

Prefatory Note

The attached document represents the most complete and accurate version available based on original files from the FOMC Secretariat at the Board of Governors of the Federal Reserve System.

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.

MAY 5, 2006

MONETARY POLICY ALTERNATIVES

PREPARED FOR THE FEDERAL OPEN MARKET COMMITTEE
BY THE STAFF OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MONETARY POLICY ALTERNATIVES

Recent Developments¹

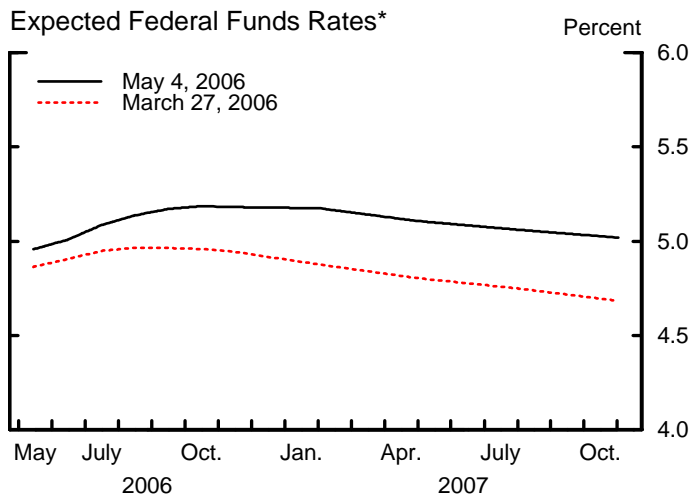
(1) Investors had anticipated the FOMC's decision at its March meeting to raise the target federal funds rate 25 basis points, to 4¾ percent, but the retention of the language that "some further policy firming may be needed" evidently led them to mark up somewhat their expected path for the federal funds rate.² Subsequently, speeches by Federal Reserve officials, the release of the minutes of the March FOMC meeting, and the Chairman's testimony before the Joint Economic Committee were generally taken to suggest that the FOMC was more likely than had previously been thought to leave policy unchanged after one more move. Money market futures rates rose in response to key data releases that were read as indicating greater global economic strength and higher inflation pressures than had been expected. On net, federal funds futures rates for the end of this year and beyond increased 25 to 35 basis points, and the expected policy path currently peaks at about 5.2 percent toward the end of this year before sloping down gradually over 2007 (Chart 1). Option-implied uncertainty about the path for money market rates edged up but remains low in its historical range. The Desk survey and futures quotes suggest that investors are virtually certain of a 25 basis point increase in the target funds rate at the May FOMC meeting and see a roughly one-in-three chance of a like-sized move in June.

(2) Over the intermeeting period, yields on two- and ten-year nominal Treasury securities rose 25 and 45 basis points, respectively. The ten-year rate, at 5.23 percent,

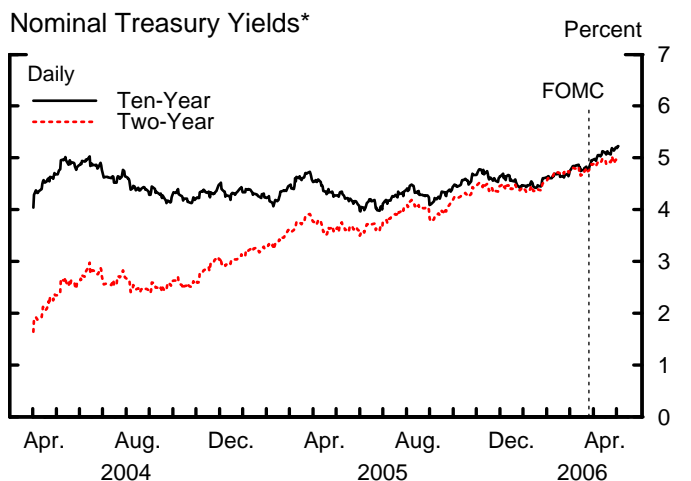
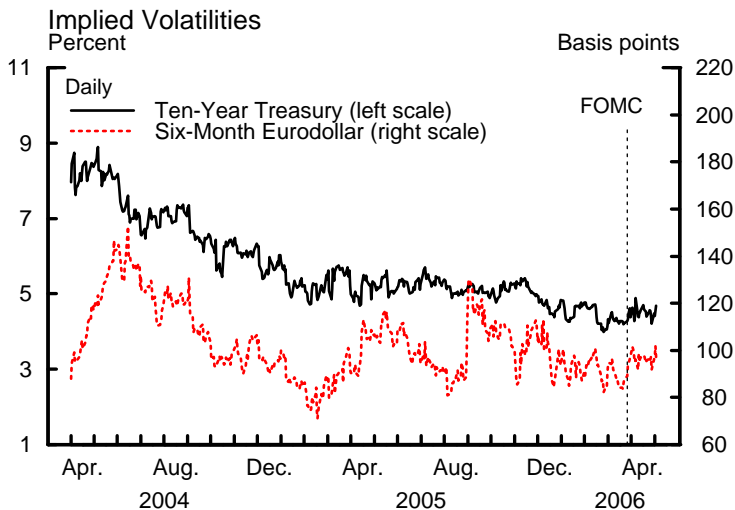
¹ Financial market quotes are as of the close of business on Thursday, May 4.

² The effective federal funds rate averaged 4.79 percent over the intermeeting period. In the last few days, the funds rate traded on the firm side despite a sizable provision of reserves by the Desk, as reserve managers at banks once again anticipated policy firming by the Committee. The Desk purchased \$1.1 billion of Treasury coupon securities in the market. The volume of outstanding long-term RPs increased \$1 billion, to \$15 billion.

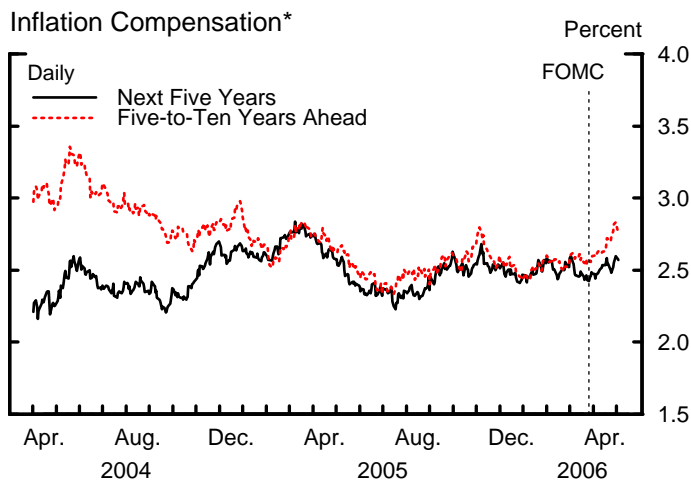
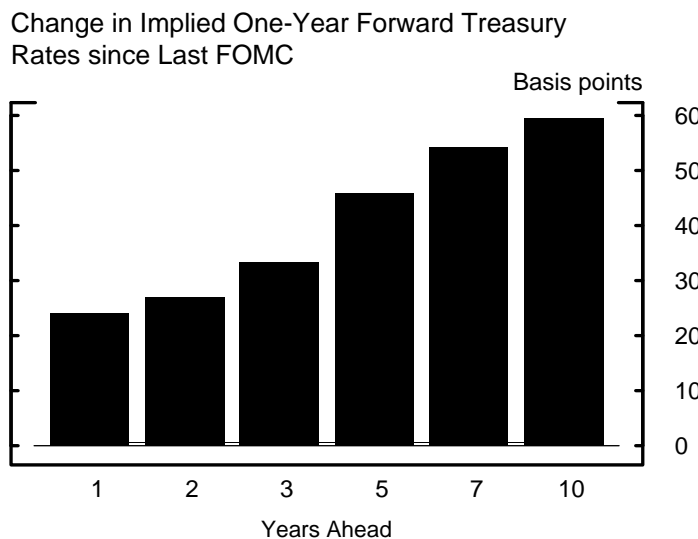
Chart 1 Interest Rate Developments



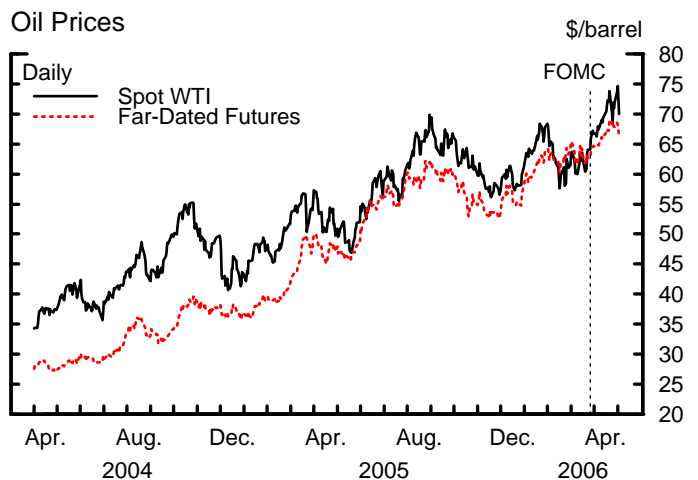
*Estimates from federal funds and Eurodollar futures, with an allowance for term premiums and other adjustments.



*Par yields from a smoothed nominal off-the-run Treasury yield curve.



*Estimates based on smoothed nominal and inflation-indexed Treasury yield curves, and adjusted for the indexation-lag (carry) effect.



Note: Vertical lines indicate March 27, 2006. Last daily observations are for May 4, 2006.

is now above its level just prior to the onset of the current round of policy tightening. A rise in distant-horizon forward rates, possibly owing to a modest rebound in term premiums, accounted importantly for this movement in yields (see box entitled “The Recent Rise in Distant-Horizon Forward Rates and Term Premiums”). Yields on TIPS rose less than those on comparable-maturity nominal Treasury securities. The 15 basis point climb in near-term inflation compensation can largely be attributed to the rise in energy prices. In contrast, with survey measures of long-run inflation expectations unchanged to 20 basis points higher, the 20 basis point increase in five-to-ten-year forward inflation compensation appears to reflect both expectations of higher inflation and an increase in the inflation risk premium.

(3) Major stock price indexes were up a bit over the intermeeting period, as positive first-quarter earnings reports more than offset the negative effects of higher energy prices and interest rates (Chart 2). The implied volatility of equity prices remained near historical lows. With the rise in long-term real Treasury yields, the equity premium is estimated to have narrowed a bit, though it remains slightly above its average level of the past two decades. Measures of the credit quality of nonfinancial firms remained solid, supported by gains in earnings and by strong and liquid balance sheets. Spreads of yields on investment-grade bonds over those on comparable-maturity Treasury securities were about unchanged, while spreads on speculative-grade bonds declined.

(4) The trade-weighted exchange value of the dollar against major foreign currencies fell $4\frac{3}{4}$ percent on balance over the intermeeting period (Chart 3). The dollar’s decline came amid fairly widespread signs of stronger global growth that boosted investors’ expectations of further monetary policy tightening abroad. Increased focus in public debate on risks posed by the large U.S. external imbalance also appeared to erode investor support for the dollar. The dollar dropped $3\frac{1}{4}$ percent versus the yen, about $4\frac{3}{4}$ percent versus the euro, and nearly $5\frac{1}{2}$ percent

The Recent Rise in Distant-Horizon Forward Rates and Term Premiums

In the Treasury market, the nine-to-ten-year-ahead nominal forward rate climbed 60 basis points over the intermeeting period, while the comparable indexed forward rate from TIPS rose about 35 basis points. Thus, distant-horizon forward inflation compensation increased about 25 basis points. Judging from the staff's arbitrage-free term structure model, the ten-year instantaneous forward nominal term premium—which includes compensation for inflation risk—moved up notably over the intermeeting period (lower left panel).

Nonetheless, the estimated term premium remains well below its historical average and is nearly a percentage point below its level at the beginning of the current tightening cycle.

The recent rise in distant-horizon forward rates appears to be a global phenomenon, with such rates posting substantial increases in other major industrialized countries (lower right panel). The correlation between these foreign and domestic forward rates has been particularly high over the last two years, suggesting that their movements owe predominantly to international factors. However, over the intermeeting period, forward rates have risen more in the United States than in foreign countries, and inflation compensation has moved up more in U.S. markets than in other countries, perhaps in part as a result of the recent depreciation of the dollar and concerns that more is in store.

The reasons for the apparent backup in U.S. term premiums of late are hard to ascertain, but may include heightened inflation concerns, some waning of foreign demand for Treasury securities that has been evident in recent auctions and in custody holdings at the Federal Reserve Bank of New York, and investors' reassessment of the appropriate pricing of interest-rate risk.

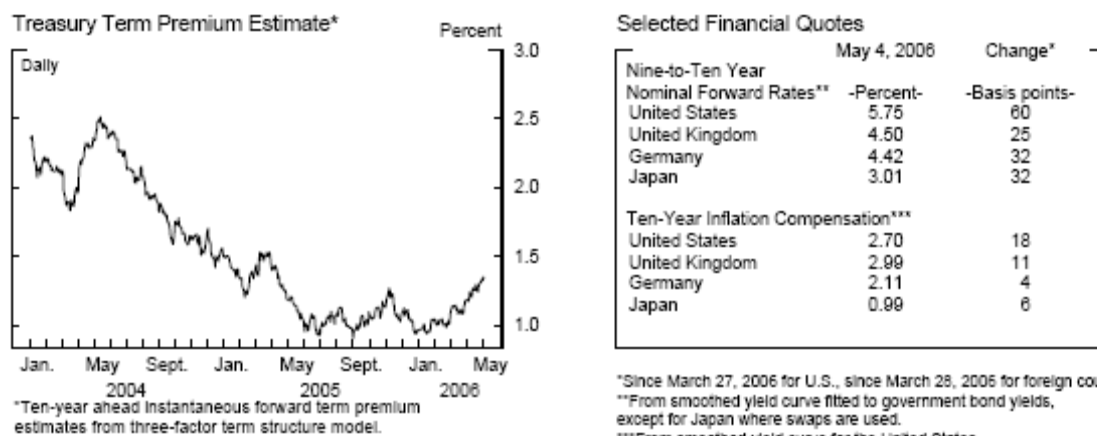
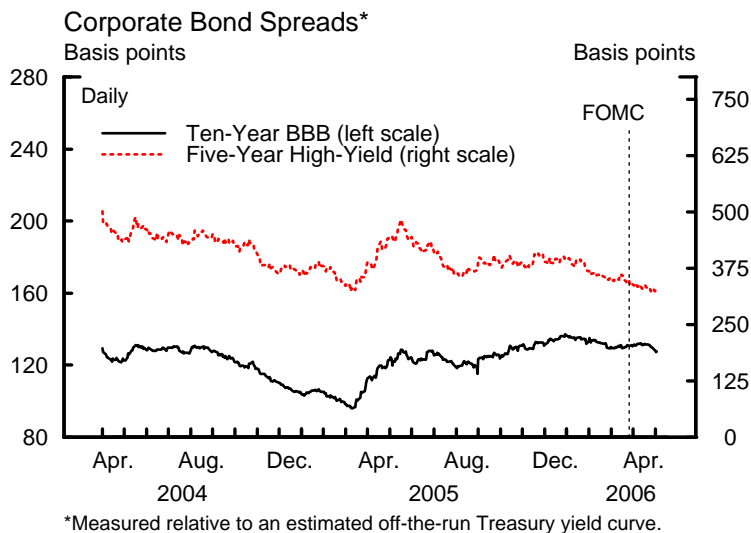
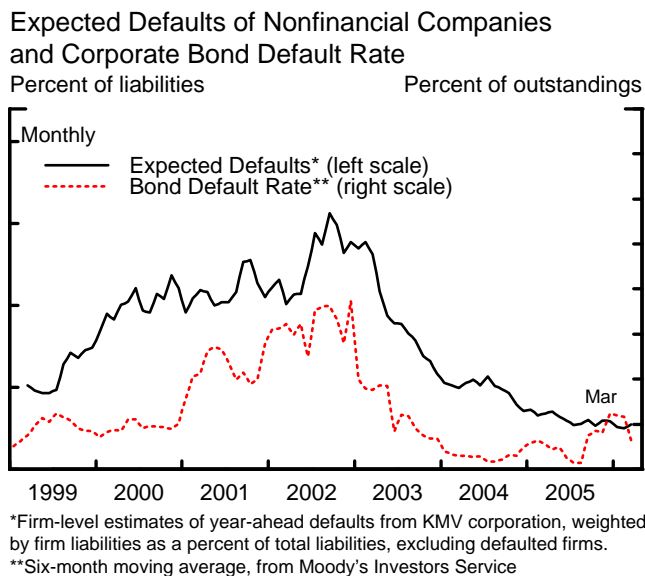
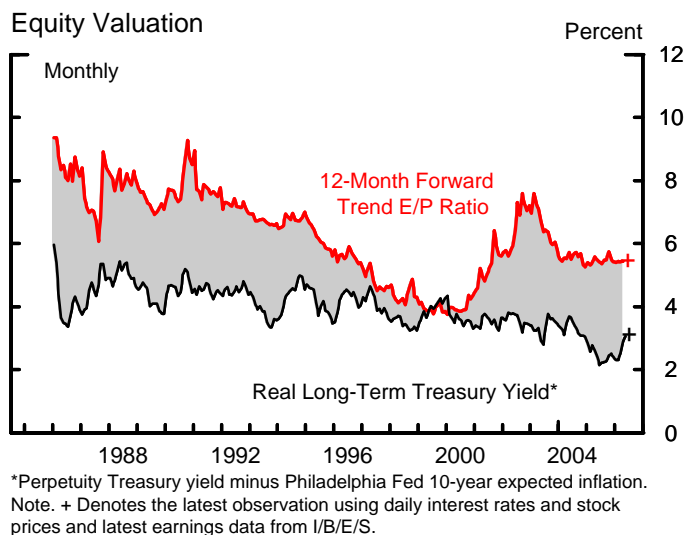
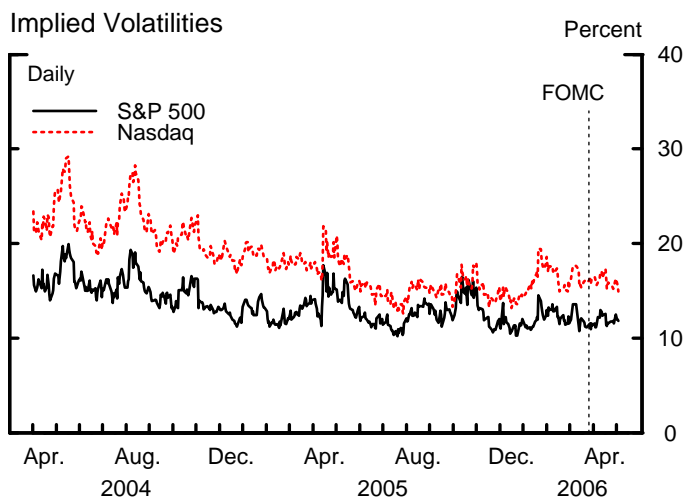
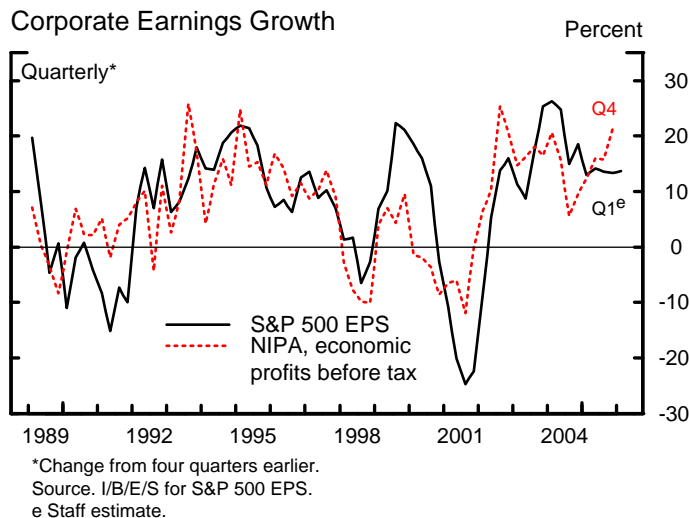
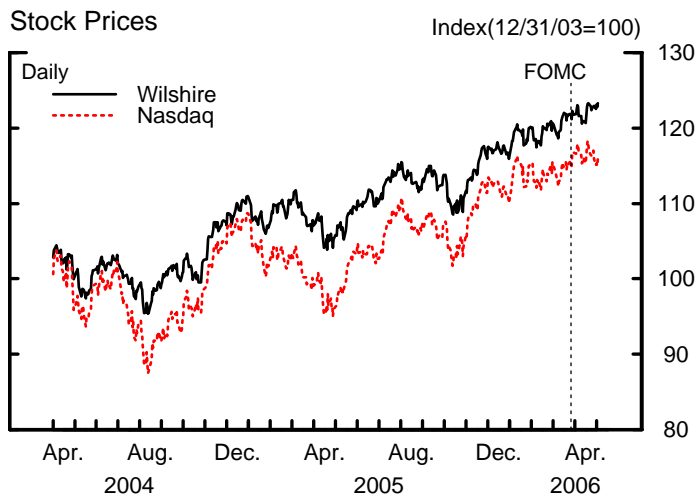


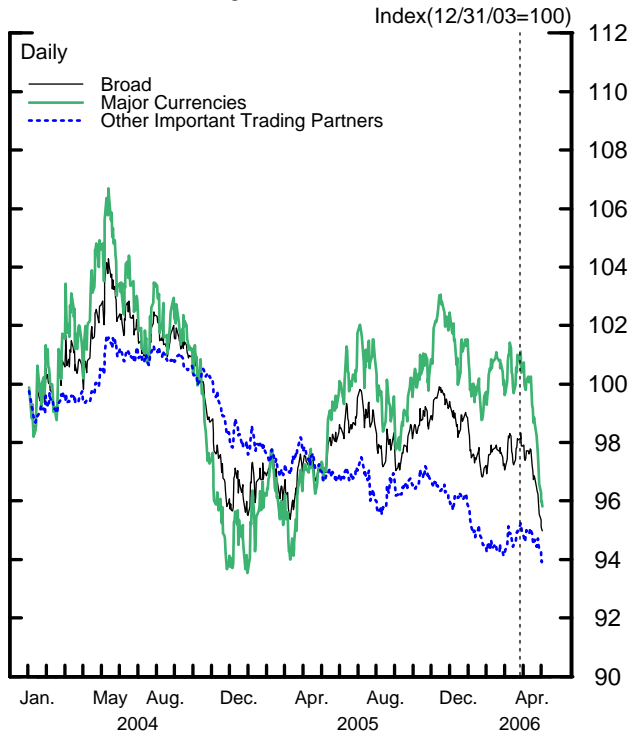
Chart 2 Asset Market Developments



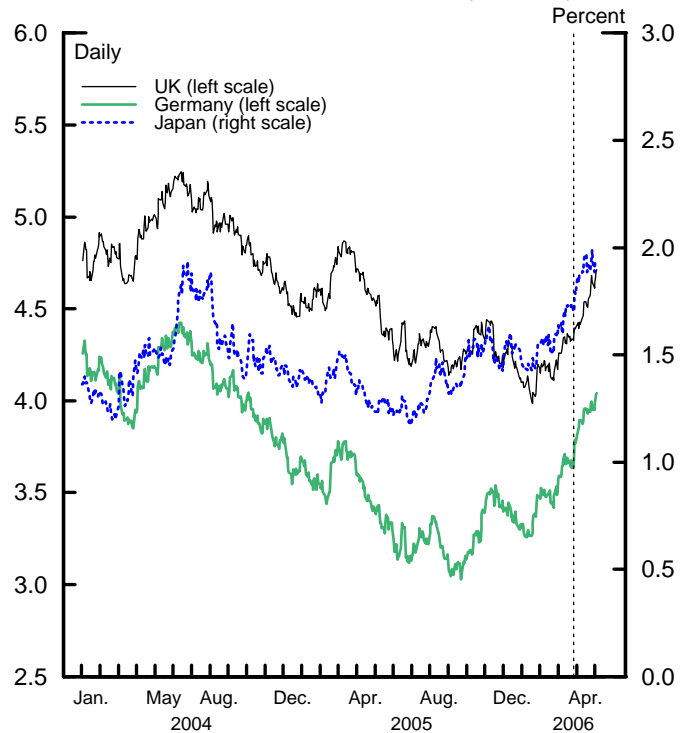
Note: Vertical lines indicate March 27, 2006. Last daily observations are for May 4, 2006.

Chart 3
International Financial Indicators

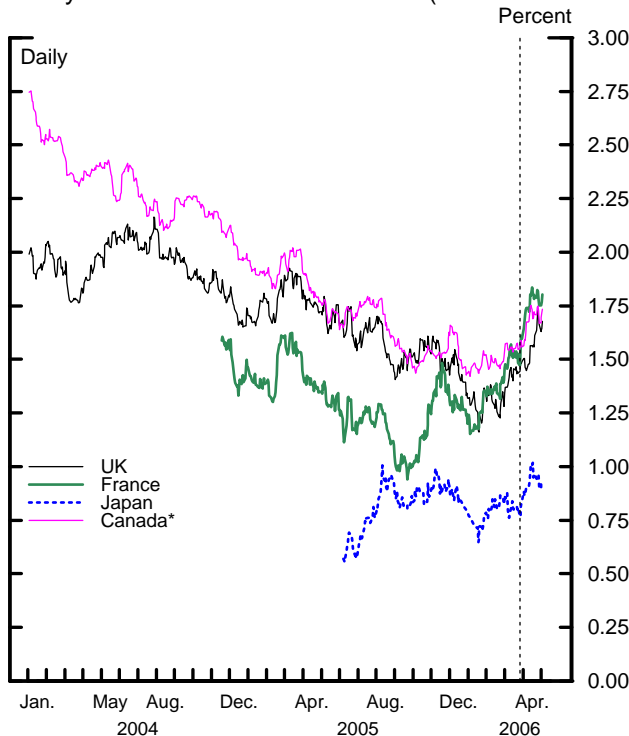
Nominal Trade-Weighted Dollar Indexes



Ten-Year Government Bond Yields (Nominal)

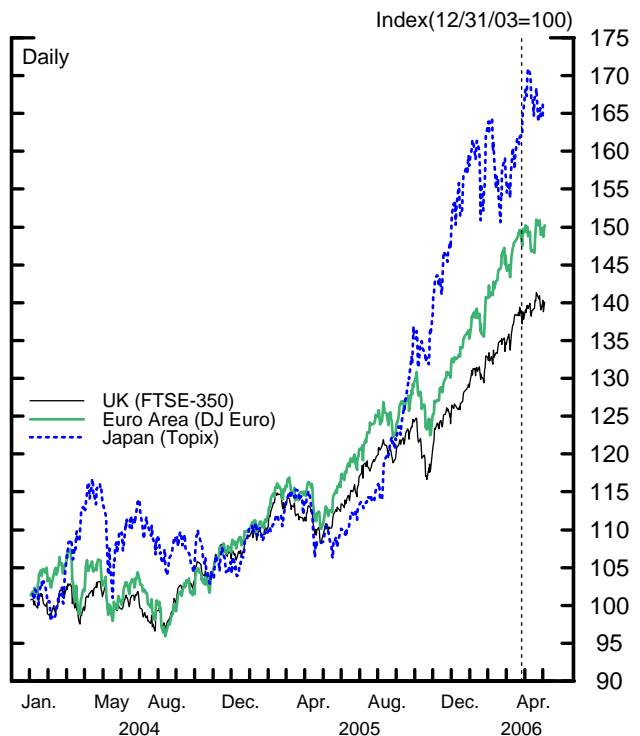


Ten-year Government Bond Yields (Inflation Indexed)



* Fifteen-year yields.

Stock Price Indexes



Note: Vertical lines indicate March 27, 2006. Last daily observations are for May 4, 2006.

versus the Canadian dollar. The Canadian currency, and those of several other smaller commodity exporters, appeared to be boosted by the sharply higher prices of oil and some other key primary products. On April 25, the Bank of Canada raised its policy rate 25 basis points and signaled that further policy tightening was likely. On May 3, the Reserve Bank of Australia also raised its policy rate 25 basis points. Yields on long-term government securities in major foreign industrial countries moved up 25 to 30 basis points on balance, somewhat less than increases in comparable U.S. yields over the period. Based on returns on inflation-indexed securities, the advances in nominal yields abroad appear to owe mostly to higher real yields. Stock prices in foreign industrial countries recorded gains of 1 to 3 percent.

(5) The dollar fell about 1¼ percent against an index of currencies of our other important trading partners.

³ Upward pressure on Asian currencies may have been accentuated by the G-7 statement calling for “greater exchange rate flexibility...in emerging economies with large current account surpluses, especially China.” Although Chinese authorities allowed only a slight appreciation of the yuan over the period, they did announce some changes in foreign exchange regulations; they also raised their benchmark lending rate 27 basis points and issued guidance on lending to certain sectors intended to slow investment growth. Central banks in Brazil and Mexico cut their policy rates again, but the Bank of Mexico added that it saw no room for further easing for the foreseeable future. Both countries continued to benefit from favorable financial conditions: EMBI+ spreads narrowed, and stock

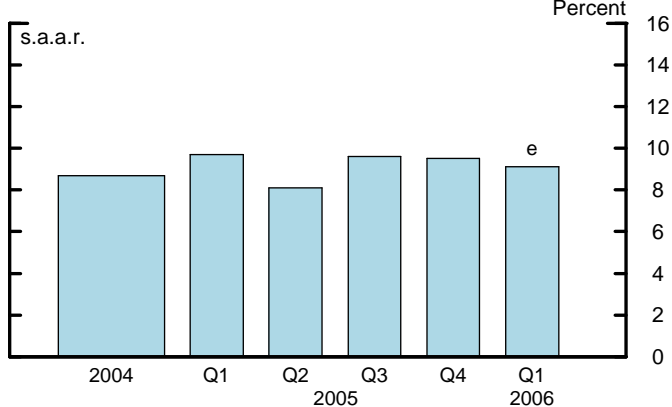
prices recorded increases close to 10 percent. The Brazilian *real* strengthened substantially, while the Mexican peso was about unchanged versus the dollar over the period.

(6) Domestic nonfinancial sector debt is estimated to have grown at a $9\frac{1}{4}$ percent annual rate in the first quarter, down only slightly from the brisk pace in 2005 (Chart 4). Business sector debt appears to have expanded at an $8\frac{3}{4}$ percent rate, supported by robust net issuance of U.S. corporate bonds and a double-digit expansion of business loans at commercial banks. Results from the latest Senior Loan Officer Opinion Survey indicate that banks eased standards and terms for C&I loans further. In the household sector, consumer credit has continued to expand slowly. Although only limited data are currently available, growth of household mortgage debt is projected to have moderated somewhat in the first quarter against a backdrop of higher mortgage interest rates, some signs of a deceleration in house prices, and reports in the Senior Loan Officer Opinion Survey indicating lower demand for residential mortgage loans. Federal debt is estimated to have expanded at nearly a 13 percent rate in the first quarter, a pace roughly in line with first-quarter growth a year earlier.

(7) M2 advanced at a $6\frac{1}{2}$ percent pace during the first quarter, somewhat below the growth rate of nominal GDP, and expanded moderately in April. This recent growth has been due importantly to increases in small time deposits, which have been buoyed by favorable offering rates.

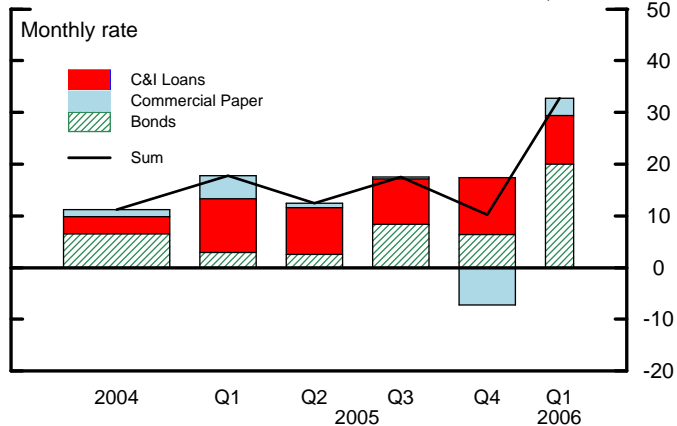
Chart 4 Debt and Money

Growth of Nonfinancial Debt



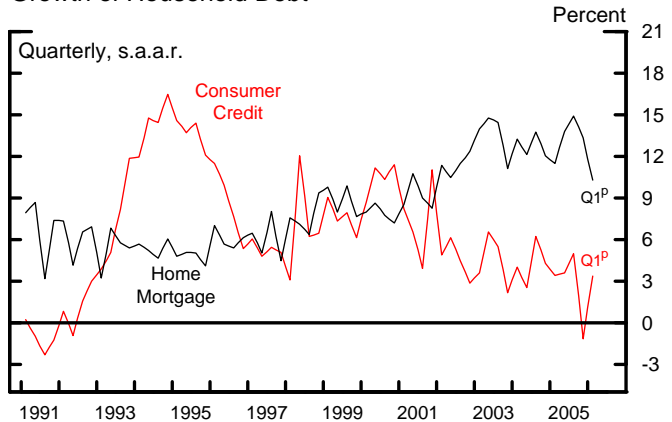
e Estimated.

Changes in Selected Components of Nonfinancial Business Debt



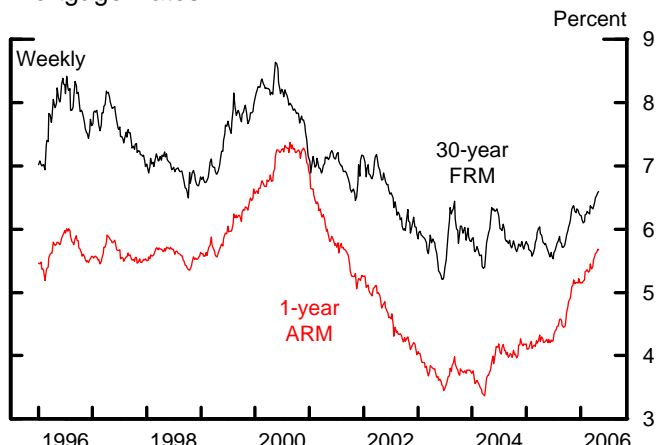
Note. Commercial paper and C&I loans are seasonally adjusted, bonds are not.

Growth of Household Debt



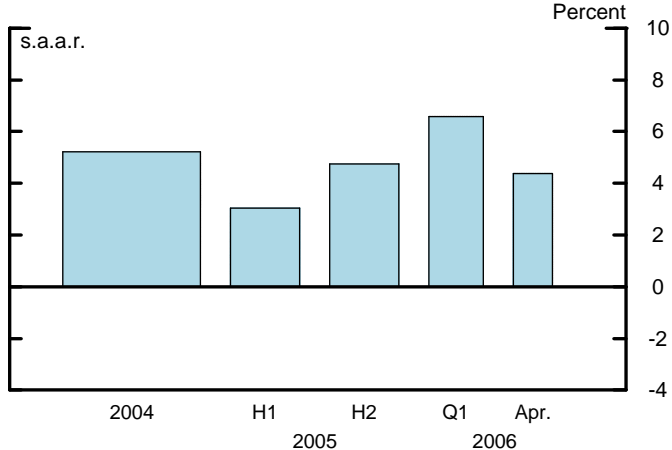
p Projected.

Mortgage Rates

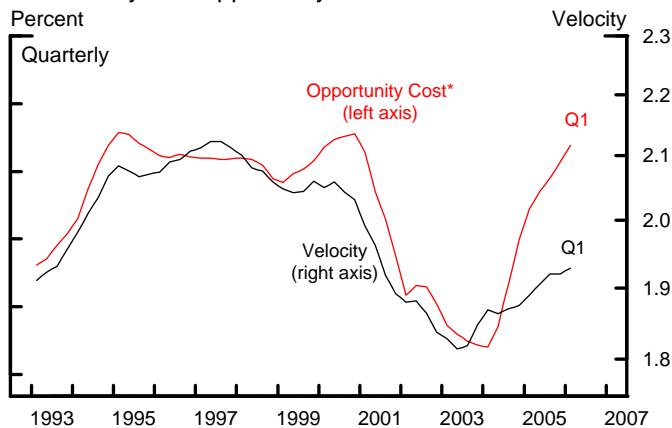


Source: Freddie Mac.

Growth of M2



M2 Velocity and Opportunity Cost



*Two-quarter moving average.

Economic Outlook

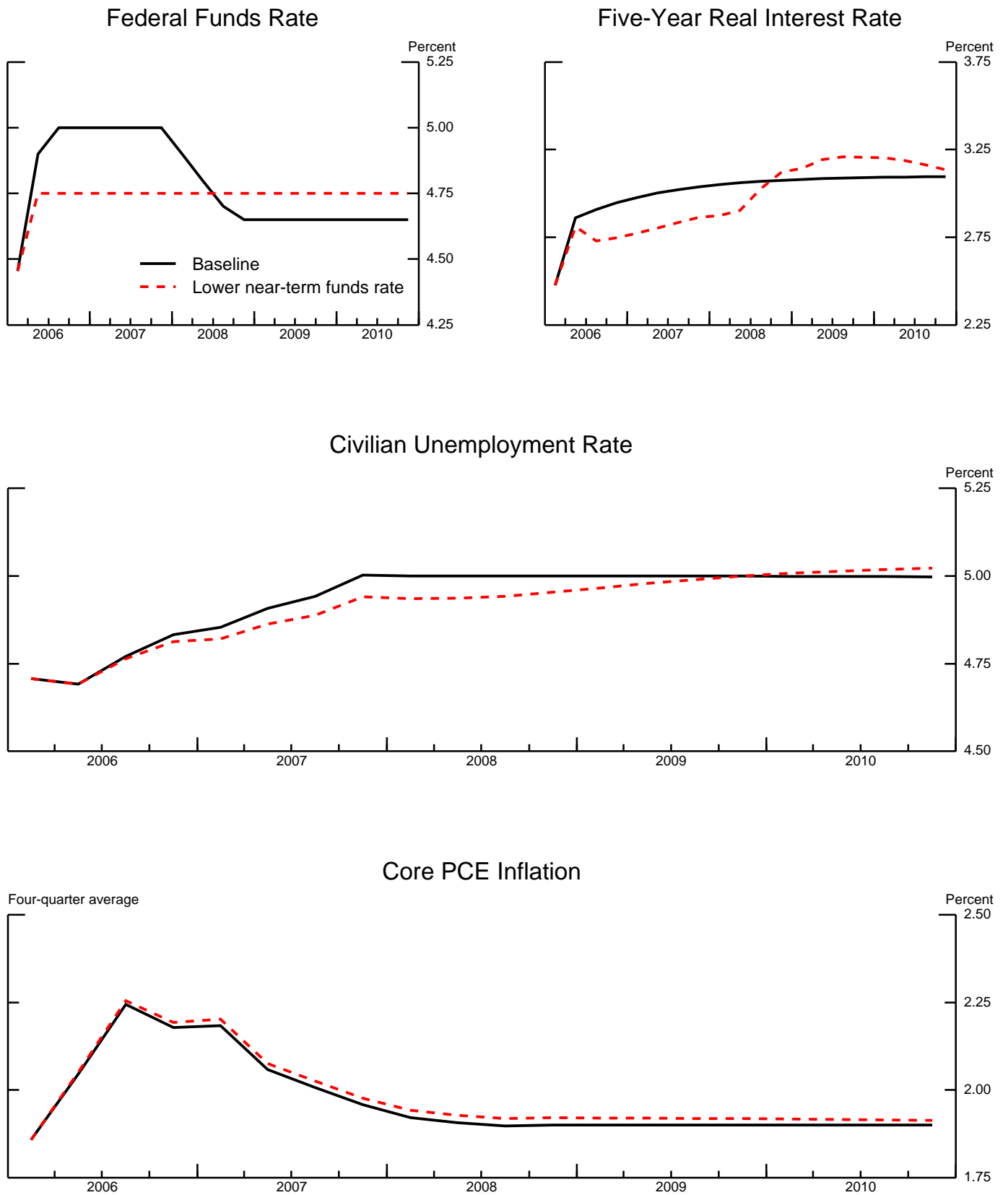
(8) The sharp run-up in energy prices over the intermeeting period, together with somewhat larger-than-expected increases in core consumer prices, led the staff to boost its inflation outlook for the near term. News on output and spending also came in above staff expectations, but little of this additional strength is expected to persist in the forecast. In view of the intensification of inflation pressures, the staff forecast now assumes that the Committee will leave the funds rate at 5 percent after this meeting rather than easing slightly next year, as was the case in the March Greenbook. In the current forecast, longer-term Treasury yields edge lower as market expectations for monetary policy come into alignment with the staff assumption, equity prices rise at a rate sufficient to produce risk-adjusted returns about equal to those on fixed-income instruments, and house price appreciation slows substantially. The real foreign exchange value of the dollar against a broad basket of currencies is assumed to decline at an average rate of a little over 2 percent over the forecast period. In line with futures quotes, the staff forecasts that the price of West Texas intermediate crude oil will be around \$75 per barrel over the projection period, roughly \$11 per barrel higher than in the last forecast. Against this backdrop, the staff projects that real GDP will expand $3\frac{3}{4}$ percent in 2006 and 3 percent in 2007, close to the March Greenbook projection. With output growing a bit less quickly than potential next year, the unemployment rate is expected to creep up to 5 percent, the staff's estimate of the NAIRU. Core PCE inflation is now expected to be $2\frac{1}{4}$ percent this year, slightly above the March forecast, but to edge down to 2 percent next year as energy prices flatten out. Total PCE prices are seen as rising about $2\frac{1}{2}$ percent and 2 percent in 2006 and 2007, respectively.

Longer-Run Scenarios

(9) Simulations of the FRB/US model provide a longer-term perspective that could help inform the Committee's near-term policy choice. To that end, staff extended the basic features of the Greenbook outlook through 2010. In that extension, monetary policy adjusts to hold core PCE inflation at about 2 percent. In the absence of any significant supply shocks or changes in expectations, the unemployment rate remains near the 5 percent staff estimate of the NAIRU. The associated medium-run value of the equilibrium real funds rate is about $2\frac{3}{4}$ percent, which implies a modest step-down in the nominal funds rate to roughly $4\frac{3}{4}$ percent after 2007. With this as the baseline, the model can be used to simulate the effects of alternative assumptions for monetary policy over the next few years. In these simulations, participants in financial markets—including those in the equity, bond, and foreign exchange markets—are assumed to understand fully the forces shaping the economic outlook, whereas households and firms are assumed to form their expectations using more limited information.

(10) To shed light on the implications of ending the process of policy firming, the first simulation considers a policy trajectory in which the federal funds rate is held constant at its current level through 2010 rather than being raised to 5 percent as in the Greenbook. The policy path beyond 2010 is set using the aggressive Taylor rule as described below in the explanatory notes for policy rules. As shown in the upper left panel of Chart 5, the funds rate path in this alternative scenario (the dashed line) is a bit lower than under the extended baseline (the solid line) over the next two years and a bit higher thereafter. Under the assumption that this policy path is fully anticipated by financial market participants, the alternative scenario produces a slightly lower trajectory for longer-term real interest rates over the next two years relative to the baseline. This in turn generates a modestly lower path for the unemployment rate

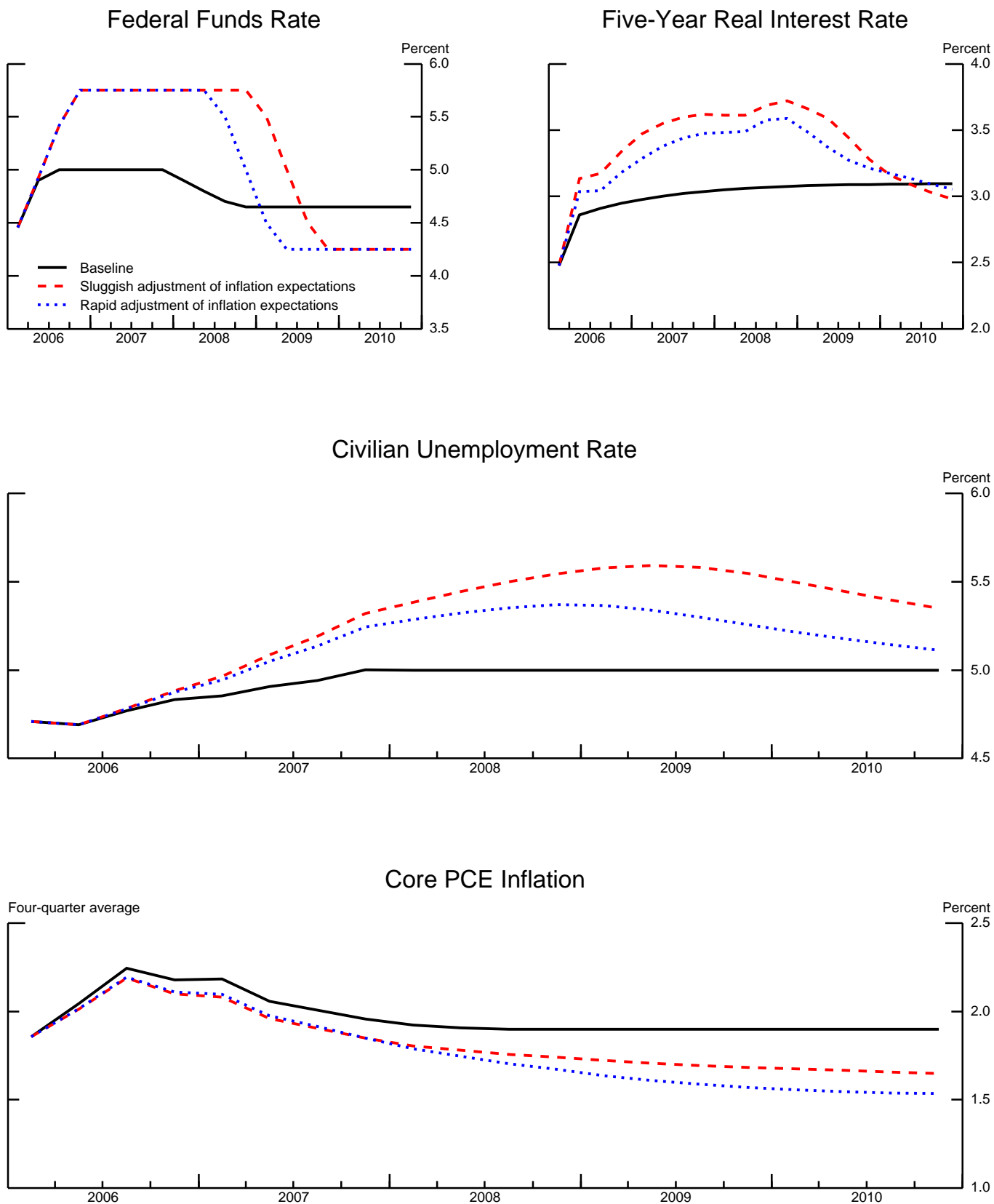
Chart 5 Ending the Policy Firming Process



during 2007 and 2008 and slightly higher core inflation through the remainder of the decade.

(11) Because policy paths that merely hold inflation around its current rate might not be viewed as acceptable by the Committee, the next set of simulations examines policies that would generate a more rapid decline in core inflation toward an inflation objective of 1½ percent. In these simulations, the funds rate reaches 5¾ percent later this year and remains at that rate through at least mid-2008 (Chart 6). Two different scenarios illustrate the role of inflation expectations in determining the macroeconomic effects of the additional policy tightening. In one, long-term inflation expectations respond only sluggishly to inflation outcomes (the dashed lines); in the other, expectations are assumed to converge to the 1½ percent target by late 2008, as might be the case if the public became convinced that the Committee had that inflation goal (the dotted lines). In the first scenario, making significant progress in reducing inflation involves holding the funds rate at 5¾ percent through the end of 2008 and then cutting it to 4¼ percent over the course of 2009. Under these conditions, the unemployment rate rises steadily to about 5½ percent over the next two years and does not start to return to the NAIRU until late in the decade; this slack helps generate a slow decline in core inflation. In the second scenario, the more rapid adjustment of long-run inflation expectations brings about a more rapid decline in actual inflation with less slack in economic activity. As a result, policymakers can begin cutting the funds rate noticeably earlier, and because investors fully anticipate the timing of the future policy easing, nominal and real yields on longer-term bonds rise somewhat less than in the first scenario.

Chart 6 Policy Tightening and the Evolution of Inflation Expectations



Short-Run Policy Alternatives

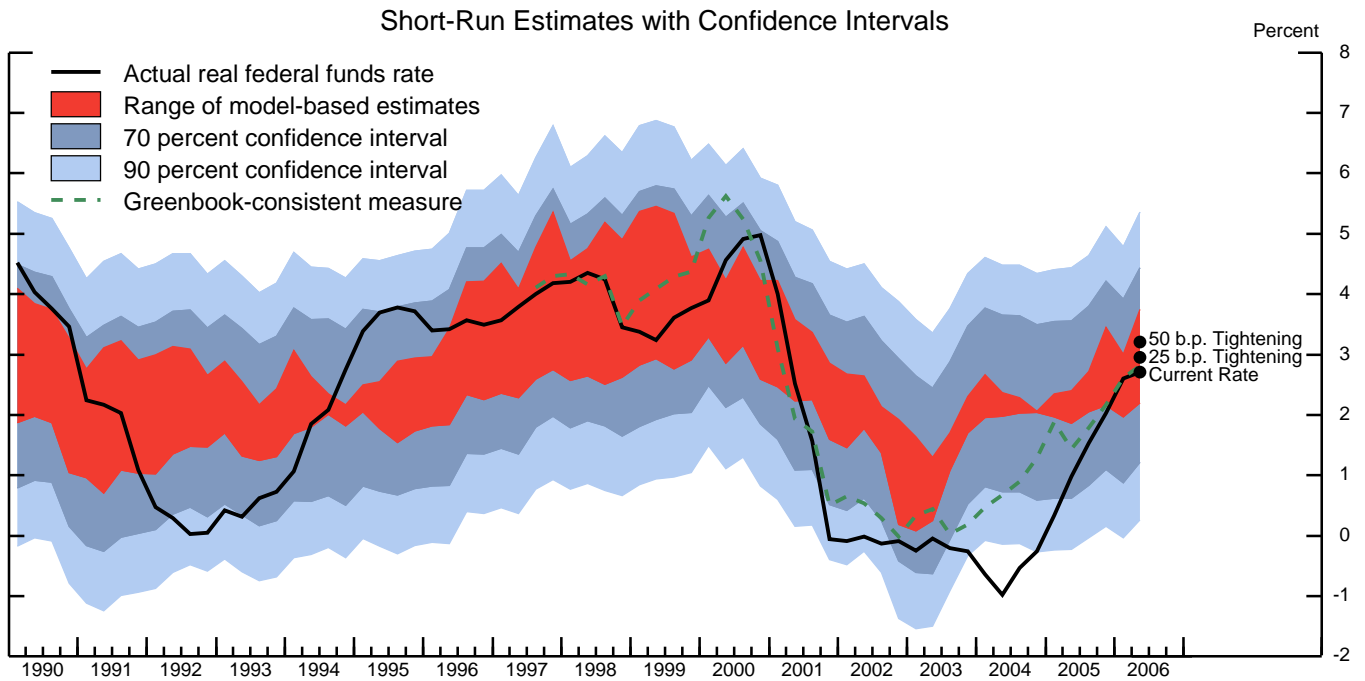
(12) This Bluebook presents three alternatives for the Committee's consideration, summarized by the draft statements in Table 1. Under Alternative A, the Committee leaves the federal funds rate unchanged at this meeting. It also indicates a best guess that, if any adjustment to the stance of policy subsequently proved necessary, it likely would be upward. Under Alternative B, the target for the federal funds rate is raised another 25 basis points at this meeting, and the risk assessment suggests that the Committee may pause in June. Under Alternative C, the target for the funds rate is raised 50 basis points and the risks are described as balanced without mention of additional policy action. All three alternatives provide a fuller description of the rationale for policy action and some forward-looking language about the economic outlook.

(13) If the Committee believes that the outcome projected by the staff in the Greenbook forecast is both likely and best balances the Federal Reserve's dual objectives, then it may wish to couple another 25 basis point firming at this meeting with a risk assessment that hints that the tightening cycle may be coming to a close, as in **Alternative B**. A quarter-point move at this meeting would bring the cumulative tightening since June 2004 to 4 percentage points. While a portion of that rise has been offset by higher inflation, real short-term interest rates have been boosted appreciably as well, from below zero to around $2\frac{3}{4}$ percent as measured using trailing core PCE inflation as a proxy for expected inflation. The real federal funds rate has been lifted to around the middle of the range of model-based estimates of its short-run equilibrium (Chart 7) and to a level about equal to the equilibrium rate implicit in the Greenbook projection. Members may also view the recent backup in longer-term rates as augmenting the financial restraint imposed by higher short-term interest rates. Indeed, under the staff forecast, the maintenance of the nominal funds rate at 5 percent through 2007 would foster financial conditions that would slow output

Table 1: Alternative Language for the May FOMC Announcement

	March FOMC	Alternative A	Alternative B	Alternative C
Policy Decision	1. The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4-3/4 percent.	The Federal Open Market Committee decided today to keep its target for the federal funds rate unchanged at 4-3/4 percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 5 percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 50 basis points to 5-1/4 percent.
Rationale	2. The slowing of the growth of real GDP in the fourth quarter of 2005 seems largely to have reflected temporary or special factors. Economic growth has rebounded strongly in the current quarter but appears likely to moderate to a more sustainable pace.	Economic growth rebounded to nearly a 5 percent annual rate in the first quarter. The Committee sees growth as likely to moderate to a sustainable pace, partly reflecting a gradual cooling of the housing market, other lagged responses to previous rate increases, and the effects of energy price increases.	Economic growth rebounded to nearly a 5 percent annual rate in the first quarter. The Committee sees growth as likely to moderate toward a more sustainable pace, partly reflecting a gradual cooling of the housing market, other lagged responses to previous rate increases, and the effects of energy price increases.	Economic growth rebounded to nearly a 5 percent annual rate in the first quarter. The Committee sees growth as likely to moderate somewhat in coming quarters, though data confirming a slowing in growth have been sparse.
	3. As yet, the run-up in the prices of energy and other commodities appears to have had only a modest effect on core inflation, ongoing productivity gains have helped to hold the growth of unit labor costs in check, and inflation expectations remain contained. Still, possible increases in resource utilization, in combination with the elevated prices of energy and other commodities, have the potential to add to inflation pressures.	As yet, the run-up in the prices of energy and other commodities appears to have had only a modest effect on core inflation, ongoing productivity gains have helped to hold the growth of unit labor costs in check, and inflation expectations remain contained. The Committee expects core inflation to remain well contained. Still, possible increases in resource utilization, in combination with the elevated prices of energy and other commodities, have the potential to add to inflation pressures.	As yet, the run-up in the prices of energy and other commodities appears to have had only a modest effect on core inflation, and ongoing productivity gains have helped to hold the growth of unit labor costs in check. The Committee expects core inflation to remain contained. However, the recent climb in energy and other commodity prices, an apparent slight rise in inflation expectations, and possible increases in resource utilization have the potential to add to inflation pressures.	As yet, the run-up in the prices of energy and other commodities appears to have had only a modest effect on core inflation, and ongoing productivity gains have helped to hold the growth of unit labor costs in check. However, the recent climb in energy and other commodity prices, an apparent rise in inflation expectations, and possible increases in resource utilization have the potential to add to inflation pressures.
Assessment of Risk	4. The Committee judges that some further policy firming may be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance.	Against this backdrop, the Committee preferred to await additional information about economic developments before taking any further action. The Committee sees the risks to its price stability objective as slightly to the upside and judges it more likely that its next policy action will be a tightening rather than an easing.	To keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance, some further policy firming may be needed. The Committee judges that any additional firming is likely to be modest. However, the extent and timing of any such firming will depend importantly on the evolution of the economic outlook as implied by incoming information.	The Committee judges that, with this action, the risks to the attainment of both sustainable economic growth and price stability are roughly in balance.
	5. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.	In any event, the Committee will respond to changes in the economic outlook, as implied by incoming information, as needed to foster its objectives of sustainable economic growth and price stability.	In any event, the Committee will respond to changes in economic prospects as needed to support the attainment of its objectives.	[Unchanged.]

Chart 7 Equilibrium Real Federal Funds Rate



Short-Run and Medium-Run Measures

	Current Estimate	<i>Previous Bluebook</i>
Short-Run Measures		
Single-equation model	2.2	2.1
Small structural model	2.6	2.5
Large model (FRB/US)	3.8	3.7
Confidence intervals for three model-based estimates		
70 percent confidence interval	1.2 - 4.4	
90 percent confidence interval	0.3 - 5.4	
Greenbook-consistent measure	2.8	2.8
Medium-Run Measures		
Single-equation model	2.2	2.1
Small structural model	2.4	2.5
Confidence intervals for two model-based estimates		
70 percent confidence interval	1.4 - 3.2	
90 percent confidence interval	0.7 - 3.8	
TIPS-based factor model	2.2	2.1
Memo		
Actual real federal funds rate	2.70	2.74

Notes: Confidence intervals reflect uncertainties about model specification, coefficients, and the level of potential output. The final column indicates the values for the current quarter based on the estimation for the previous Bluebook, except that the TIPS-consistent measure and the actual real funds rate are the values published in the previous Bluebook.

Equilibrium Real Rate Chart: Explanatory Notes

The equilibrium real rate is the real federal funds rate that, if maintained, would be projected to return output to its potential level over time. For the first three measures listed below, the short-run equilibrium rate is defined as the rate that would close the output gap in twelve quarters given the corresponding model's projection of the economy. For the first two measures, the medium-run concept is the value of the real federal funds rate projected to keep output at potential in seven years under the assumption that monetary policy acts to bring actual and potential output into line in the short run and then keeps them equal thereafter. The TIPS-based factor model measure provides an estimate of market expectations for the real federal funds rate seven years ahead. The actual real federal funds rate is constructed as the difference between the nominal rate and realized inflation, where the nominal rate is measured as the quarterly average of the observed federal funds rate, and realized inflation is given by the log difference between the staff's estimate of the core PCE price index and its lagged value four quarters earlier. For the current quarter, the nominal rate is specified as the target federal funds rate on the Bluebook publication date.

Measure	Description
Single-equation Model	The measure of the equilibrium real rate in the single-equation model is based on an estimated aggregate-demand relationship between the current value of the output gap and its lagged values as well as the lagged values of the real federal funds rate. In light of this model's simple structure, the short-run measure of the equilibrium real rate depends only on the recent position of output relative to potential, and the medium-run measure is virtually constant.
Small Structural Model	The small-scale model of the economy consists of equations for five variables: the output gap, the equity premium, the federal budget surplus, the trend growth rate of output, and the real bond yield. Unlike the estimates from the single-equation model, values of the equilibrium real rate also depend directly on conditions associated with output growth, fiscal policy, and capital markets.
Large Model (FRB/US)	Estimates of the equilibrium real rate using FRB/US—the staff's large-scale econometric model of the U.S. economy—depend on a very broad array of economic factors, some of which take the form of projected values of the model's exogenous variables. These projections make use of several simple forecasting rules which are appropriate for the three-year horizon relevant for the short-run concept but are less sensible over longer horizons. Thus, we report only the short-run measure for the FRB/US model.
Greenbook-consistent	Measures of the equilibrium real rate cannot be directly obtained from the Greenbook forecast, because the Greenbook is not based on a formal model. Rather, we use the FRB/US model in conjunction with an extended version of the Greenbook forecast to derive a Greenbook-consistent measure. FRB/US is first add-factored so that its simulation matches the extended Greenbook forecast, and then a second simulation is run off this baseline to determine the value of the real federal funds rate that closes the output gap. The medium-run concept of the equilibrium real rate is not computed because it requires a relatively long extension of the Greenbook forecast.
TIPS-based Factor Model	Yields on TIPS (Treasury Inflation-Protected Securities) reflect investors' expectations of the future path of real interest rates, but also include term and liquidity premiums. The TIPS-based measure of the equilibrium real rate is constructed using the seven-year-ahead instantaneous real forward rate derived from TIPS yields as of the Bluebook publication date. This forward rate is adjusted to remove estimates of the term and liquidity premiums based on a three-factor arbitrage-free term-structure model applied to TIPS yields, nominal yields, and inflation. Because TIPS indexation is based on the total CPI, this measure is also adjusted for the medium-term difference—projected at 40 basis points—between total CPI inflation and core PCE inflation.

growth to a pace a little below that of its potential, slightly easing pressures on resources and promoting a modest downward tilt in core inflation to rates below 2 percent late in the forecast period and beyond. Even if the Committee is not convinced that output growth would slow to this extent if the funds rate were maintained at 5 percent, it might nonetheless believe that the stance of policy is not far from neutral. If so, a pause in policy firming before long would be unlikely to jeopardize the Committee's price stability objective and might be appropriate to allow a better assessment at a later date of the cumulative effects of its policy actions.

(14) Under Alternative B, the rationale paragraph could indicate that spending is likely to slow because of a cooling of the housing market and the restraint imparted by increases in energy prices and interest rates. The Committee could repeat its analysis in the March statement of recent factors affecting inflation, but then acknowledge that a slight rise in inflation expectations could also add to inflation pressures. To treat its dual objectives symmetrically, row 3 includes the Committee's expectation that core inflation will remain contained, just as there is forward-looking language on economic growth in the previous row. In view of the additional quarter-point firming that would be implemented under this alternative, the risk assessment might be softened a little relative to that released after the last meeting by adding "The Committee judges that any additional firming is likely to be modest" and adopting some of the language of the Chairman's recent testimony: "the extent and timing of any such firming will depend importantly on the evolution of the economic outlook as implied by incoming information." Inclusion of the reference to "timing" is intended to suggest that additional firming would not necessarily take place at the June meeting. If the Committee saw only a small probability that it would act again in June, it could tune the message by replacing the second sentence of row 4 with "The Committee judges that additional firming, if any, is likely to be modest." In either case, the dependency

of future policy actions on data could be underscored by essentially reiterating the final sentence from the March announcement.

(15) Investors seem sure of a 25 basis point hike in the federal funds rate at this meeting and see only about a one-in-three chance of a similar move in June. The statement accompanying Alternative B would likely maintain or slightly increase these odds. Market interest rates could back up a few basis points, and downward pressure on the dollar might be reduced a bit, at least for a time, and equity prices could decline.

(16) The sizable rise over the intermeeting period in long-term nominal interest rates (which apparently included a significant pickup in compensation for expected inflation), the weakening of the exchange value of the dollar, and the rise in some survey measures of inflation expectations could be read by members as evidence of an erosion in the public's confidence in the Committee's commitment to price stability. If so, the combination of a half-point action at this meeting and the words presented in **Alternative C** might be appealing. With energy prices having risen sharply further in recent weeks, the Committee could be concerned that elevated energy and commodity prices and relatively high levels of resource utilization may begin to leave a more distinct imprint on core inflation and inflation expectations. Moreover, members may believe that core inflation currently is already at or above the upper end of an acceptable range, inclining them to foster a steeper downward trajectory in inflation than that forecast in the Greenbook. In that regard, the alternative simulation provided earlier suggests that the nominal federal funds rate would need to reach 5¾ percent by year-end to foster a 1½ percent inflation goal over the next few years.

(17) The rationale portion of the policy statement associated with Alternative C could temper the expectation of a moderation in growth with the observation that “data confirming a slowing in growth have been sparse.” As in March, the inflation

paragraph could cite limited energy-price pass-through and productivity gains as having helped to hold inflation in check, but would not indicate that the Committee expected core inflation to remain contained. Reasserting that “inflation expectations are contained” might be problematic, and, as in Alternative B, rising inflation expectations could be cited as a factor that could add to inflation pressures. In light of the size of the policy move, the Committee might want to declare that the risks to its dual objectives are balanced.

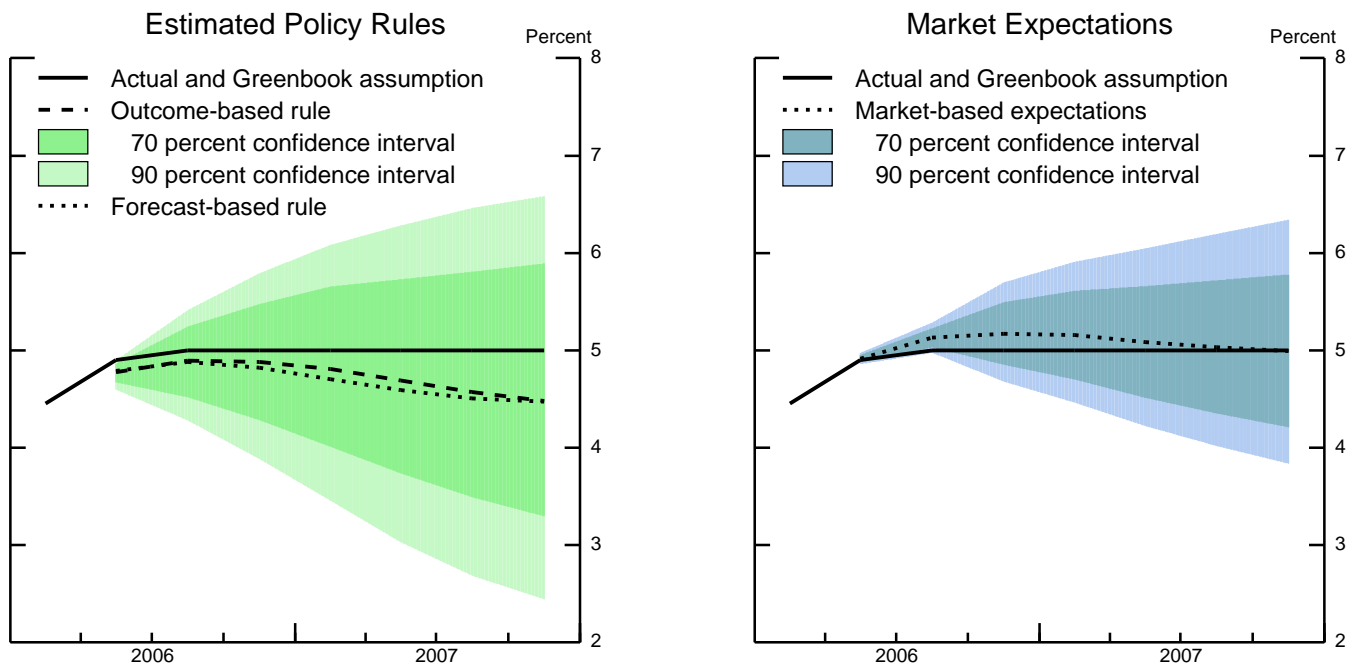
(18) The policy action and statement associated with Alternative C would catch market participants unawares. Real bond yields could jump up noticeably; the rise in nominal yields would be somewhat less if inflation expectations declined—but that would depend on the extent to which investors took the action as an assertion of the Committee’s anti-inflation resolve. The recent tendency toward weakness in the foreign exchange value of the dollar would likely be checked, and stock prices would decline. Given the size of the policy surprise, volatility, both actual and implied, could rise.

(19) The likely reaction in financial markets, which could be sizable, to a 50 basis point increase in the target for the federal funds rate might diminish the appeal of Alternative C for the Committee. But some of the rationale language of this alternative could be used to stiffen the policy statement announcing a quarter-point increase and thus make it more likely that financial markets would build in high odds of a like-sized action in June. For instance, the Committee could combine the rationale paragraphs of Alternative C with the risk assessment of Alternative B. To make it more likely that market participants price in an additional move, the Committee could strike the sentence characterizing additional firming as likely to be “modest” in row 4 of Alternative B. This might be favored if the Committee was impressed by the resilience of aggregate demand in the face of the substantial increase in energy prices and concerned that the momentum of spending could push the level

of output well above the economy's potential. Indeed, if the Committee harbored a suspicion that economic slack had already been more than eliminated, it might see increased inflation pressures as a palpable risk. In that vein, members might read the most recent figures on new and existing home sales as suggesting that the housing market, while off its peak, is not cooling quickly enough to provide much assurance that overall economic growth is in the process of slowing to potential. In that regard, the "domestic boom" alternative simulation in the Greenbook, which puts the funds rate at 6 $\frac{1}{4}$ percent by year-end 2007, may strike some members as an uncomfortably plausible outcome.

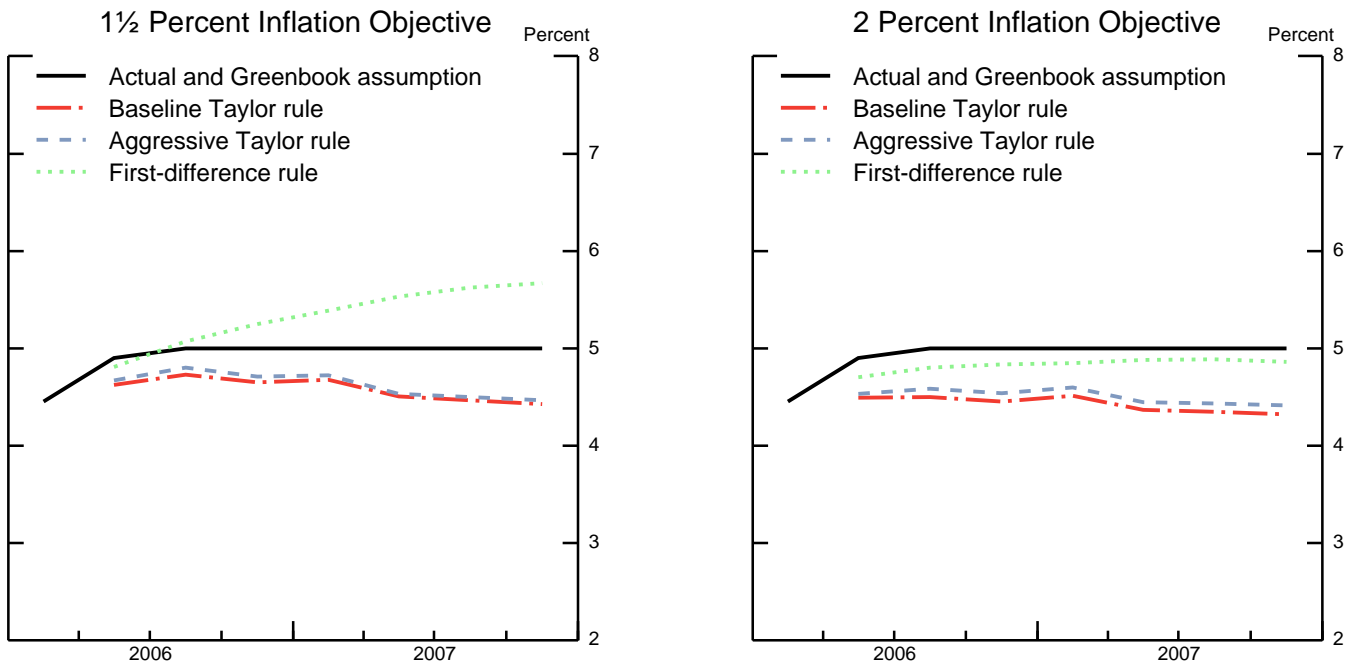
(20) In contrast, the Committee may believe that further policy tightening at this meeting is not necessary or desirable and that, at least for now, maintaining the current stance of policy is appropriate, as in **Alternative A**. As noted previously, the cumulative firming of policy to date has been significant, and the real federal funds rate is now well within the range of model-based estimates of its equilibrium value. In these circumstances, the Committee may wish to pause to obtain more information that would be useful in assessing whether further action will be necessary. Put differently, policy accommodation now appears to have been eliminated, and, with core inflation remaining contained—and perhaps believed likely to edge lower over time—despite sharp increases in energy and commodity prices, the Committee may not feel a need to move from a roughly neutral posture to a restrictive stance. That is the message of the simulation presented earlier: If the equilibrium real rate is in the neighborhood of 2 $\frac{3}{4}$ percent, a 2 percent inflation goal could be achieved by holding the nominal funds rate at 4 $\frac{3}{4}$ percent. Indeed, estimated monetary policy rules imply that the existing stance of policy is about appropriate or even a little firmer than would be predicted by past Committee behavior (Chart 8). Model simulations using a number of simple policy rules also suggest that further tightening may not be required at this time (Chart 9). And even if members believe that further tightening could

Chart 8 Information from Estimated Policy Rules and Financial Markets



	2006			2007			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Estimated Policy Rules							
Outcome-based policy rule	4.8	4.9	4.9	4.8	4.7	4.6	4.5
70 percent confidence interval							
Lower bound	4.7	4.5	4.3	4.0	3.7	3.5	3.3
Upper bound	4.9	5.2	5.5	5.7	5.7	5.8	5.9
90 percent confidence interval							
Lower bound	4.6	4.3	3.9	3.5	3.0	2.7	2.4
Upper bound	4.9	5.4	5.8	6.1	6.3	6.5	6.6
Forecast-based policy rule	4.8	4.9	4.8	4.7	4.6	4.5	4.5
Market Expectations							
Expected funds rate path	4.9	5.1	5.2	5.2	5.1	5.0	5.0
70 percent confidence interval							
Lower bound	4.9	5.0	4.9	4.7	4.5	4.4	4.2
Upper bound	5.0	5.2	5.5	5.6	5.7	5.7	5.8
90 percent confidence interval							
Lower bound	4.9	5.0	4.7	4.5	4.2	4.0	3.8
Upper bound	5.0	5.3	5.7	5.9	6.0	6.2	6.3
Memo							
Greenbook assumption	4.9	5.0	5.0	5.0	5.0	5.0	5.0

Chart 9
Policy Paths under Alternative Inflation Objectives



	2006			2007			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Simple Policy Rules							
Baseline Taylor rule							
1 1/2 percent inflation objective	4.6	4.7	4.7	4.7	4.5	4.5	4.4
2 percent inflation objective	4.5	4.5	4.5	4.5	4.4	4.3	4.3
Aggressive Taylor rule							
1 1/2 percent inflation objective	4.7	4.8	4.7	4.7	4.5	4.5	4.5
2 percent inflation objective	4.5	4.6	4.5	4.6	4.4	4.4	4.4
First-difference rule							
1 1/2 percent inflation objective	4.8	5.1	5.3	5.4	5.5	5.6	5.7
2 percent inflation objective	4.7	4.8	4.8	4.8	4.9	4.9	4.9
Memo							
Greenbook assumption	4.9	5.0	5.0	5.0	5.0	5.0	5.0

Policy Rule Charts: Explanatory Notes

For the rules described below, i_t denotes the federal funds rate for quarter t , while the explanatory variables include the staff's estimate of trailing four-quarter core PCE inflation (π_t), its forecasts of inflation two and three quarters ahead ($\pi_{t+2|t}$ and $\pi_{t+3|t}$), its assessment of the current output gap ($y_t - y_t^*$), its one-quarter-ahead forecast of the output gap ($y_{t+1|t} - y_{t+1|t}^*$), its three-quarter-ahead forecast of annual average GDP growth relative to potential ($\Delta^4 y_{t+3|t} - \Delta^4 y_{t+3|t}^*$), and the assumed value of policymakers' long-run inflation objective (π^*).

Rule prescriptions are computed using dynamic simulations of the FRB/US model, implemented as though the rule is followed starting at this FOMC meeting. This quarter's prescription is a weighted average of the actual value of the federal funds rate thus far this quarter and the value obtained from the FRB/US model simulations using the timing of this meeting within the quarter to determine the weights. Finally, for the forecast-based rule and the first-difference rule, it should be noted that prescriptions near the end of the Greenbook horizon also depend on an extension of the Greenbook baseline forecast.

Estimated Policy Rules: Estimation is performed using real-time quarterly data taken from the Greenbook and staff memoranda closest to the middle of each quarter. The specific lag structure of the outcome-based rule is chosen according to the Bayesian information criterion over the sample period starting from 1988Q1. The forecast-based rule differs from the outcome-based rule in that it also permits staff forecasts of inflation and the output gap to be among the explanatory variables. Confidence intervals, shown only for the outcome-based rule, are based on stochastic simulations of the FRB/US model, where the shocks are randomly drawn from the set of model equations residuals for the period 1986-2004. The following table indicates the specification of each rule and its root mean squared error (RMSE) over the sample 1993:1-2005:4.

Outcome-based Rule	$i_t = 0.27 + 1.14i_{t-1} - 0.36i_{t-2} + 0.32\pi_t + 0.60(y_t - y_t^*) - 0.40(y_{t-1} - y_{t-1}^*)$.19
Forecast-based Rule	$i_t = 0.24 + 1.14i_{t-1} - 0.35i_{t-2} + 0.31\pi_{t+2 t} + 0.42(y_{t+1 t} - y_{t+1 t}^*) - 0.23(y_{t-1} - y_{t-1}^*)$.18

Market Expectations: The expected funds rate path is based on quotes from fed funds and Eurodollar futures, and the confidence intervals are obtained from options on those futures.

Simple Policy Rules: The following table indicates the specification of each rule and its RMSE over the sample 1993:1-2005:4 for two inflation objectives.

		$\pi^*=1.5$	$\pi^*=2$
Baseline Taylor Rule	$i_t = 2 + \pi_t + 0.5(\pi_t - \pi^*) + 0.5(y_t - y_t^*)$.99	.99
Aggressive Taylor Rule	$i_t = 2 + \pi_t + 0.5(\pi_t - \pi^*) + (y_t - y_t^*)$.62	.63
First-difference Rule	$i_t = i_{t-1} + 0.5(\pi_{t+3 t} - \pi^*) + 0.5(\Delta^4 y_{t+3 t} - \Delta^4 y_{t+3 t}^*)$.51	.44

eventually prove necessary to address upside risks to inflation, they may see no urgency to implement such restraint. Such an assessment might be importantly influenced by members' regional knowledge of the housing situation. With national data, particularly survey information, pointing to some cooling, the Committee may put some weight on the "housing slump" alternative simulation in the Greenbook, which suggests that if significant confidence effects accompany a drop in housing values, then considerably easier monetary policy would be warranted.

(21) The rationale section of the Committee's statement associated with Alternative A could begin like that in Alternative B but soften the characterization of the outlook for growth to "likely to moderate to a sustainable pace." It could use essentially the same paragraph discussing inflation as that for Alternative B, but retain the assertion that "inflation expectations remain contained" and emphasize the expectation that core inflation will remain "well contained." The risk assessment might be revised considerably from that employed at recent meetings. In particular, it could indicate that "Against this backdrop, the Committee preferred to await additional information about economic developments before taking any further action. The Committee sees the risks to its price stability objective as slightly to the upside and judges it more likely that its next policy action will be a tightening rather than an easing." To accommodate those changes, the final sentence of the risk assessment might be modified slightly to read "In any event, the Committee will respond to changes in the economic outlook, as implied by incoming information, as needed to foster its objectives of sustainable economic growth and price stability."

(22) Both the absence of policy action and the statement associated with Alternative A would come as a considerable surprise to market participants. Short-term market rates would probably drop by about 25 basis points as market participants removed all but a small probability of near-term policy firming. The effect on bond yields would depend in part on whether inflation expectations were

adversely affected by the lack of tightening at this meeting and the suggestion that policy could be on hold for some time. If inflation expectations were unperturbed, bond yields most likely would decline, stock markets rally, and the foreign exchange value of the dollar weaken.

Money and Debt Forecasts

(23) Under the Greenbook forecast, M2 growth is projected to expand 5 percent this year, restrained by a further increase in the opportunity cost of holding M2. As a result, M2 velocity would rise about 1½ percent, after increases of 1½ and 2½ percent in 2004 and 2005, respectively. Next year, M2 growth is forecast at 5½ percent, in line with the expansion in nominal GDP, as opportunity costs are expected to be about unchanged on balance following the leveling off of short-term market interest rates.

(24) Domestic nonfinancial sector debt growth is expected to slow to 7¼ percent this year from last year's 9½ percent increase. Household debt growth is likely to fall off fairly sharply, reflecting a deceleration in mortgage debt, but at 8 percent is nonetheless projected to remain relatively brisk. Business sector debt is seen as expanding 7½ percent, only a little lower than last year's pace, with the proceeds of a considerable portion of the borrowing slated to finance equity retirement. Despite the widening of the federal budget deficit, federal debt growth slows to 6¾ percent in 2006. Next year, overall debt growth is projected to drop further, reflecting a noticeable slowdown in the nonfederal components.

Table 2
Alternative Growth Rates for M2
(percent, annual rate)

	No Change	Raise 25 bp/ Greenbook*	Raise 50 bp**
Monthly Growth Rates			
Jan-06	11.2	11.2	11.2
Feb-06	4.1	4.1	4.1
Mar-06	3.1	3.1	3.1
Apr-06	4.4	4.4	4.4
May-06	3.9	3.5	3.2
Jun-06	6.3	5.4	4.5
Jul-06	5.8	4.6	3.4
Aug-06	6.0	4.5	3.0
Sep-06	6.0	4.5	3.0
Quarterly Growth Rates			
2005 Q2	2.5	2.5	2.5
2005 Q3	4.4	4.4	4.4
2005 Q4	5.1	5.1	5.1
2006 Q1	6.6	6.6	6.6
2006 Q2	4.2	4.0	3.8
2006 Q3	5.8	4.6	3.5
Annual Growth Rates			
2004	5.2	5.2	5.2
2005	3.9	3.9	3.9
2006	5.7	5.0	4.3
2007	5.7	5.5	5.3
Growth From			
Apr-06			
To			
Sep-06	5.7	4.5	3.4

* Increase of 25 basis points in the target federal funds rate at this meeting and no change thereafter. This forecast is consistent with nominal GDP and interest rates in the Greenbook forecast.

** Increase of 50 basis points in the target federal funds rate at this meeting and no change thereafter.

Directive and Balance of Risks Statement

(25) Draft language for the directive and draft risk assessments identical to those presented in Table 1 are provided below.

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 _____ ~~4~~³/₄ percent.

Risk Assessments

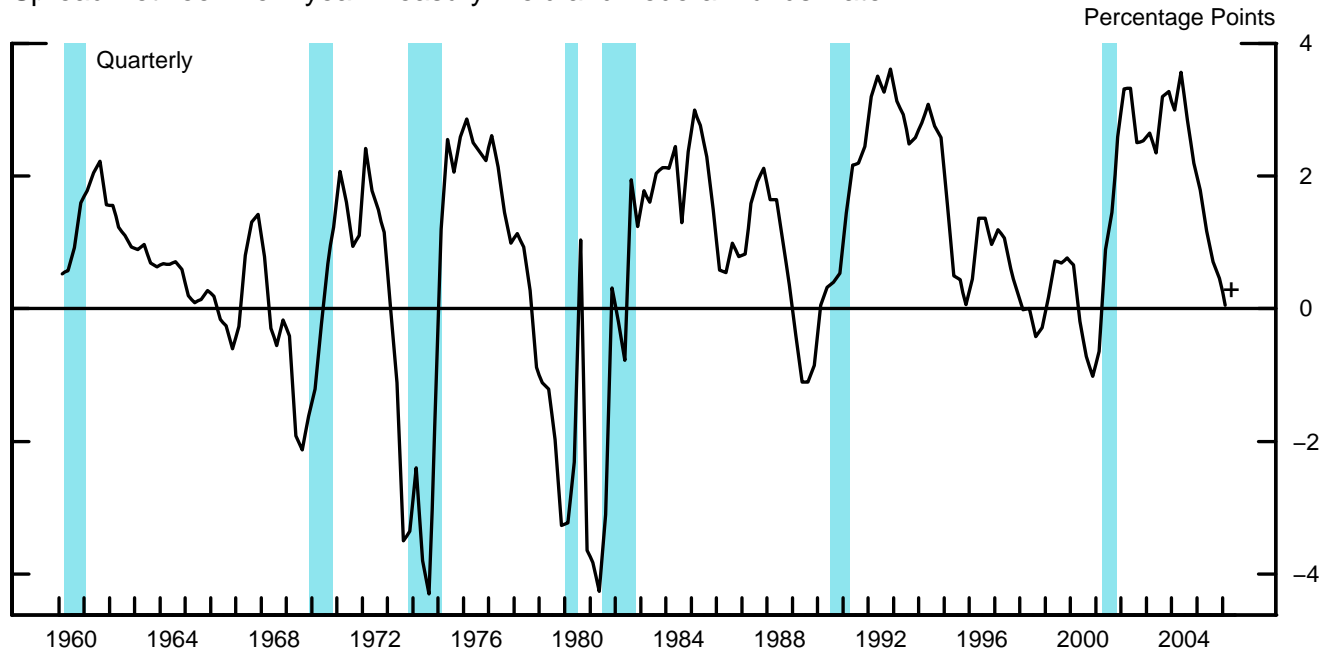
- A. Against this backdrop, the Committee preferred to await additional information about economic developments before taking any further action. The Committee sees the risks to its price stability objective as slightly to the upside and judges it more likely that its next policy action will be a tightening rather than an easing. In any event, the Committee will respond to changes in the economic outlook, as implied by incoming information, as needed to foster its objectives of sustainable economic growth and price stability.
- B. To keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance, some further policy firming may be needed. The Committee judges that any additional firming is likely to be modest. However, the extent and timing of any such firming will depend importantly on the evolution of the economic outlook as implied by incoming information. In any

event, the Committee will respond to changes in economic prospects as needed to support the attainment of its objectives.

- C.** The Committee judges that, with this action, the risks to the attainment of both sustainable economic growth and price stability are roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

Treasury Yield Curve

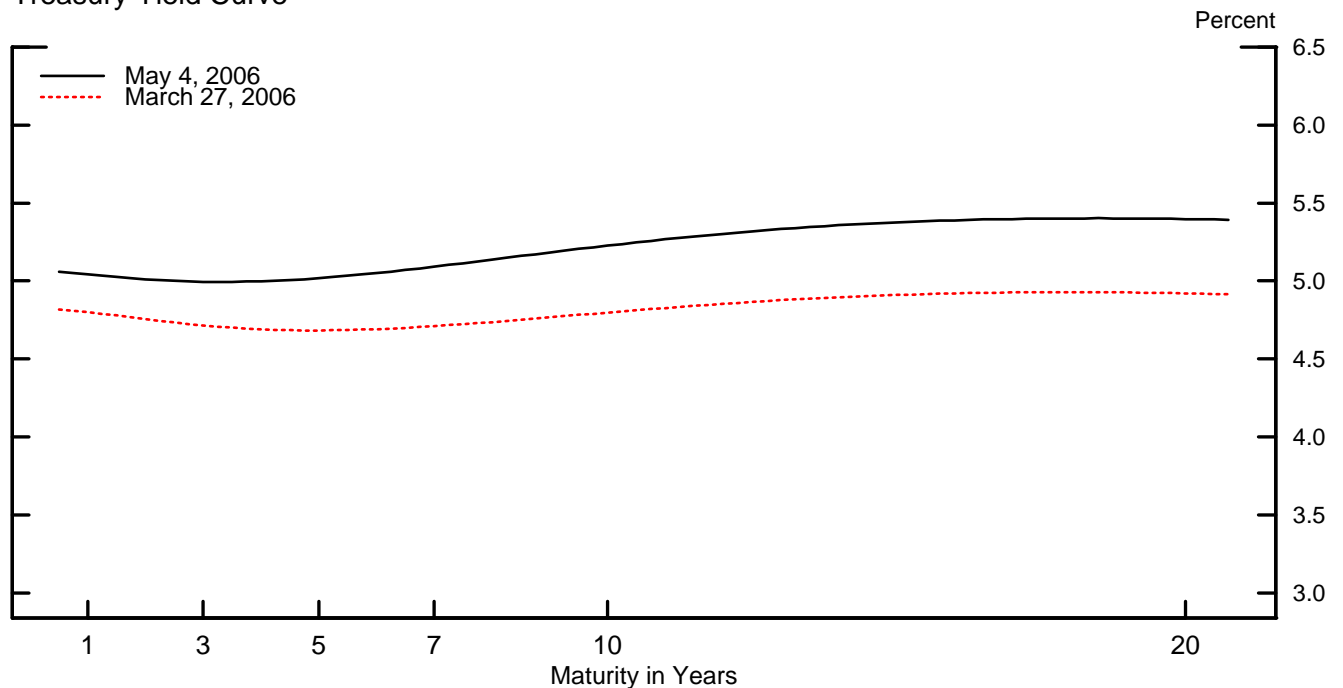
Spread Between Ten-year Treasury Yield and Federal Funds Rate



+ Denotes most recent weekly value.

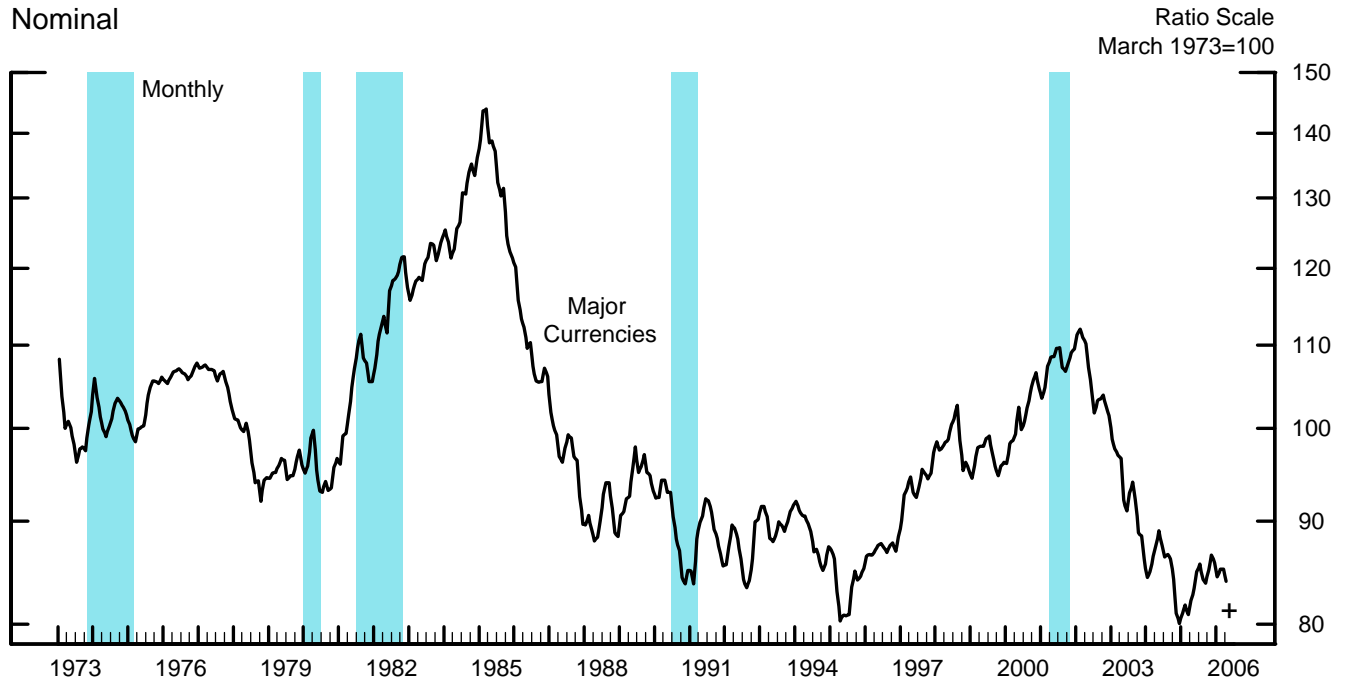
Note. Blue shaded regions denote NBER-dated recessions.

Treasury Yield Curve*

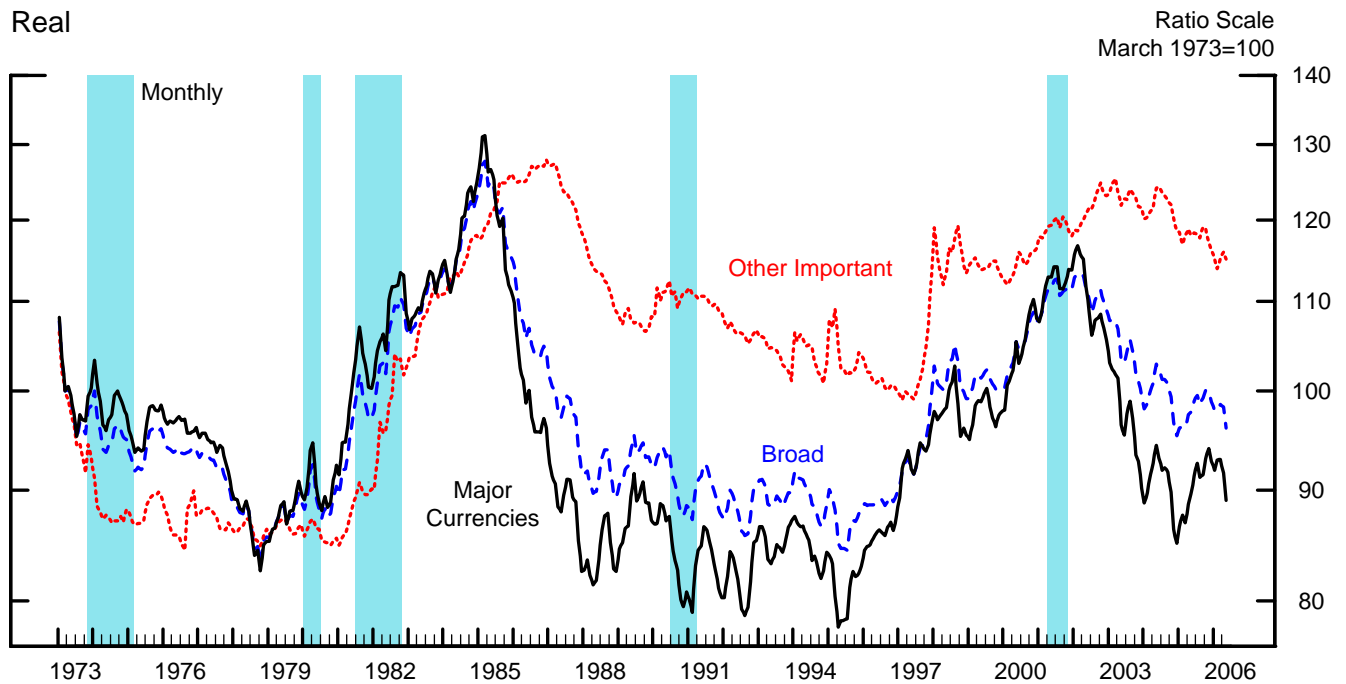


*Smoothed yield curve estimated from off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semi-annual coupons.

Dollar Exchange Rate Indexes

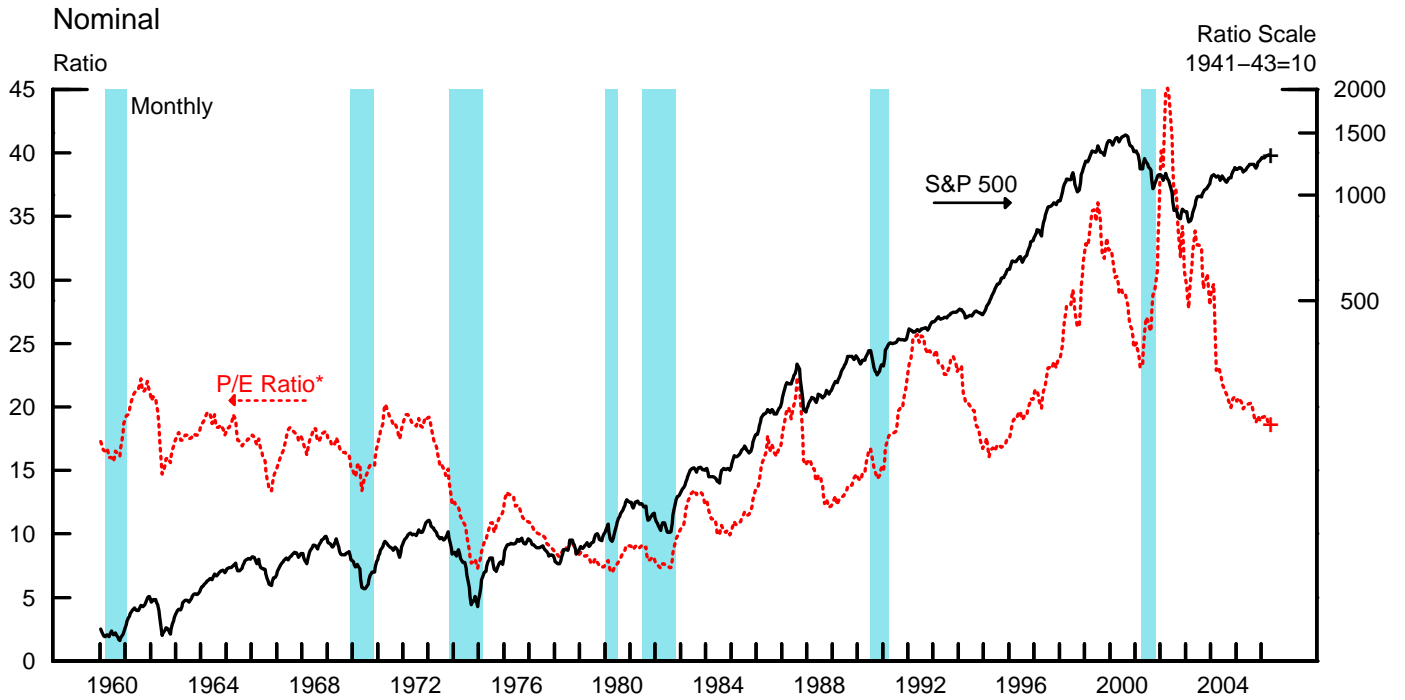


+ Denotes most recent weekly value.

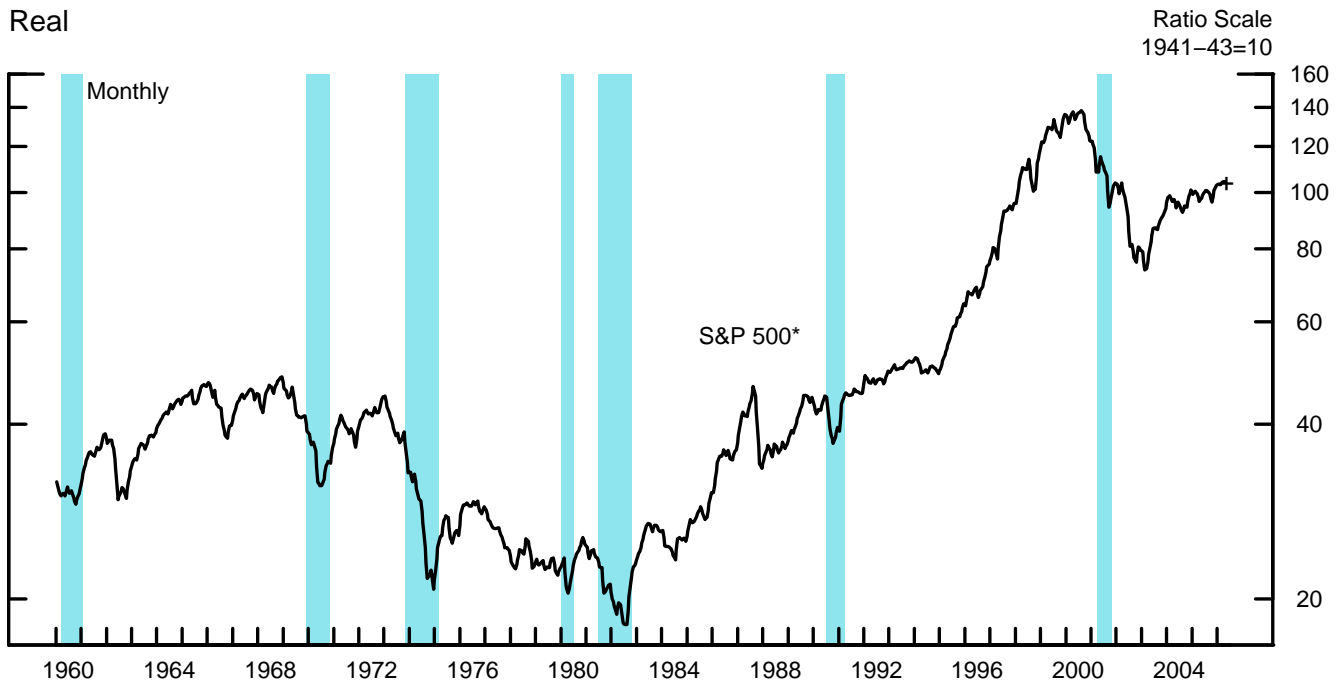


Note. The major currencies index is the trade-weighted average of currencies of the Euro area, Canada, Japan, the U.K., Switzerland, Australia, and Sweden. The other important trading partners index is the trade-weighted average of currencies of 19 other important trading partners. The Broad index is the trade-weighted average of currencies of all important trading partners. Real indexes have been adjusted for relative changes in U.S. and foreign consumer prices. Blue shaded regions denote NBER-dated recessions.

Stock Indexes



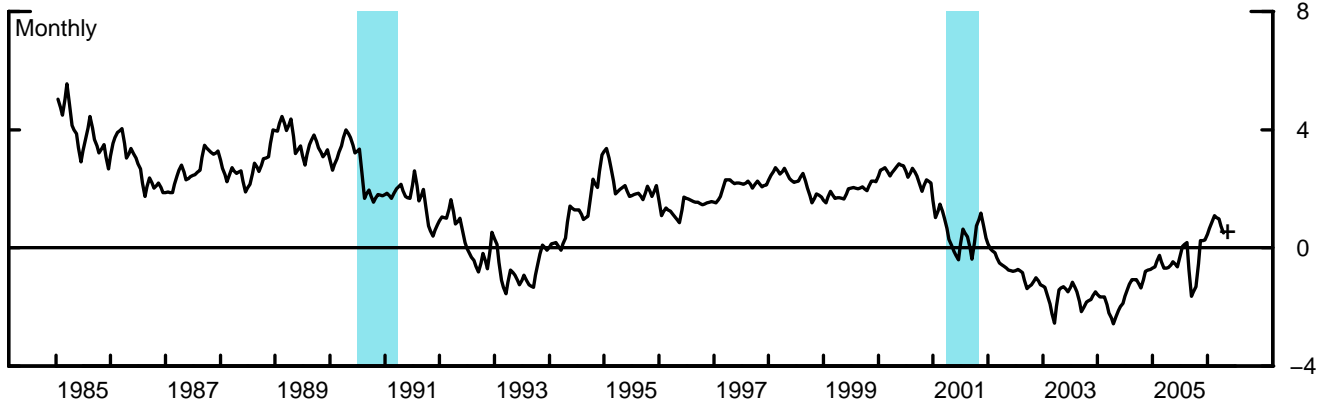
* Based on trailing four-quarter earnings.
+ Denotes most recent weekly value.



* Deflated by the CPI.
+ Denotes most recent weekly value.
Note. Blue shaded regions denote NBER-dated recessions.

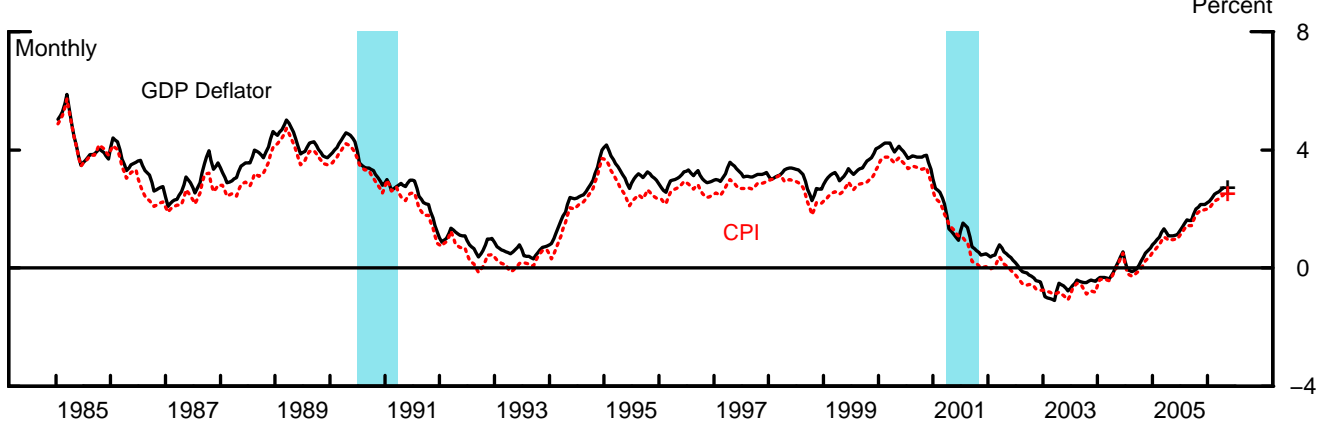
One-Year Real Interest Rates

One-Year Treasury Constant Maturity Yield Less One-Year Inflation Expectations (Michigan Survey)*



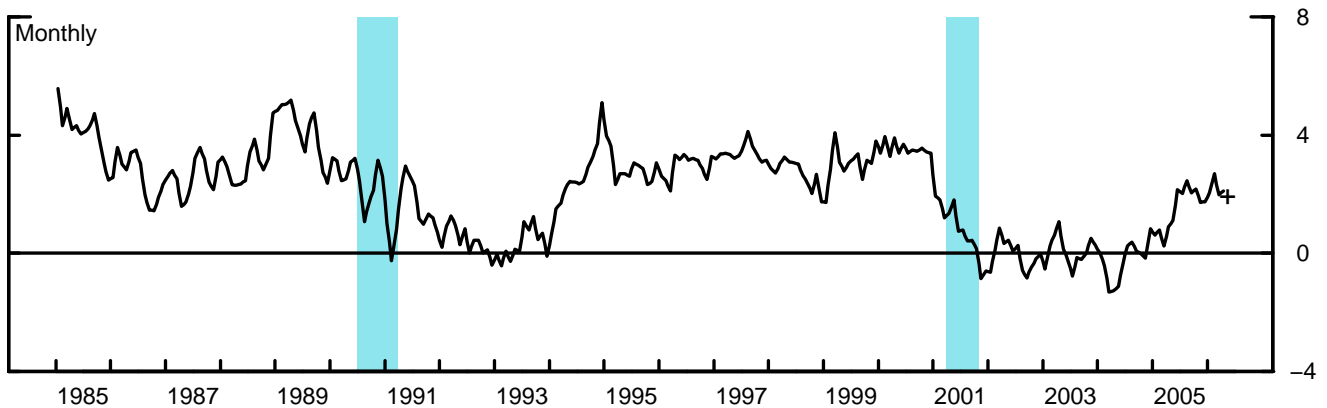
* Mean value of respondents.

One-Year Treasury Constant Maturity Yield Less One-Year Inflation Expectations (Philadelphia Fed)*



* ASA/NBER quarterly survey until 1990:Q1; Philadelphia Federal Reserve Bank Survey of Professional Forecasters thereafter. Median value of respondents.

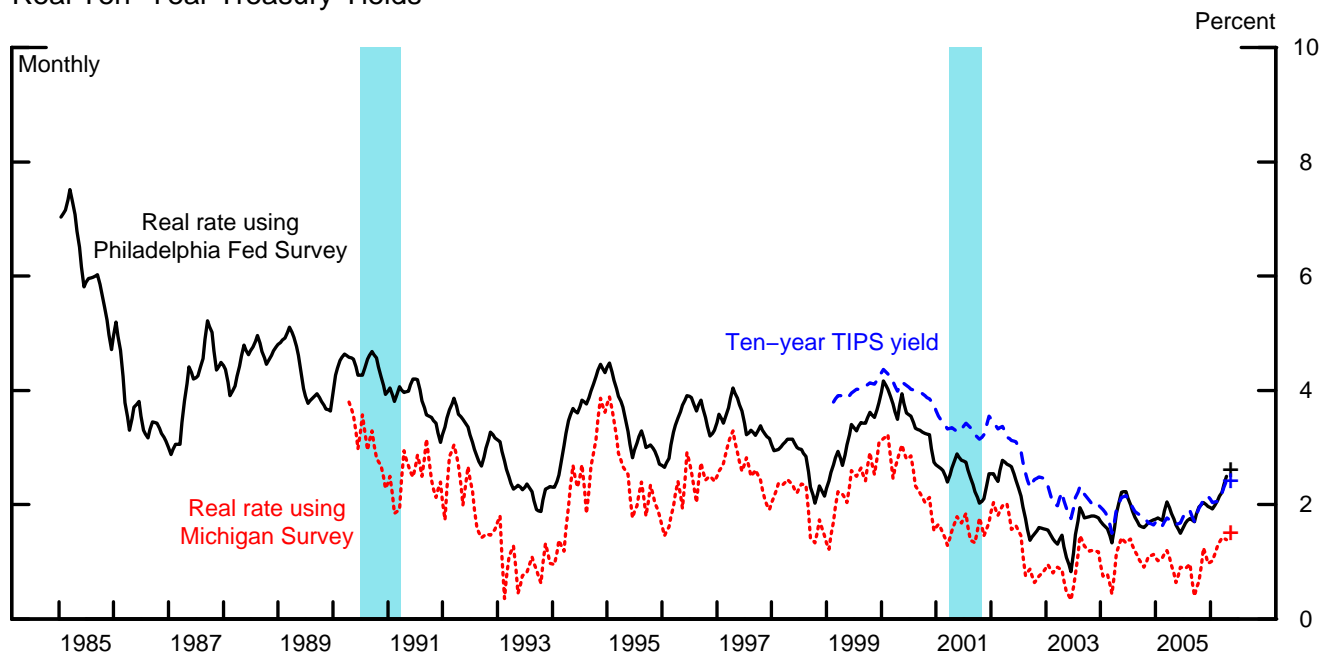
One-Year Treasury Constant Maturity Yield Less Change in the Core CPI from Three Months Prior



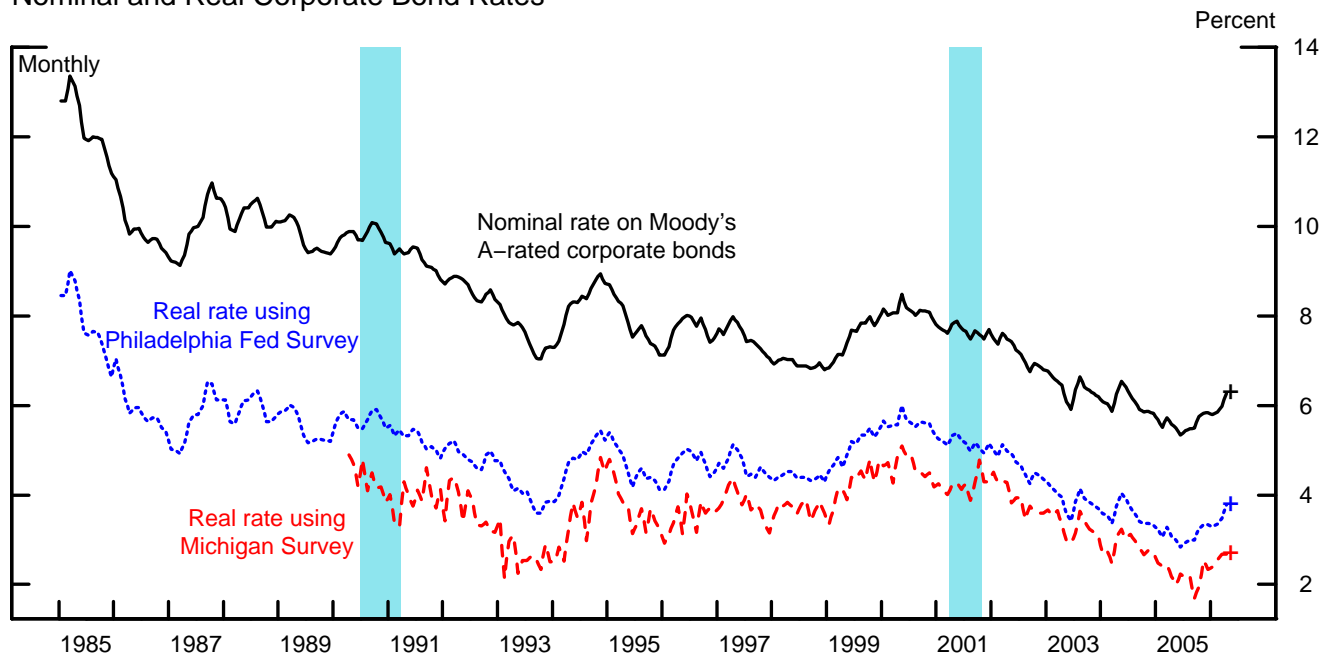
+ Denotes most recent weekly Treasury constant maturity yield less most recent inflation expectation.
Note. Blue shaded regions denote NBER-dated recessions.

Long-Term Real Interest Rates*

Real Ten-Year Treasury Yields



Nominal and Real Corporate Bond Rates



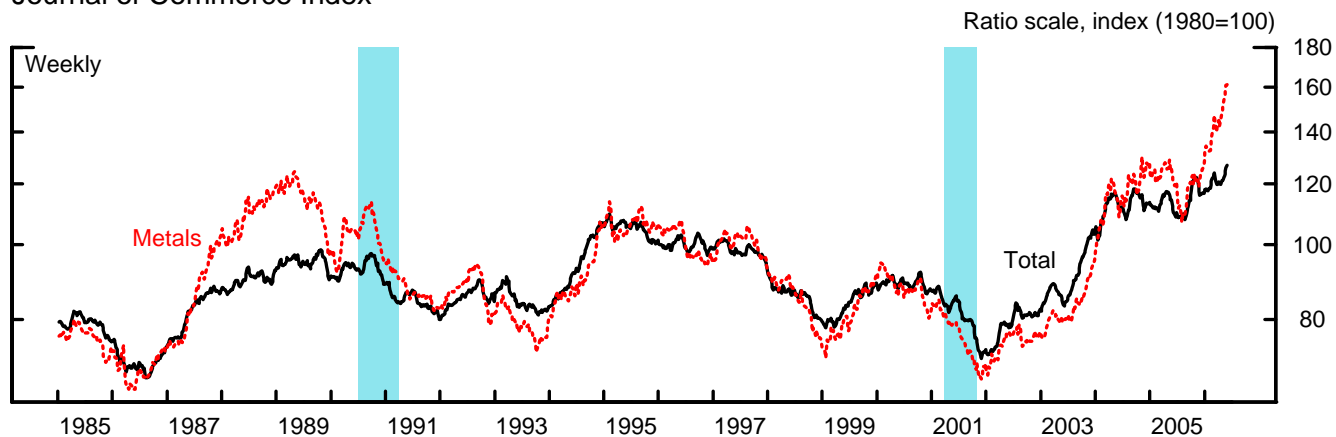
* For real rates, measures using the Philadelphia Fed Survey employ the ten-year inflation expectations from the Blue Chip Survey until April 1991 and the Philadelphia Federal Reserve Bank Survey of Professional Forecasters thereafter (median value of respondents). Measures using the Michigan Survey employ the five- to ten-year inflation expectations from that survey (mean value of respondents).

+ For TIPS and nominal corporate rate, denotes the most recent weekly value. For other real rate series, denotes the most recent weekly nominal yield less the most recent inflation expectation.

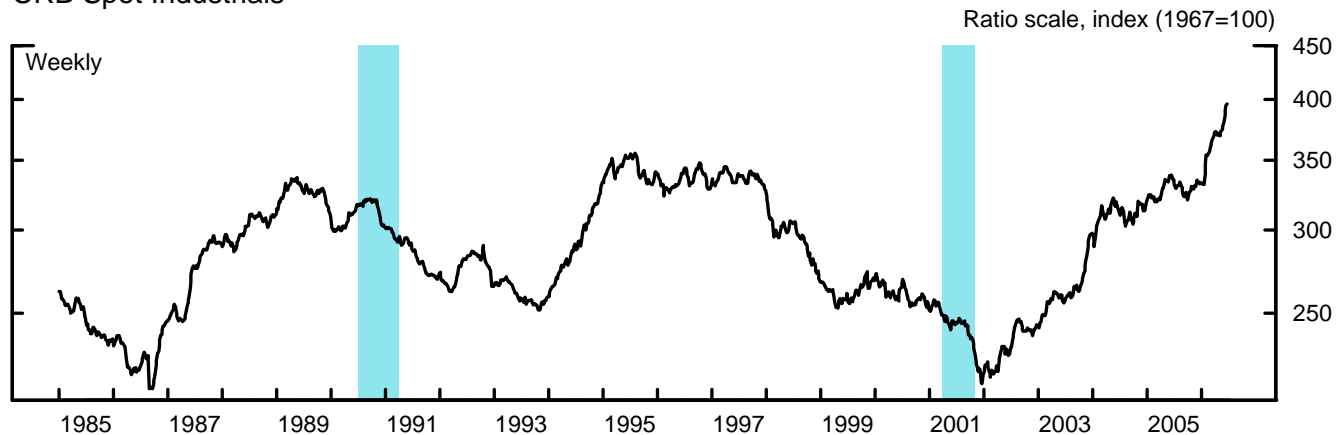
Note. Blue shaded regions denote NBER-dated recessions.

Commodity Price Measures

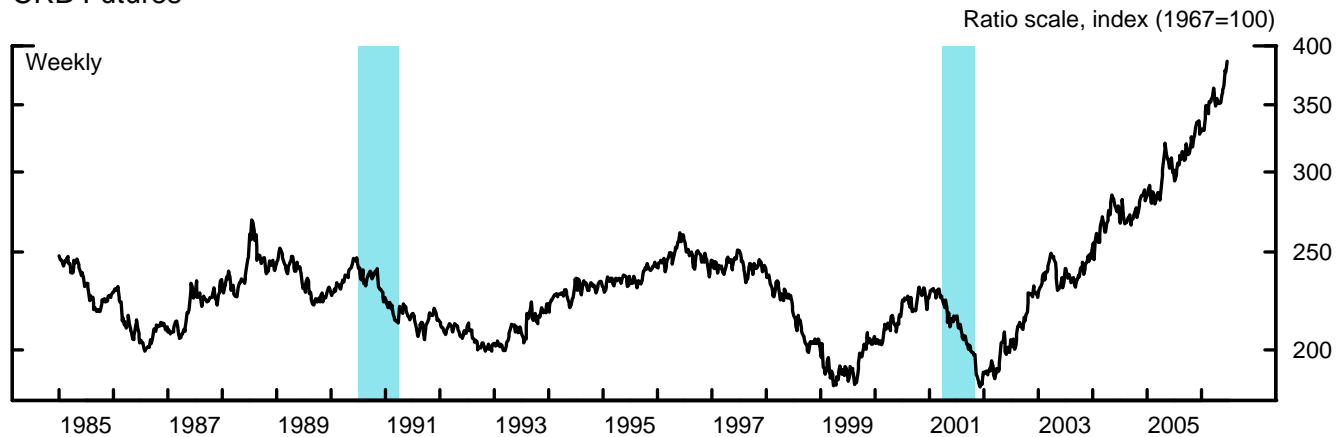
Journal of Commerce Index



CRB Spot Industrials



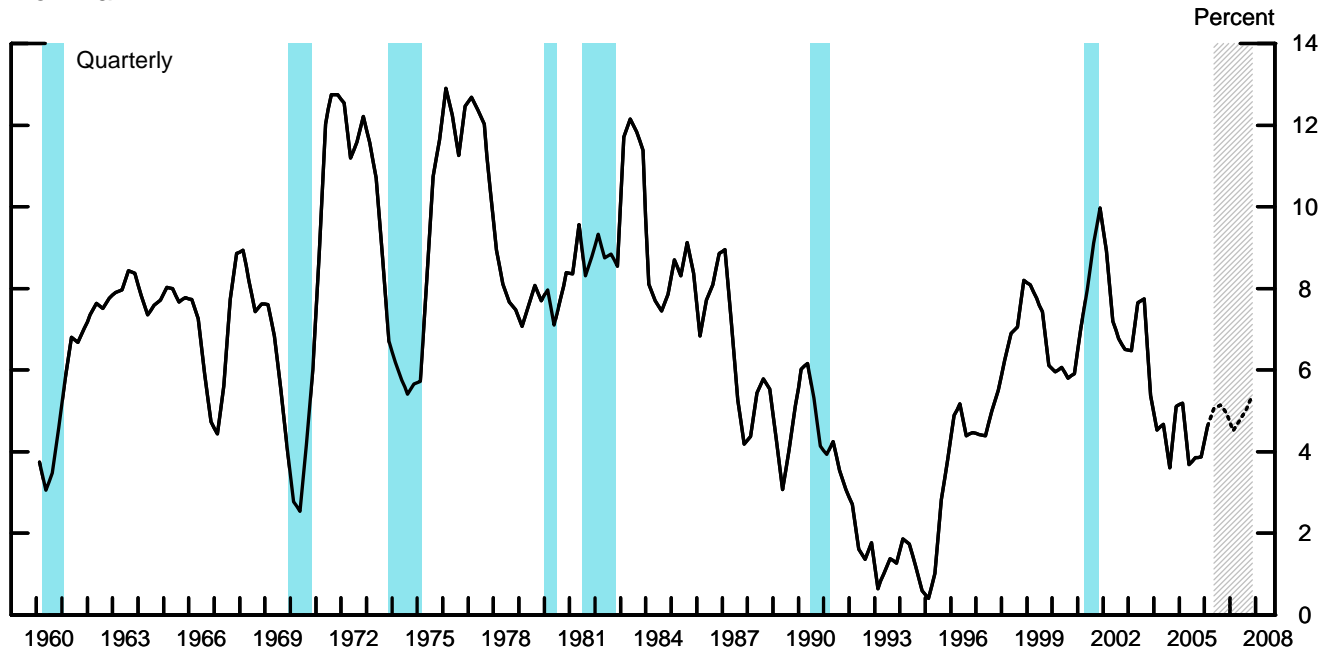
CRB Futures



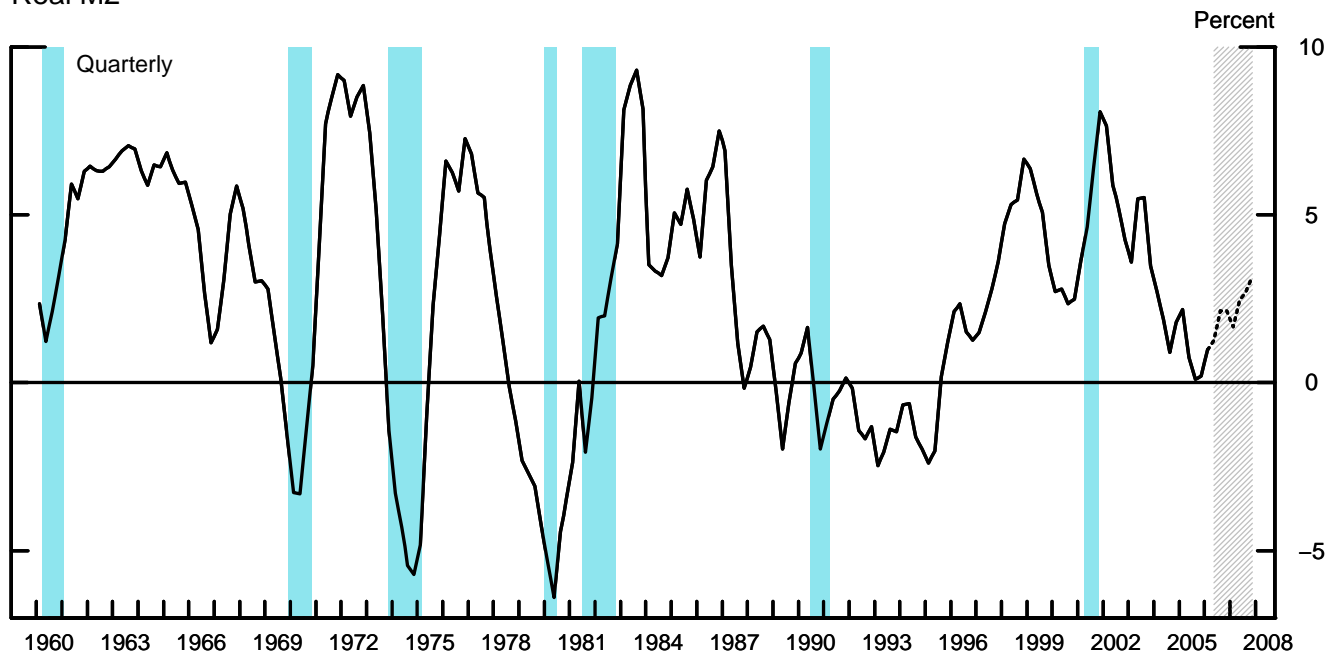
Note. Blue shaded regions denote NBER-dated recessions.

Growth of M2

Nominal M2

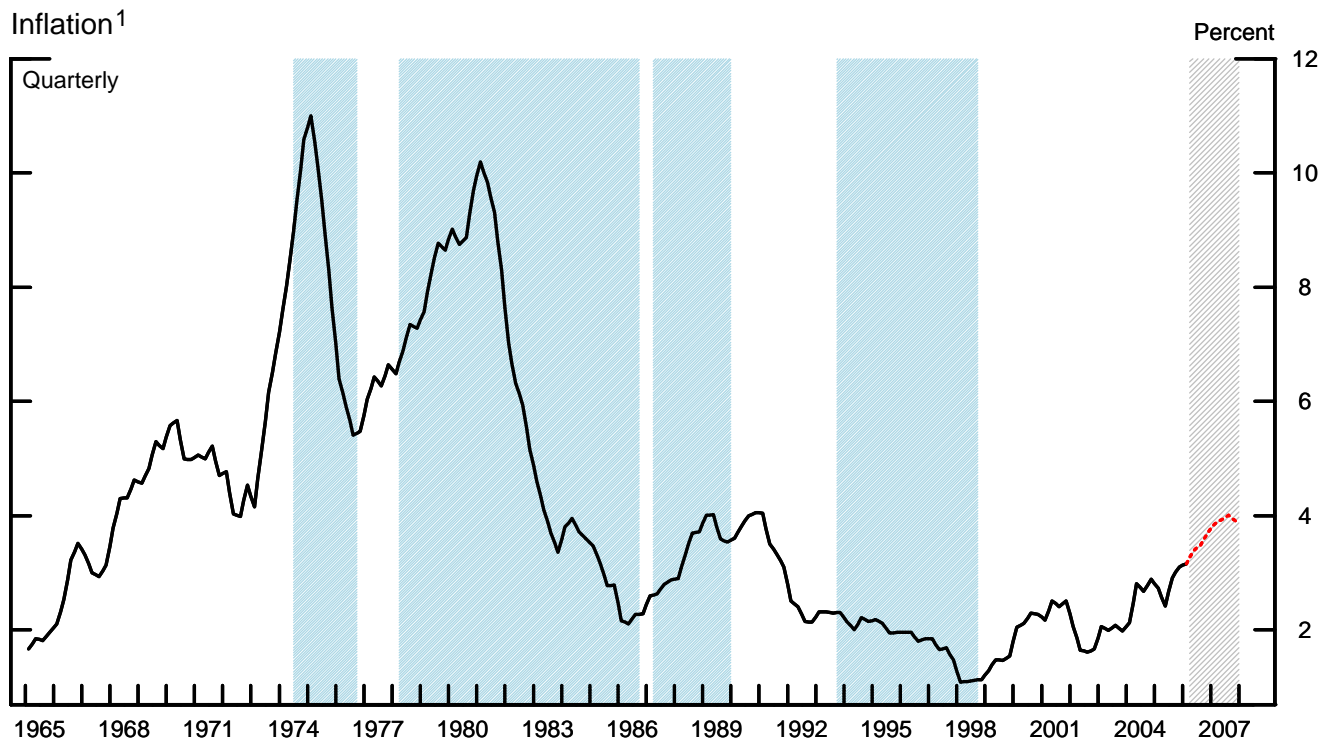
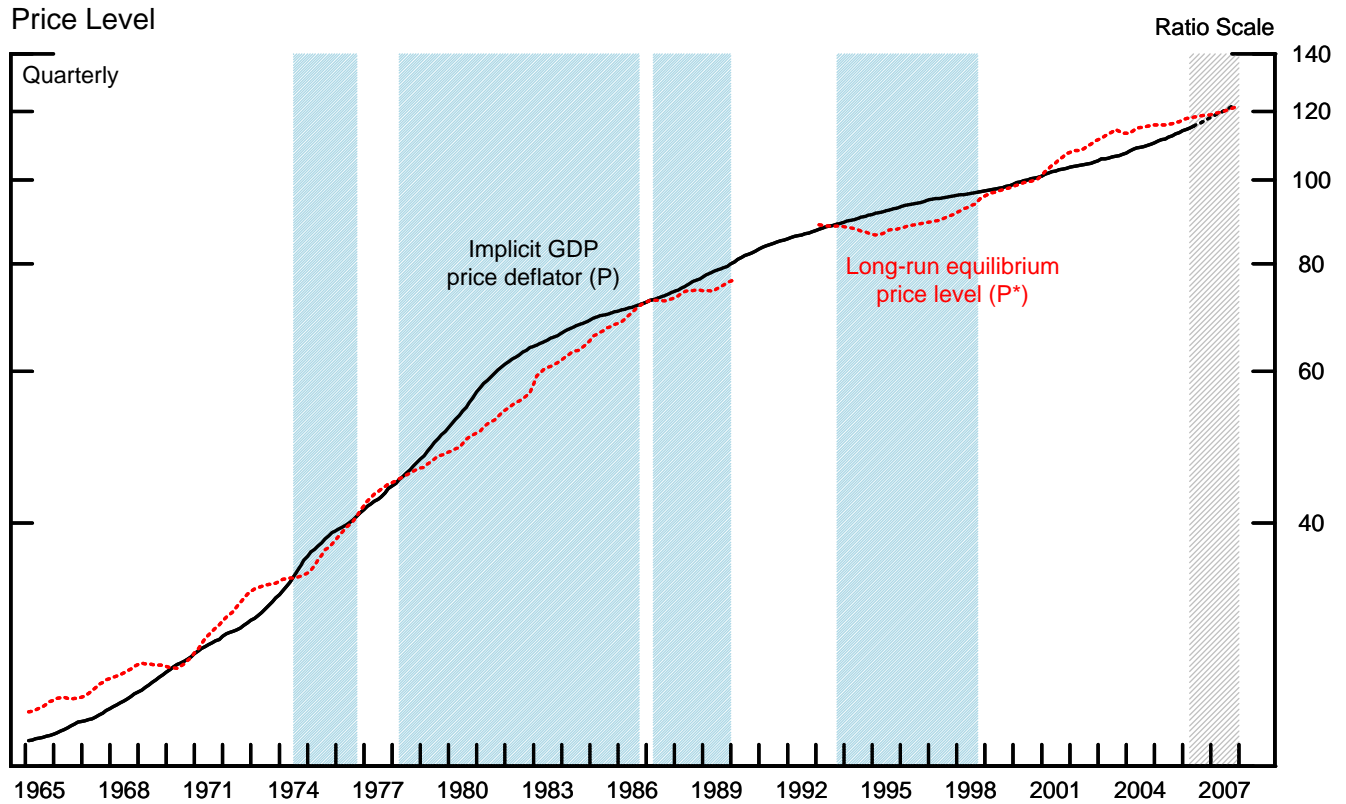


Real M2



Note. Four-quarter moving average. Blue shaded regions denote NBER-dated recessions. Gray areas denote projection period. Real M2 is deflated by CPI.

Inflation Indicator Based on M2



1. Change in the implicit GDP price deflator over the previous four quarters.

Note: P^* is defined to equal $M2$ times V^* divided by potential GDP. V^* , or long-run velocity, is estimated using average velocity over the 1959:Q1-to-1989:Q4 period and then, after a break, over the interval from 1993:Q1 to the present. For the forecast period, P^* is based on the staff M2 forecast and P is simulated using a short-run dynamic model relating P to P^* . Blue areas indicate periods in which P^* is notably less than P . Gray areas denote the projection period.

**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	20-year	5-year	10-year			Fixed-rate	ARM
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
05 -- High	4.30	4.01	4.08	4.37	4.49	4.30	4.52	4.59	4.79	5.04	2.11	2.22	6.48	5.24	6.37	5.22
05 -- Low	2.19	1.86	2.31	2.63	2.50	2.24	3.11	3.58	3.97	4.28	0.98	1.50	5.64	4.72	5.53	4.10
06 -- High	5.00	4.71	4.82	5.01	5.12	4.95	5.02	5.02	5.23	5.40	2.35	2.49	6.77	5.24	6.59	5.68
06 -- Low	4.22	3.91	4.17	4.37	4.50	4.22	4.34	4.28	4.42	4.59	1.82	1.94	6.17	4.22	6.10	5.15
Monthly																
May 05	3.00	2.62	2.90	3.17	3.22	2.97	3.65	3.84	4.22	4.59	1.25	1.65	6.01	4.83	5.72	4.23
Jun 05	3.04	2.82	3.03	3.22	3.38	3.11	3.65	3.76	4.07	4.38	1.37	1.67	5.86	4.77	5.58	4.24
Jul 05	3.26	3.09	3.29	3.53	3.57	3.27	3.90	3.98	4.25	4.50	1.64	1.88	5.95	4.85	5.70	4.40
Aug 05	3.50	3.33	3.52	3.78	3.77	3.47	4.06	4.12	4.34	4.56	1.69	1.89	5.96	4.90	5.82	4.55
Sep 05	3.62	3.21	3.50	3.80	3.87	3.64	3.96	4.01	4.28	4.55	1.40	1.70	6.03	4.94	5.77	4.51
Oct 05	3.78	3.49	3.79	4.13	4.13	3.84	4.31	4.34	4.56	4.77	1.69	1.94	6.30	5.13	6.07	4.86
Nov 05	4.00	3.91	3.97	4.30	4.31	4.01	4.44	4.46	4.66	4.85	1.96	2.09	6.39	5.22	6.33	5.14
Dec 05	4.16	3.67	3.98	4.33	4.45	4.23	4.43	4.39	4.57	4.76	2.07	2.15	6.32	5.18	6.27	5.17
Jan 06	4.29	4.10	4.34	4.47	4.56	4.36	4.42	4.35	4.50	4.67	1.92	2.03	6.24	5.11	6.15	5.17
Feb 06	4.49	4.38	4.54	4.69	4.72	4.47	4.69	4.60	4.66	4.75	1.97	2.06	6.27	5.12	6.25	5.34
Mar 06	4.59	4.55	4.63	4.79	4.88	4.61	4.77	4.72	4.82	4.93	2.08	2.21	6.41	5.10	6.32	5.42
Apr 06	4.79	4.60	4.72	4.90	5.03	4.80	4.92	4.90	5.07	5.24	2.25	2.41	6.68	4.94	6.51	5.62
Weekly																
Mar 3 06	4.50	4.45	4.62	4.75	4.80	4.47	4.74	4.66	4.71	4.78	1.92	2.05	6.27	5.07	6.24	5.34
Mar 10 06	4.51	4.44	4.60	4.77	4.84	4.53	4.80	4.76	4.85	4.93	2.08	2.20	6.41	5.11	6.37	5.45
Mar 17 06	4.52	4.48	4.61	4.80	4.89	4.62	4.73	4.68	4.80	4.92	2.05	2.18	6.41	5.08	6.34	5.37
Mar 24 06	4.60	4.64	4.67	4.80	4.91	4.68	4.74	4.68	4.79	4.91	2.10	2.22	6.39	5.08	6.32	5.41
Mar 31 06	4.76	4.68	4.63	4.82	4.94	4.72	4.84	4.78	4.90	5.02	2.20	2.32	6.50	5.14	6.35	5.51
Apr 7 06	4.84	4.64	4.68	4.85	4.98	4.75	4.88	4.84	4.99	5.13	2.26	2.39	6.59	5.16	6.43	5.57
Apr 14 06	4.78	4.61	4.70	4.91	5.02	4.73	4.94	4.90	5.07	5.23	2.26	2.43	6.69	5.18	6.49	5.61
Apr 21 06	4.75	4.55	4.73	4.91	5.05	4.79	4.91	4.90	5.10	5.28	2.20	2.40	6.72	5.20	6.53	5.63
Apr 28 06	4.77	4.62	4.78	4.94	5.09	4.87	4.95	4.94	5.14	5.31	2.28	2.43	6.73	4.22	6.58	5.68
May 5 06	--	4.62	4.81	4.99	5.11	4.92	4.98	4.99	5.21	5.38	2.26	2.45	--	5.24	6.59	5.67
Daily																
Apr 18 06	4.72	4.54	4.73	4.90	5.05	4.76	4.88	4.87	5.07	5.25	2.18	2.38	6.69	--	--	--
Apr 19 06	4.70	4.54	4.73	4.90	5.04	--	4.90	4.90	5.12	5.31	2.16	2.38	6.74	--	--	--
Apr 20 06	4.73	4.55	4.73	4.90	5.05	4.85	4.92	4.92	5.12	5.31	2.22	2.42	6.74	--	--	--
Apr 21 06	4.74	4.57	4.75	4.90	5.06	4.80	4.93	4.90	5.09	5.27	2.20	2.38	6.71	--	--	--
Apr 24 06	4.77	4.57	4.76	4.93	5.07	4.81	4.91	4.89	5.06	5.23	2.23	2.39	6.66	--	--	--
Apr 25 06	4.74	4.63	4.79	4.96	5.07	4.80	4.97	4.96	5.15	5.32	2.33	2.47	6.75	--	--	--
Apr 26 06	4.73	4.65	4.79	4.98	5.09	4.90	5.02	5.00	5.18	5.35	2.35	2.48	6.76	--	--	--
Apr 27 06	4.79	4.64	4.78	4.93	5.11	4.91	4.94	4.95	5.16	5.34	2.27	2.43	6.76	--	--	--
Apr 28 06	4.86	4.59	4.77	4.91	5.09	4.92	4.90	4.91	5.14	5.33	2.21	2.38	6.74	--	--	--
May 1 06	4.84	4.59	4.82	4.98	5.09	4.92	4.96	4.98	5.21	5.39	2.23	2.42	6.77	--	--	--
May 2 06	4.79	4.66	4.81	4.98	5.11	4.94	4.96	4.97	5.19	5.37	2.23	2.42	6.73	--	--	--
May 3 06	4.81	4.64	4.82	5.00	5.11	4.85	4.98	5.00	5.22	5.40	2.28	2.47	6.76	--	--	--
May 4 06	4.83	4.60	4.80	5.01	5.12	4.95	5.01	5.02	5.23	5.40	2.30	2.49	6.76	--	--	--

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.

Appendix Table 2
Money Aggregates
 Seasonally Adjusted

Period	M1	M2	Nontransactions Components in M2
	1	2	3
<u>Annual growth rates (%):</u>			
<u>Annually (Q4 to Q4)</u>			
2003	7.4	5.5	5.0
2004	5.4	5.2	5.2
2005	0.0	3.9	5.0
<u>Quarterly (average)</u>			
2005-Q2	-0.3	2.5	3.2
Q3	-0.6	4.4	5.7
Q4	0.8	5.1	6.2
2006-Q1	3.6	6.6	7.4
<u>Monthly</u>			
2005-Apr.	-6.3	1.1	3.1
May	4.4	1.6	0.8
June	-1.1	4.9	6.5
July	-6.2	3.7	6.3
Aug.	7.0	5.6	5.2
Sep.	-2.5	5.5	7.7
Oct.	1.6	5.3	6.3
Nov.	0.7	4.0	4.8
Dec.	-1.2	5.1	6.7
2006-Jan.	12.4	11.2	10.9
Feb.	-5.3	4.1	6.6
Mar.	7.3	3.1	2.0
Apr. e	7.9	4.4	3.4
<u>Levels (\$billions):</u>			
<u>Monthly</u>			
2005-Nov.	1370.2	6647.6	5277.3
Dec.	1368.8	6675.7	5306.9
2006-Jan.	1383.0	6737.9	5354.9
Feb.	1376.9	6761.2	5384.3
Mar.	1385.3	6778.4	5393.1
<u>Weekly</u>			
2006-Mar. 6	1377.1	6783.2	5406.2
13	1360.0	6757.1	5397.1
20	1382.9	6782.9	5400.1
27	1388.8	6776.5	5387.6
Apr. 3	1424.3	6799.9	5375.7
10	1374.2	6776.2	5402.0
17p	1384.7	6806.7	5422.0
24p	1402.9	6810.0	5407.1

p preliminary

e estimated

Appendix Table 3
Changes in System Holdings of Securities ¹
(Millions of dollars, not seasonally adjusted)

May 4, 2006

	Treasury Bills			Treasury Coupons						Federal Agency Redemptions (-)	Net change total outright holdings ⁴	Net RPs ⁵		
	Net Purchases ²	Redemptions (-)	Net Change	Net Purchases ³				Redemptions (-)	Net Change			Short-Term ⁶	Long-Term ⁷	Net Change
				< 1	1-5	5-10	Over 10							
2003	18,150	---	18,150	6,565	7,814	4,107	220	---	18,706	10	36,846	2,223	1,036	3,259
2004	18,138	---	18,138	7,994	17,249	5,763	1,364	---	32,370	---	50,507	-2,522	-331	-2,853
2005	8,300	---	8,300	2,894	11,309	3,626	2,007	2,795	17,041	---	25,341	-2,415	-192	-2,607
2005 QI	35	---	35	---	---	---	---	544	-544	---	-509	1,653	-3,454	-1,801
QII	2,010	---	2,010	---	3,495	1,708	1,015	1,305	4,914	---	6,923	1,082	1,361	2,443
QIII	4,743	---	4,743	1,298	5,025	1,118	90	757	6,774	---	11,517	964	1,538	2,502
QIV	1,512	---	1,512	1,596	2,789	800	902	189	5,897	---	7,410	-1,202	-1,293	-2,496
2006 QI	4,099	---	4,099	1,200	7,443	1,704	1,219	1,321	10,245	---	14,345	793	1,839	2,631
2005 Sep	1,992	---	1,992	---	3,635	130	90	---	3,855	---	5,847	283	-599	-316
Oct	1,023	---	1,023	500	1,693	---	902	---	3,095	---	4,118	-1,468	-5,369	-6,837
Nov	489	---	489	1,096	1,096	800	---	189	2,802	---	3,292	-627	3,635	3,008
Dec	---	---	---	---	---	---	---	---	---	---	---	1,322	6,719	8,042
2006 Jan	1,563	---	1,563	---	2,809	1,505	205	1,321	3,198	---	4,761	252	-1,355	-1,103
Feb	1,308	---	1,308	1,200	2,498	25	924	---	4,647	---	5,955	-396	-3,672	-4,068
Mar	1,228	---	1,228	---	2,136	174	90	---	2,400	---	3,628	393	-232	162
Apr	---	---	---	---	1,096	---	---	---	1,096	---	1,096	626	-3,995	-3,368
2006 Feb 8	14	---	14	---	---	---	---	---	---	---	14	-2,824	-2,000	-4,824
Feb 15	1,274	---	1,274	---	1,250	---	---	---	1,250	---	2,524	4,204	1,000	5,204
Feb 22	---	---	---	---	1,248	---	---	---	1,248	---	1,248	-1,211	3,000	1,789
Mar 1	---	---	---	1,200	---	25	924	---	2,149	---	2,149	-362	1,000	638
Mar 8	---	---	---	---	676	174	---	---	850	---	850	-1,927	-1,000	-2,927
Mar 15	---	---	---	---	1,460	---	90	---	1,550	---	1,550	2,475	---	2,475
Mar 22	---	---	---	---	---	---	---	---	---	---	---	-56	---	-56
Mar 29	1,228	---	1,228	---	---	---	---	---	---	---	1,228	-24	-6,000	-6,024
Apr 5	---	---	---	---	---	---	---	---	---	---	---	3,105	-2,000	1,105
Apr 12	---	---	---	---	---	---	---	---	---	---	---	-4,143	1,000	-3,143
Apr 19	---	---	---	---	---	---	---	---	---	---	---	4,093	1,000	5,093
Apr 26	---	---	---	---	1,096	---	---	---	1,096	---	1,096	-5,428	2,000	-3,428
May 3	---	---	---	---	---	---	---	---	---	---	---	3,218	---	3,218
2006 May 4	---	---	---	---	---	---	---	---	---	---	---	92	-1,000	-908
Intermeeting Period														
Mar 28-May 4	---	---	---	---	1,096	---	---	---	1,096	---	1,096	606	1,000	1,606
Memo: LEVEL (bil. \$)														
May 4			275.4	132.7	216.2	55.4	80.0		484.3	---	759.7	-14.6	15.0	0.4

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 13 days or less.
7. Original maturity of 14 to 90 days.