to edge down, but along a slightly lower trajectory that reflects the surprisingly subdued price data of late. In this quarter and next, declines in energy prices are projected to pull the rate of overall PCE inflation down to ½ percent. Over 2004, both total and core inflation average 1 percent.

(9) Should the Committee believe the staff forecast likely and be attracted to the projected combination of accelerating output and some further decline in inflation, it might wish to **leave the stance of policy unchanged** at this meeting. The projected pickup in the growth of activity, albeit gradual, does suggest that maintaining the current stance of policy would be consistent with a narrowing of the output gap by the end of next year. Indeed, the Committee might anticipate that economic slack will be worked down more quickly, and downward pressures on inflation diminished correspondingly sooner, than in the Greenbook. In particular, the Committee might see substantial odds that aggregate demand will grow more vigorously than portrayed in the Greenbook. With the war concluded, business confidence could rebound sharply and, combined with the improvement in consumer sentiment and financial market conditions already seen, prove more supportive of growth than projected by the staff. In addition, the forthcoming degree of fiscal stimulus, which currently is being debated in the Congress, could well turn out to be greater than assumed in the Greenbook. Even if the Committee expects aggregate demand growth about in line with that of the staff forecast, it might still expect the output gap to shrink more quickly if it is less optimistic about productivity growth. If so, the Committee may regard the further disinflation projected by the staff as less likely, despite the recent subdued price data, a view that might be reinforced by the observation that core PCE inflation shows no discernable trend over the past few years and other readings on inflation show mixed changes (Chart 5).

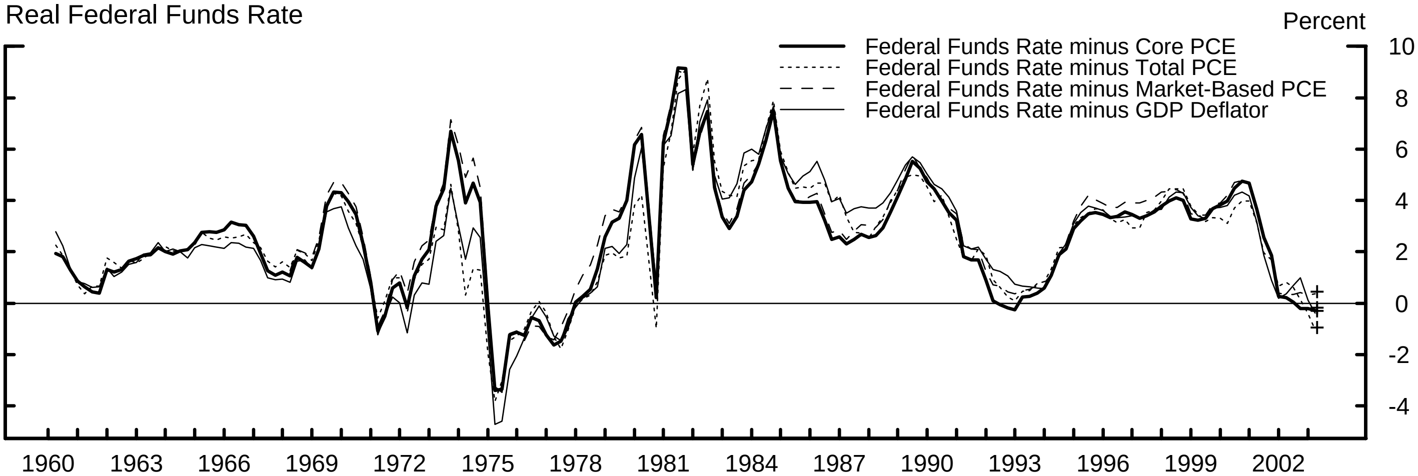
(10) If the Committee instead found the Greenbook projection of only sluggish progress in closing the output gap over the next six quarters with a PCE inflation rate of 1 percent at the end of the projection period to be credible but undesirable, it might choose to **ease monetary policy** at this meeting. In particular, concerns about a protracted output gap may be especially pressing in the current

Chart 5
Inflation and Real Federal Funds Rates

Price Indexes



Real Federal Funds Rate



Federal funds rate minus four-quarter inflation rate.

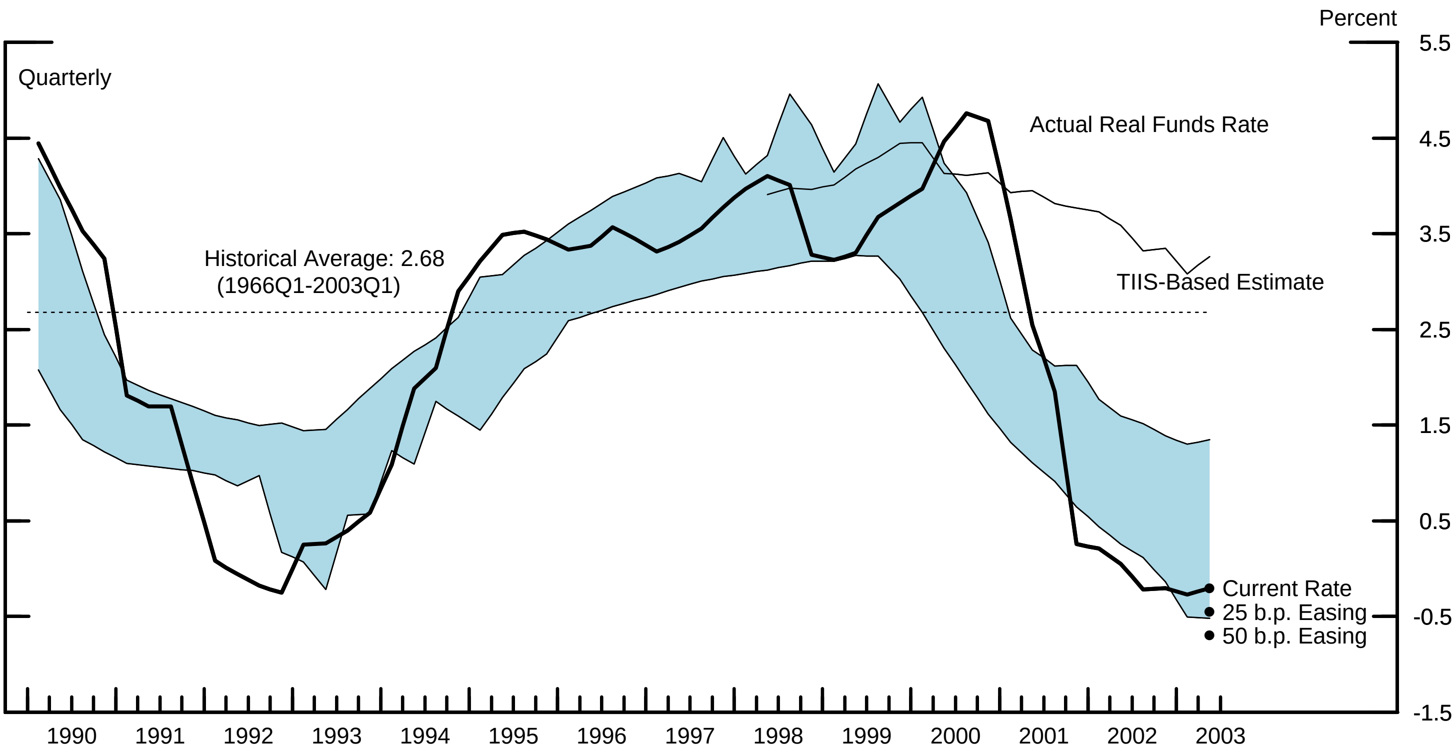
	Average[1] 1960 - present	Most Recent[2]
Inflation		
Core PCE	3.83	1.52
Total PCE	3.90	2.28
Market-based PCE	4.04	0.89
GDP Deflator	3.86	1.64
Real Federal Funds Rate		
Core PCE	2.55	-0.27
Total PCE	2.48	-1.03
Market-based PCE	3.00	0.36
GDP Deflator	2.53	-0.39

1. 1968 - present for market-based PCE.
2. Based on four-quarter averages.

circumstances of surprisingly low inflation. Indeed, as shown in Chart 6, the real short-term federal funds rate does not differ much from the level prevailing before the Committee's November 6th policy easing. Cutting the nominal funds rate at this meeting may be appropriate to reestablish the previously sought spread of the actual real funds rate below its estimated equilibrium. Going forward, a further decline in inflation from its already low level, by limiting the scope for reductions in short-term interest rates, could inordinately constrain the ability of monetary policy to provide stimulus in response to an adverse shock to spending at some later date. Even if the Committee saw the risks surrounding the projected paths of aggregate demand and inflation in the Greenbook as symmetric, it might view the costs of falling unexpectedly short of either of those paths in coming quarters as larger than the costs of an overage. In that case, the regret associated with easing policy and subsequently discovering that it was unnecessary would presumably be small relative to that of holding the funds rate at 1¼ percent and eventually learning that a lower level would have been appropriate.

(11) The evident reduction in "Knightian uncertainty" in recent weeks may incline the Committee to return to its practice of announcing an assessment of the balance of risks. If so, and if it elects to leave the stance of policy unchanged, an outlook in which resource slack remains substantial and inflation declines slightly over the next several quarters, such as in the Greenbook, might suggest that the balance of risks is weighted toward economic weakness for the foreseeable future. However, if the Committee either were to interpret the "foreseeable future" as referring to a period extending beyond the next few quarters or were to judge aggregate demand as likely to be notably stronger or aggregate supply weaker than in the Greenbook, then it might characterize the risks to its objectives as balanced. The appropriate balance of risks following an easing move would depend partly on the Committee's economic

Chart 6
Actual Real Federal Funds Rate and Range of Estimated Equilibrium Real Rates



Note: The shaded range represents the maximum and the minimum values each quarter of four estimates of the equilibrium real federal funds rate based on a statistical filter and the FRB/US model. Real federal funds rates employ a four-quarter moving average of core PCE inflation as a proxy for inflation expectations, with the staff projection used for 2003Q2.

Equilibrium Real Funds Rate Estimates (Percent)

	2001	2002	2003Q1	2003Q2
Statistical Filter				
- Two-sided:				
Based on historical data and the staff forecast	1.0	0.2	0.1	0.2
March Bluebook	*1.0*	*0.3*	*0.2*	--
- One-sided:				
Based on historical data*	2.2	0.6	-0.5	-0.5
March Bluebook	*2.2*	*0.7*	*-0.3*	--
FRB/US Model				
- Two-sided:				
Based on historical data and the staff forecast	2.2	1.6	1.3	1.3
March Bluebook	*2.2*	*1.5*	*1.2*	--
- One-sided:				
Based on historical data**	2.0	0.9	0.1	0.1
March Bluebook	*2.1*	*0.9*	*0.2*	--
Treasury Inflation-Indexed Securities	3.9	3.5	3.1	3.3
March Bluebook	*3.9*	*3.5*	*3.1*	--

* Also employs the staff projection for the current and next quarters.

** Also employs the staff projection for the current quarter.

outlook and perhaps partly on the forcefulness of its action. Particularly if members' basic outlook was more pessimistic than that of the Greenbook or the cost of a downside surprise to that outlook loomed especially large, the risks might be viewed as weighted toward economic weakness—especially if the easing action was limited to 25 basis points. A 25-basis-point easing coupled with a more sanguine outlook for the economy, however, or a 50-basis-point action, by providing appreciably more stimulus, arguably could equalize the risks, especially if the "foreseeable future" was interpreted as extending well into next year.

(12) Financial markets have incorporated a one-in-three chance of a policy easing at this meeting. As to the balance-of-risks statement, one-half of the respondents to a recent survey of primary dealers expected the FOMC to adopt a neutral assessment, but the other half were about evenly split between expecting one tilted toward weakness and a deferral of any assessment. If this reflects broader market thinking, a decision to leave the stance of monetary policy unchanged and to issue a neutral balance-of-risks statement would likely elicit only a modest backup in yields on money market instruments and have little effect on bond yields, equity prices, and the foreign exchange value of the dollar. However, a statement that the balance of risks was tilted toward economic weakness, coupled with an unchanged stance of policy, would prompt investors to reexamine their own forecasts and would probably lead to a decline in interest rates across the yield curve, especially at intermediate maturities, and a depreciation of the dollar. In view of the countervailing effects of lower interest rates and the chance of a weaker earnings outcome implicit in such a statement of risks, the response of equity prices is more difficult to judge, but some decline cannot be ruled out. An easing of policy would come as some surprise to financial markets, and short-term yields would fall substantially. Bond yields likely would drop as well, and equity prices should increase. A judgment that the risks were

weighted toward weakness likely would give pause to equity investors, while a neutral balance of risks and a generally optimistic statement that stressed an "insurance" motive for the action would be more likely to fuel a stock market rally.

(13) Under the Greenbook projections of income and interest rates, domestic nonfinancial sector debt is expected to expand about 7 percent this year, close to last year's pace and distinctly above the rate of expansion of nominal GDP. This relatively rapid growth primarily reflects federal debt, which at 10 percent this year expands a bit faster than forecasted in the March Greenbook because of wider projected budget deficits. Business sector debt is forecast to accelerate gradually to finance a widening financing gap, but debt growth in this sector still is only 4¼ percent in 2003. While business borrowing is expected to remain concentrated in bond and mortgage markets, the acceleration is accounted for entirely by a sizable swing from runoffs to increases in shorter-term debt such as bank loans and commercial paper. Household sector debt growth should slow somewhat as stimulus from previous declines in mortgage rates tapers off and increases in home prices moderate further. Still, households are expected to continue to rely mainly on mortgage debt over the balance of this year. M2 is projected to grow 6 percent this year, down from last year's 7 percent advance. With that performance, the velocity of that aggregate would decline, but a little less rapidly than in 2002 as the effects of past monetary policy easings begin to ebb.

Alternative Growth Rates for M2

		Ease 50 bp	Ease 25 bp	No change	Greenbook Forecast*
Monthly Growth Rates					
	Oct-02	8.3	8.3	8.3	8.3
	Nov-02	8.1	8.1	8.1	8.1
	Dec-02	3.2	3.2	3.2	3.2
	Jan-03	6.4	6.4	6.4	6.4
	Feb-03	11.6	11.6	11.6	11.6
	Mar-03	3.1	3.1	3.1	3.1
	Apr-03	3.4	3.4	3.4	3.4
	May-03	13.3	13.1	12.9	12.9
	Jun-03	7.2	6.6	6.0	6.0
	Jul-03	6.6	5.8	5.0	5.0
	Aug-03	6.5	5.8	5.0	5.0
	Sep-03	5.7	5.1	4.5	4.5
Quarterly Growth Rates					
	2002 Q4	7.1	7.1	7.1	7.1
	2003 Q1	6.7	6.7	6.7	6.7
	2003 Q2	6.9	6.8	6.7	6.7
	2003 Q3	7.4	6.7	6.1	6.1
Annual Growth Rates					
	2002	6.9	6.9	6.9	6.9
	2003	6.7	6.4	6.1	6.1
	Growth Rates				
From	**To**				
2002 Q4	Apr-03	5.9	5.9	5.9	5.9
2002 Q4	May-03	7.2	7.2	7.1	7.1
2002 Q4	Sep-03	7.0	6.7	6.4	6.4
Dec-02	Sep-03	7.2	6.9	6.6	6.6
Apr-03	Sep-03	8.0	7.4	6.8	6.8
May-03	Sep-03	6.6	5.9	5.2	5.2

* This forecast is consistent with nominal GDP and interest rates in the Greenbook forecast.

Directive and Balance-of-Risks Language

(14) Presented below for the members' consideration is draft wording for (1) the directive and (2) the "balance of risks" sentence that the Committee may want to include in the press release issued after the meeting (not part of the directive).

(1) Directive Wording

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining/INCREASING/REDUCING the federal funds rate at/TO an average of around ___~~1-1/4~~ percent.

(2) "Balance of Risks" Sentence

(*Not adopted at March meeting*)

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks [ARE WEIGHTED MAINLY TOWARD CONDITIONS THAT MAY GENERATE ECONOMIC WEAKNESS] [ARE BALANCED WITH RESPECT TO PROSPECTS FOR BOTH GOALS] [ARE WEIGHTED MAINLY TOWARD CONDITIONS THAT MAY GENERATE HEIGHTENED INFLATION PRESSURES] in the foreseeable future.

SELECTED INTEREST RATES
(percent)

	Short-term						Long-term									
	Federal funds	Treasury bills secondary market			CDs secondary market	Comm. paper	Off-the-run Treasury yields				Indexed yields		Moody's Baa	Municipal Bond Buyer	Conventional home mortgages primary market	
		4-week	3-month	6-month	3-month	1-month	2-year	5-year	10-year	30-year	5-year	10-year			Fixed-rate	ARM
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
02 -- High	1.80	1.80	1.85	2.12	1.97	1.79	3.69	4.94	5.69	6.00	3.31	3.54	8.18	5.67	7.18	5.26
-- Low	1.23	1.13	1.18	1.26	1.34	1.28	1.69	2.79	4.01	4.91	1.62	2.17	7.37	5.02	5.93	4.01
03 -- High	1.28	1.23	1.22	1.25	1.31	1.28	1.80	3.13	4.36	5.20	1.77	2.38	7.44	5.20	5.97	4.06
-- Low	1.20	1.12	1.11	1.09	1.18	1.19	1.47	2.63	3.88	4.85	0.82	1.69	6.79	5.06	5.61	3.68
Monthly																
May 02	1.75	1.74	1.76	1.91	1.82	1.75	3.24	4.54	5.40	5.82	2.50	3.10	8.09	5.54	6.81	4.79
Jun 02	1.75	1.71	1.73	1.83	1.81	1.74	2.97	4.24	5.16	5.71	2.46	3.08	7.95	5.44	6.65	4.65
Jul 02	1.73	1.72	1.71	1.74	1.79	1.74	2.52	3.86	4.90	5.60	2.39	2.92	7.90	5.34	6.49	4.51
Aug 02	1.74	1.68	1.65	1.64	1.73	1.72	2.12	3.37	4.54	5.27	2.11	2.51	7.58	5.30	6.29	4.38
Sep 02	1.75	1.67	1.66	1.64	1.76	1.73	1.98	3.01	4.16	4.97	1.80	2.25	7.40	5.10	6.09	4.29
Oct 02	1.75	1.62	1.61	1.59	1.73	1.72	1.92	3.02	4.25	5.13	1.90	2.40	7.73	5.16	6.11	4.27
Nov 02	1.34	1.26	1.25	1.30	1.39	1.34	1.94	3.13	4.33	5.16	2.00	2.44	7.62	5.25	6.07	4.16
Dec 02	1.24	1.20	1.21	1.27	1.34	1.31	1.84	3.09	4.31	5.12	1.89	2.41	7.45	5.20	6.05	4.12
Jan 03	1.24	1.17	1.19	1.22	1.29	1.25	1.76	3.07	4.30	5.14	1.64	2.26	7.35	5.19	5.92	3.99
Feb 03	1.26	1.20	1.19	1.20	1.27	1.24	1.64	2.92	4.14	5.01	1.21	1.95	7.06	5.15	5.84	3.86
Mar 03	1.25	1.18	1.15	1.16	1.23	1.21	1.59	2.81	4.04	4.98	1.03	1.88	6.95	5.12	5.75	3.76
Apr 03	1.26	1.16	1.15	1.17	1.24	1.22	1.65	2.94	4.16	5.07	1.27	2.12	6.85	5.17	5.81	3.80
Weekly																
Feb 28 03	1.27	1.23	1.21	1.20	1.27	1.25	1.57	2.78	4.01	4.93	0.95	1.78	6.97	5.10	5.79	3.83
Mar 7 03	1.26	1.20	1.17	1.18	1.26	1.23	1.47	2.63	3.88	4.85	0.84	1.70	6.90	5.06	5.67	3.76
Mar 14 03	1.24	1.15	1.11	1.09	1.18	1.19	1.48	2.64	3.88	4.86	0.82	1.69	6.90	5.06	5.61	3.68
Mar 21 03	1.25	1.18	1.16	1.18	1.22	1.21	1.75	3.00	4.19	5.09	1.23	2.07	7.04	5.17	5.79	3.75
Mar 28 03	1.24	1.18	1.17	1.18	1.25	1.23	1.67	2.97	4.19	5.12	1.20	2.07	6.97	5.17	5.91	3.84
Apr 4 03	1.26	1.17	1.12	1.11	1.22	1.21	1.57	2.87	4.13	5.08	1.11	2.00	6.91	5.20	5.79	3.82
Apr 11 03	1.24	1.18	1.15	1.16	1.23	1.22	1.64	2.95	4.18	5.12	1.23	2.10	6.93	5.19	5.85	3.80
Apr 18 03	1.27	1.16	1.18	1.21	1.26	1.21	1.72	2.99	4.19	5.10	1.28	2.14	6.89	5.16	5.82	3.79
Apr 25 03	1.26	1.14	1.16	1.19	1.26	1.23	1.68	2.98	4.17	5.05	1.37	2.18	6.79	5.11	5.79	3.79
May 2 03	--	1.12	1.13	1.16	1.25	1.23	1.58	2.88	4.10	4.98	1.31	2.11	--	--	5.70	3.74
Daily																
Apr 15 03	1.34	1.17	1.18	1.21	1.26	1.22	1.70	2.97	4.18	5.10	1.25	2.12	6.90	--	--	--
Apr 16 03	1.26	1.15	1.17	1.20	1.26	1.23	1.69	2.96	4.16	5.08	1.27	2.13	6.86	--	--	--
Apr 17 03	1.28	1.14	1.18	1.20	1.27	1.22	1.74	3.00	4.18	5.06	1.32	2.16	6.84	--	--	--
Apr 18 03	1.24	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Apr 21 03	1.29	1.14	1.18	1.20	1.26	1.25	1.74	3.03	4.20	5.08	1.36	2.19	6.84	--	--	--
Apr 22 03	1.26	1.14	1.18	1.21	1.26	1.23	1.73	3.02	4.21	5.09	1.39	2.21	6.84	--	--	--
Apr 23 03	1.24	1.14	1.17	1.21	1.26	1.23	1.72	3.03	4.21	5.08	1.45	2.24	6.81	--	--	--
Apr 24 03	1.24	1.13	1.15	1.18	1.26	1.23	1.64	2.93	4.12	5.01	1.35	2.16	6.73	--	--	--
Apr 25 03	1.28	1.13	1.14	1.17	1.26	1.22	1.59	2.89	4.10	4.99	1.31	2.12	6.73	--	--	--
Apr 28 03	1.29	1.13	1.14	1.18	1.24	1.24	1.62	2.91	4.11	4.99	1.31	2.11	6.71	--	--	--
Apr 29 03	1.27	1.14	1.15	1.18	1.25	1.20	1.64	2.95	4.14	5.02	1.37	2.16	6.73	--	--	--
Apr 30 03	1.31	1.13	1.13	1.15	1.26	1.24	1.54	2.85	4.08	4.96	1.29	2.10	6.65	--	--	--
May 1 03	--	1.09	1.10	1.12	1.24	--	1.51	2.83	4.06	4.97	1.25	2.08	--	--	--	--

NOTE: Weekly data for columns 1 through 13 are week-ending averages. Columns 2 through 4 are on a coupon equivalent basis. Data in column 6 are interpolated from data on certain commercial paper trades settled by the Depository Trust Company. Column 14 is the Bond Buyer revenue index, which is a 1-day quote for Thursday. 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

Money Aggregates

Seasonally adjusted

Period	M1	M2	nontransactions components: In M2	nontransactions components: In M3 only	M3
	1	2	3	4	5
Annual growth rates(%):					
Annually (Q4 to Q4)					
2000	-1.7	6.0	8.5	17.4	9.2
2001	6.8	10.2	11.2	18.3	12.7
2002	3.2	6.9	8.0	5.4	6.4
Quarterly(average)					
2002-Q2	-0.6	4.1	5.4	4.3	4.1
Q3	3.1	9.1	10.8	4.5	7.7
Q4	4.5	7.1	7.8	8.6	7.6
2003-Q1	7.1	6.7	6.6	3.1	5.5
Monthly					
2002-Apr.	-14.5	-2.6	0.7	6.9	0.4
May	10.9	14.4	15.3	-0.9	9.5
June	5.9	6.9	7.1	2.1	5.4
July	7.3	10.5	11.4	0.3	7.3
Aug.	-11.1	8.3	13.5	14.3	10.2
Sep.	6.3	5.5	5.3	7.5	6.1
Oct.	11.2	8.3	7.5	-14.7	1.0
Nov.	-0.9	8.1	10.5	37.4	17.3
Dec.	7.8	3.2	2.0	17.9	7.8
2003-Jan.	2.1	6.4	7.5	-14.6	-0.4
Feb.	19.8	11.6	9.4	-1.1	7.6
Mar.	3.2	3.1	3.1	2.3	2.8
Apr. e	-2.4	3.4	4.9	-9.5	-0.6
Levels ($billions):					
Monthly					
2002-Nov.	1202.7	5781.4	4578.6	2680.9	8462.3
Dec.	1210.5	5796.6	4586.1	2720.8	8517.5
2003-Jan.	1212.6	5827.3	4614.7	2687.7	8515.0
Feb.	1232.6	5883.5	4650.9	2685.3	8568.8
Mar.	1235.9	5898.7	4662.8	2690.4	8589.1
Weekly					
2003-Mar. 3	1249.5	5898.8	4649.3	2674.1	8572.9
10	1230.4	5895.2	4664.8	2670.3	8565.5
17	1229.9	5910.8	4680.9	2705.1	8615.8
24	1235.7	5897.6	4661.9	2695.7	8593.3
31	1241.4	5894.0	4652.6	2699.0	8592.9
Apr. 7	1222.7	5890.2	4667.5	2665.7	8555.8
14p	1222.2	5894.2	4672.0	2664.2	8558.4
21p	1240.5	5910.2	4669.7	2673.0	8583.2

p preliminary
e estimated

Changes in System Holdings of Securities [1]
(Millions of dollars, not seasonally adjusted)

May 1, 2003

	Treasury Bills			Treasury Coupons						Federal Agency	Net change	Net RPs [5]		
	Net Purchases [2]	Redemptions (-)	Net Change	Net Purchases [3] < 1	Net Purchases [3] 1-5	Net Purchases [3] 5-10	Net Purchases [3] Over 10	Redemptions (-)	Net Change	Redemptions (-)	total outright holdings [4]	Short-Term [6]	Long-Term [7]	Net Change
2000	8,676	24,522	-15,846	8,809	14,482	5,871	5,833	3,779	31,215	51	15,318	-2,163	7,133	4,970
2001	15,503	10,095	5,408	15,663	22,814	6,003	8,531	16,802	36,208	120	41,496	3,492	636	4,128
2002	21,421	---	21,421	12,720	12,748	5,074	2,280	---	32,822	---	54,242	-5,366	517	-4,850
2002 QI	6,827	---	6,827	4,349	6,153	971	1,927	---	13,401	---	20,228	-1,961	-2,191	-4,152
QII	8,227	---	8,227	5,535	2,580	2,471	210	---	10,796	---	19,023	-2,644	-4,563	-7,207
QIII	6,117	---	6,117	2,835	3,676	1,318	143	---	7,972	---	14,089	-3,067	-5,225	-8,291
QIV	250	---	250	---	339	314	---	---	653	---	903	4,892	-304	4,588
2003 QI	6,024	---	6,024	1,796	2,837	1,291	50	---	5,974	---	11,998	1,957	3,770	5,727
2002 Aug	529	---	529	445	1,921	690	80	---	3,136	---	3,665	-527	-4,645	-5,172
Sep	750	---	750	1,286	---	51	---	---	1,337	---	2,087	1,084	-1,026	59
Oct	---	---	---	---	---	---	---	---	---	---	---	2,779	-4,716	-1,937
Nov	250	---	250	---	---	---	---	---	---	---	250	2,910	4,616	7,526
Dec	---	---	---	---	339	314	---	---	653	---	653	-1,097	10,706	9,610
2003 Jan	---	---	---	---	---	---	---	---	---	---	---	1,342	-3,581	-2,239
Feb	4,161	---	4,161	478	2,127	769	---	---	3,374	---	7,534	1,736	-2,262	-526
Mar	1,863	---	1,863	1,318	710	522	50	---	2,600	---	4,463	-2,254	520	-1,734
2003 Feb 5	---	---	---	---	---	---	---	---	---	---	---	4,163	---	4,163
Feb 12	556	---	556	478	520	---	---	---	998	---	1,554	-7,574	2,000	-5,574
Feb 19	323	---	323	---	---	---	---	---	---	---	323	11,807	---	11,807
Feb 26	3,045	---	3,045	---	995	701	---	---	1,696	---	4,740	-7,559	1,000	-6,559
Mar 5	455	---	455	---	612	68	---	---	680	---	1,135	3,474	---	3,474
Mar 12	244	---	244	1,318	---	---	---	---	1,318	---	1,562	-7,176	-1,000	-8,176
Mar 19	451	---	451	---	710	---	---	---	710	---	1,161	5,816	---	5,816
Mar 26	387	---	387	---	---	522	50	---	572	---	959	-5,733	---	-5,733
Apr 2	564	---	564	---	---	---	---	---	---	---	564	6,207	2,000	8,207
Apr 9	2,843	---	2,843	---	733	---	---	---	733	---	3,576	-7,933	---	-7,933
Apr 16	264	---	264	1,422	---	---	---	---	1,422	---	1,686	4,836	---	4,836
Apr 23	81	---	81	---	---	---	---	---	---	---	81	-1,735	-1,000	-2,735
Apr 30	354	---	354	---	---	---	---	---	---	---	354	5,460	-999	4,461
2003 May 1	45	---	45	---	---	---	---	---	---	---	45	-12,768	---	-12,768
Intermeeting Period														
Mar 18-May 1	4,866	---	4,866	1,422	733	522	50	---	2,727	---	7,593	-6,696	1	-6,695
Memo: LEVEL (bil. $)														
May 1			236.3	99.0	180.5	51.5	80.0		411.0	0.0	647.3	-12.1	16.0	3.9

1. Change from end-of-period to end-of-period. Excludes changes in compensation for the effects of inflation on the principal of inflation-indexed securities.
2. Outright purchases less outright sales (in market and with foreign accounts).
3. Outright purchases less outright sales (in market and with foreign accounts). Includes short-term notes acquired in exchange for maturing bills. Excludes maturity shifts and rollovers of maturing issues, except the rollover of inflation compensation.
4. Includes redemptions (-) of Treasury and agency securities.
5. RPs outstanding less reverse RPs.
6. Original maturity of 15 days or less.
7. Original maturity of 16 to 90 days.

MRA:HRM