Prefatory Note

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Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. 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 optimal 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.

STRICTLY CONFIDENTIAL (FR) CLASS II FOMC

SEPTEMBER 19, 2002

MONETARY POLICY ALTERNATIVES

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

Strictly Confidential (F.R.) **September 19, 2002**
Class II – FOMC

MONETARY POLICY ALTERNATIVES

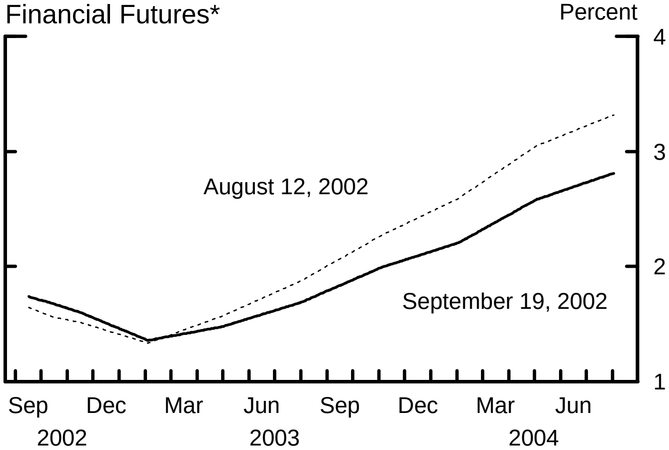
Recent Developments

(1) Investors' view of the economic outlook seemed to be colored by the FOMC's announcement following the August meeting of no change in the target funds rate and a shift in the assessment of the balance of risks toward economic weakness. Over the remainder of that day, near-term interest rate futures edged higher as those expecting imminent ease were disappointed, but rates several months ahead dropped as much as 20 basis points and broad equity indexes were off about 2-1/2 percent as the tilt and the wording of the announcement were taken to signal weaker economic prospects. Spirits were lifted briefly by the uneventful passing of the August 14 deadline for the recertification of corporate financial statements; equity markets rallied for several days, pulling Treasury yields up in tow. Since then, however, the softer tone to incoming data on production and employment, heightened tensions over Iraq, and a gloomier assessment of the path for business profits seem again to have left investors marking down their outlook for the economy. On balance over the intermeeting period, the expected path of the federal funds rate embedded in futures rates rose slightly at near maturities, largely reflecting the absence of an easing at the August meeting and statements by Federal Reserve officials that appeared to convey lower odds on near-term policy action (Chart 1).[1] Current quotes suggest that investors see only a small likelihood of policy easing at this meeting, and

[1] The federal funds rate averaged close to 1-3/4 percent over the intermeeting period. The slowing growth of currency implied that the Desk purchased only \$4.6 billion of Treasury securities in outright operations: \$3.6 billion of Treasury coupon securities in the market and \$1.1 billion of bills from foreign official institutions. The outstanding volume of long-term System RPs fell \$1 billion, to \$11 billion.

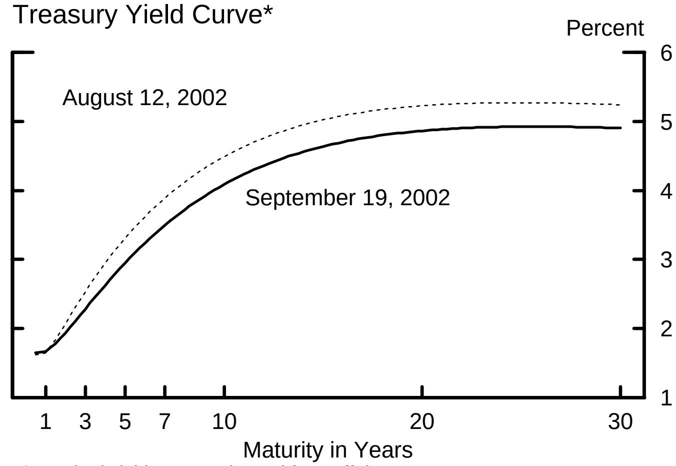
Chart 1
Financial Market Indicators

Expected Federal Funds Rates Estimated from Financial Futures*



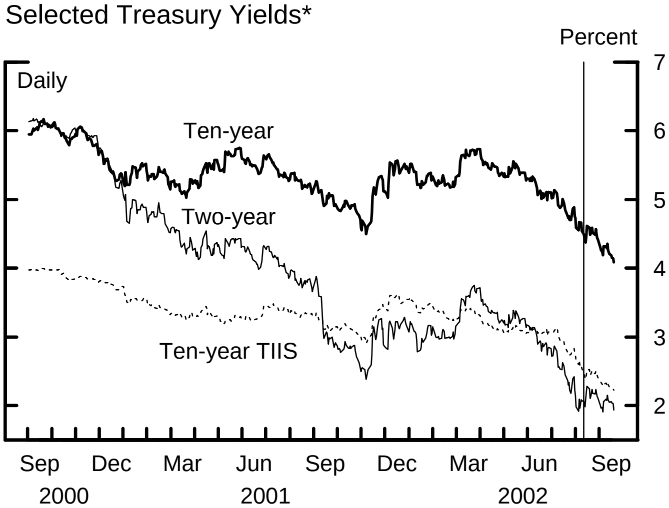
*Estimates from federal funds and eurodollar futures rates with an allowance for term premia and other adjustments.

Treasury Yield Curve*



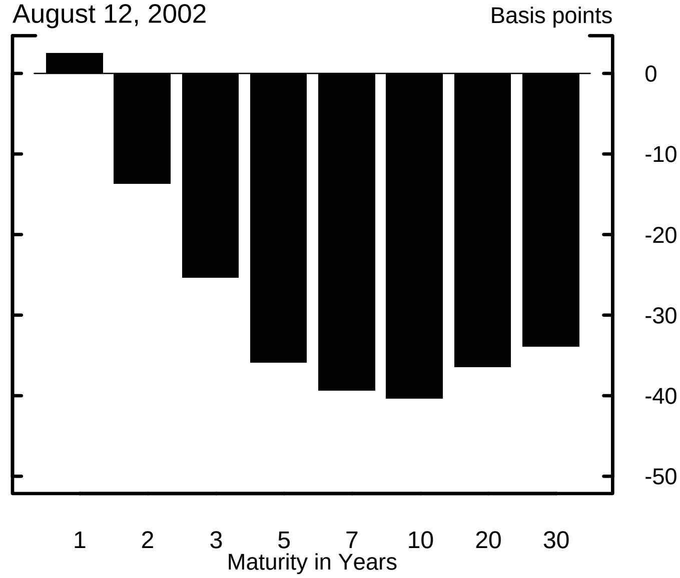
*Smoothed yield curve estimated from off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semi-annual coupons.

Selected Treasury Yields*

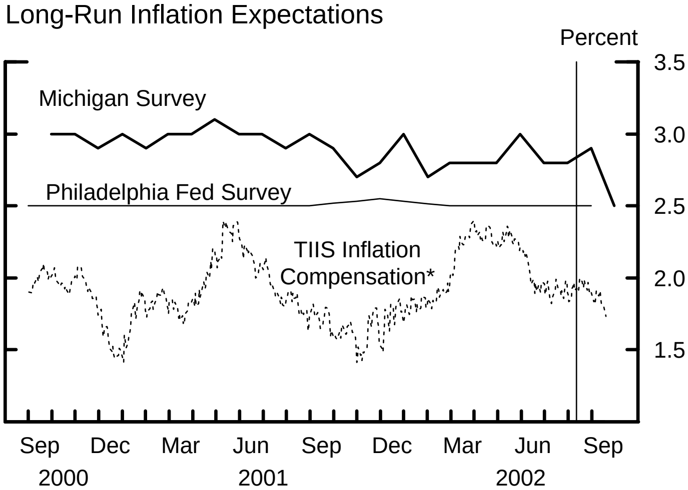


*Nominal Treasury yields are based on a smoothed yield curve estimated from off-the-run securities.

Change in Treasury Yield Curve Since August 12, 2002

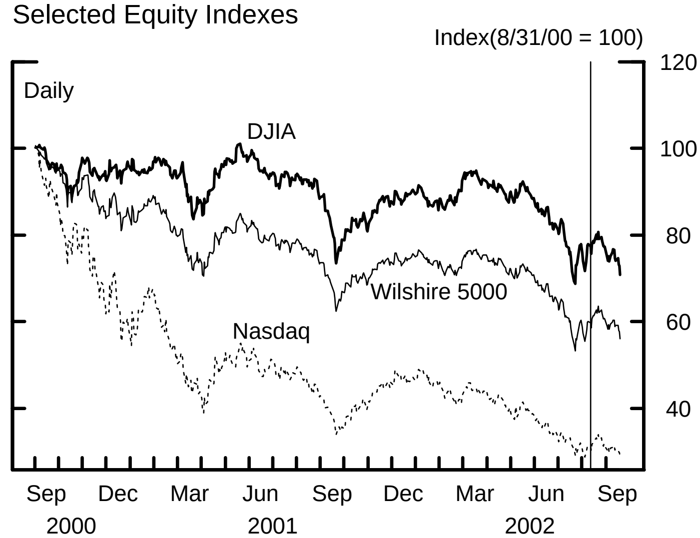


Long-Run Inflation Expectations



*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.

Selected Equity Indexes



Note: Solid vertical line indicates August 12. Daily data are through September 19.

recent surveys of market participants have indicated that most anticipate the Committee will retain a balance of risks toward economic weakness. Futures rates suggest that investors think it likely that the Federal Reserve will respond to weaker economic outcomes with additional easing at some point in the next few months. Moreover, the futures curve beyond midyear 2003 dropped 15 to 45 basis points and now points to a more gradual expected tightening of policy than previously anticipated.

(2) In keeping with the revisions to policy expectations, short-term Treasury yields were about unchanged to up slightly while intermediate- and long-term Treasury yields shed 35 to 40 basis points. The decline in longer-term Treasury yields reportedly was amplified by hedging demands from mortgage-backed securities investors. Those investors apparently purchased longer-term Treasuries to offset the shortening in the duration of their portfolios stemming from the jump in prepayments on mortgage-backed securities that accompanied the surge in mortgage refinancings.[2] At the ten-year maturity, yields on Treasury indexed securities fell a bit less than those on their nominal counterparts–perhaps because indexed securities did not experience increased hedging demands to the same degree–but also probably suggestive of a slight decline in inflation compensation and a downward revision to economic prospects. The absence of any major new accounting scandals was a palliative for the corporate bond market. Issuers returned to the market after mid-August, though gross issuance was still light, and anecdotal reports suggest that market liquidity has

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[2] Market attention focused in particular on the hedging activities of Fannie Mae, which announced that the average duration of its assets was substantially shorter than that of its liabilities. Over the intermeeting period, Fannie Mae's share price fell 10.3 percent compared with a 2.7 percent decline in that of Freddie Mac, which had announced a rough balance between assets and liabilities.

largely returned to normal, at least for higher-tier credits. Yields on highly rated issues kept pace with declining Treasury yields, but risk spreads for speculative-grade bonds were unchanged to a bit narrower (Chart 2). (More detail on credit market conditions is provided in the following box.) Major equity price indexes finished the period down about 6-1/4 to 8-1/2 percent, on balance, moving the forward earnings-price

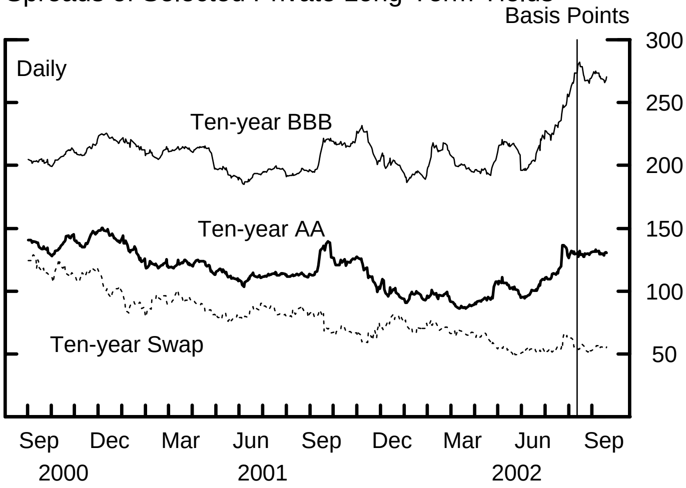
Credit Market Conditions

On net, it appears that credit market conditions improved marginally over the intermeeting period. The dimunition of event risk following the passing of both the August 14 recertification date and September 11 without major incident seemed to contribute to an improved climate in capital markets. Anecdotal reports suggest that bid-asked spreads and market depth for investment-grade credits have returned close to normal. Transaction volumes in corporate securities reported by primary dealers moved higher over the period (Chart 3), and the drop in long-term interest rates prompted a pickup in bond issuance. In the high-yield bond market, spreads remain at very high levels and issuance has been anemic. By some measures, however, risk spreads for speculative-grade bonds narrowed a little over the intermeeting period and, very recently, liquidity in this market segment reportedly has improved somewhat. These recent stirrings in the speculative-grade sector may have been occasioned by the sizable net inflows to high-yield bond funds recorded in late August and early September.

Market pressures on major broker-dealers may be a factor hindering further improvement in capital market conditions. Credit default swap spreads for broker-dealers increased substantially this summer and, although narrowing a touch in recent weeks, remain quite wide. Major banks have also been under some market pressure recently. The well-publicized troubles of JP Morgan Chase and Citigroup led to a widening in their subordinated debt spreads in recent months, and subordinated debt spreads gapped wider for a number of other major banking institutions after mid-year as well. Late in the period, JP Morgan Chase's risk spread ticked higher after the firm was downgraded by one of the two major ratings agencies. However, spreads for most other banks narrowed over the intermeeting period. In the syndicated loan market, market participants have noted a pickup in new deals in early September and a growing forward calendar. The sense of continued availability of business credit from banks seemed to apply to smaller firms as well. The most recent survey by the National Federation of Independent Businesses suggested a marginal improvement in credit availability for such firms.

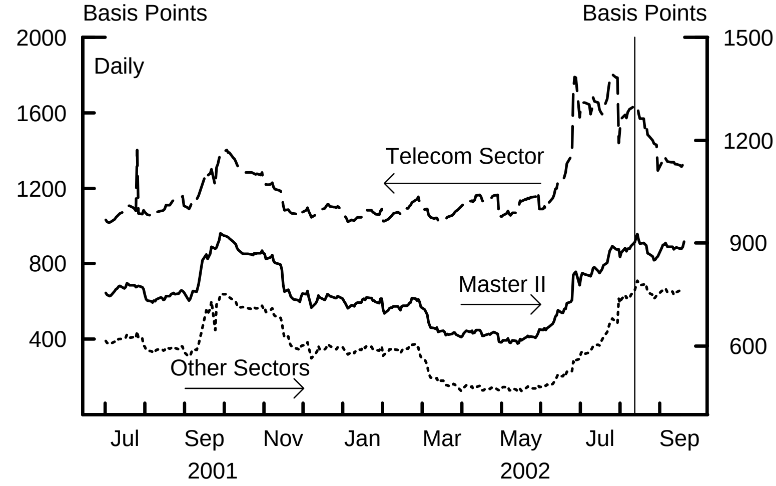
Chart 2
Financial Market Indicators

Spreads of Selected Private Long-Term Yields



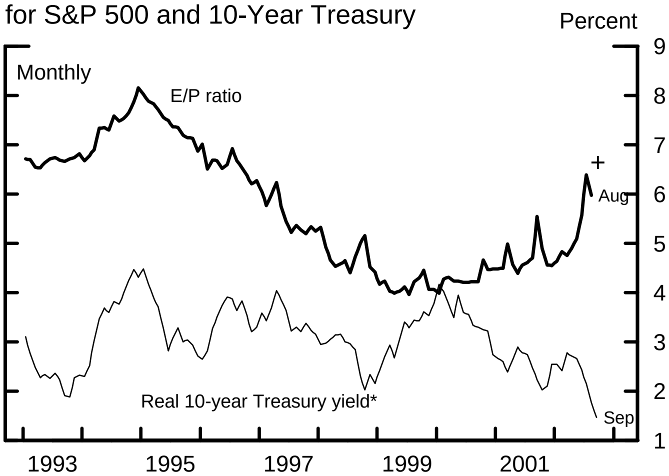
Note: Spreads measured over ten-year Treasury.

High-Yield Debt Spreads



Note: Spreads measured over ten-year Treasury. Last observations for Telecom and Other Sectors are for September 18. Source: Merrill Lynch.

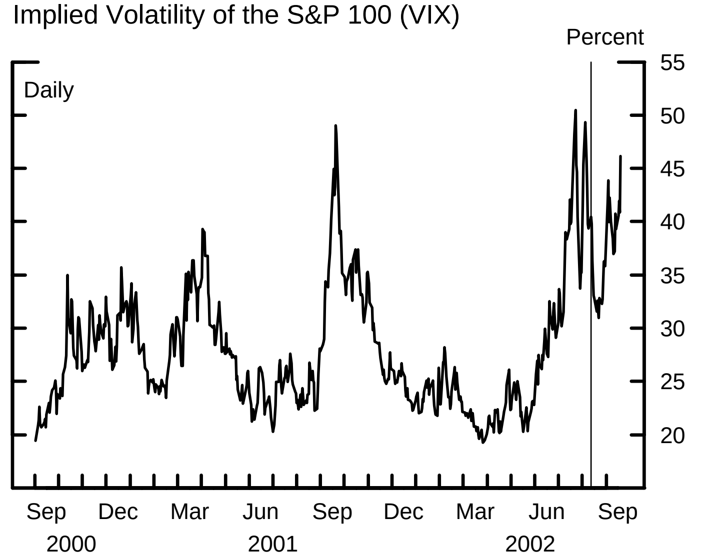
12-Month Forward Earnings-Price Ratio for S&P 500 and 10-Year Treasury



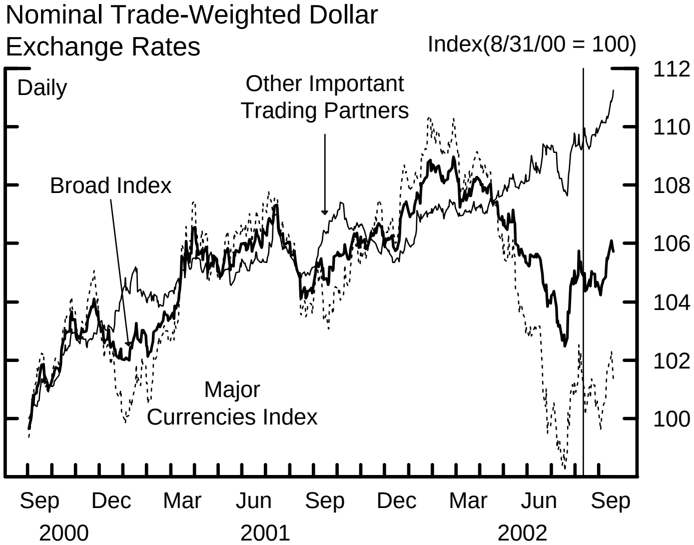
* 10-year Treasury yield minus Philadelphia Fed 10-year expected inflation.

+ Denotes the latest observation using daily prices and latest earnings data from I/B/E/S.

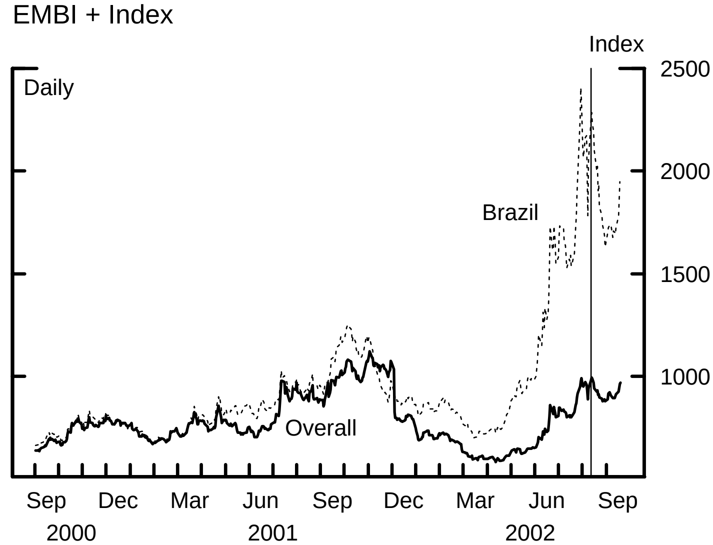
Implied Volatility of the S&P 100 (VIX)



Nominal Trade-Weighted Dollar Exchange Rates



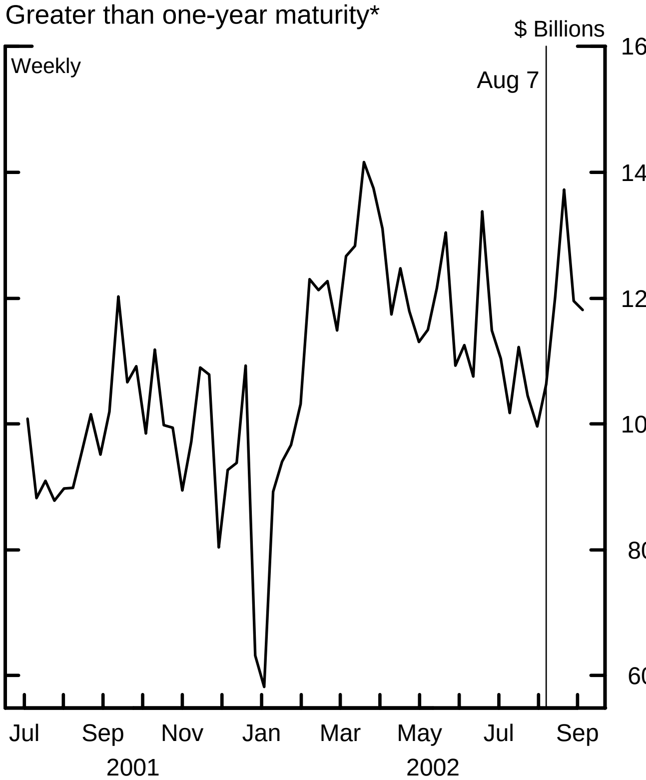
EMBI + Index



Note: Solid vertical line indicates August 12. Data are through September 19, except as noted.

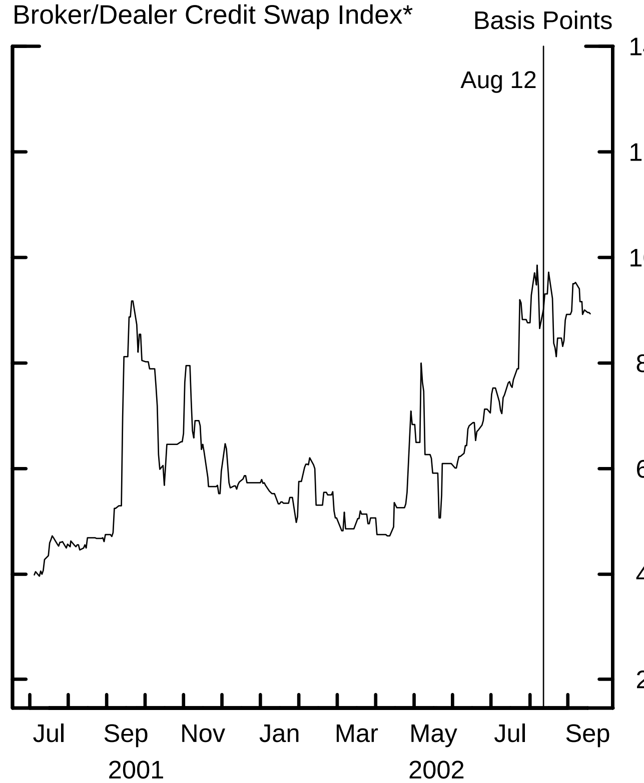
Chart 3
Credit Market Conditions

Transactions in Corporate Securities: Greater than one-year maturity*



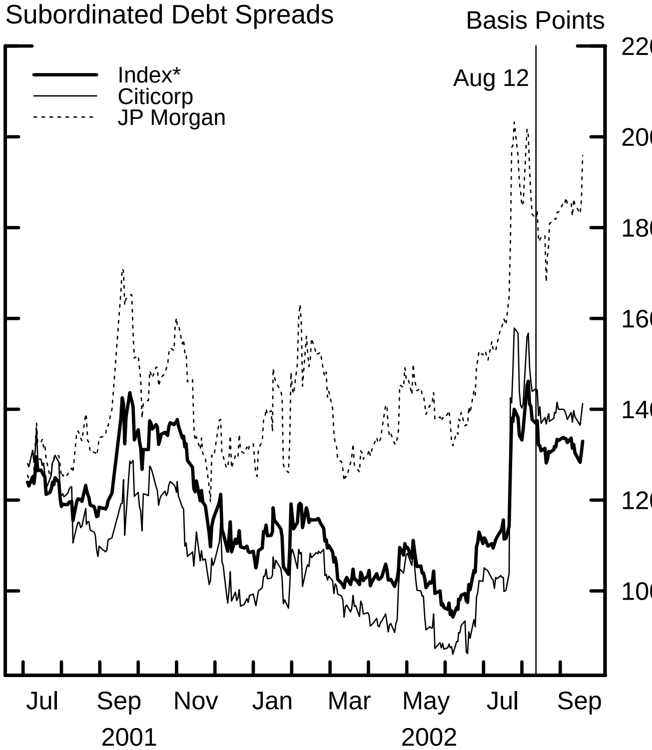
*Total transaction volume in corporate securities reported by primary dealers.

Broker/Dealer Credit Swap Index*



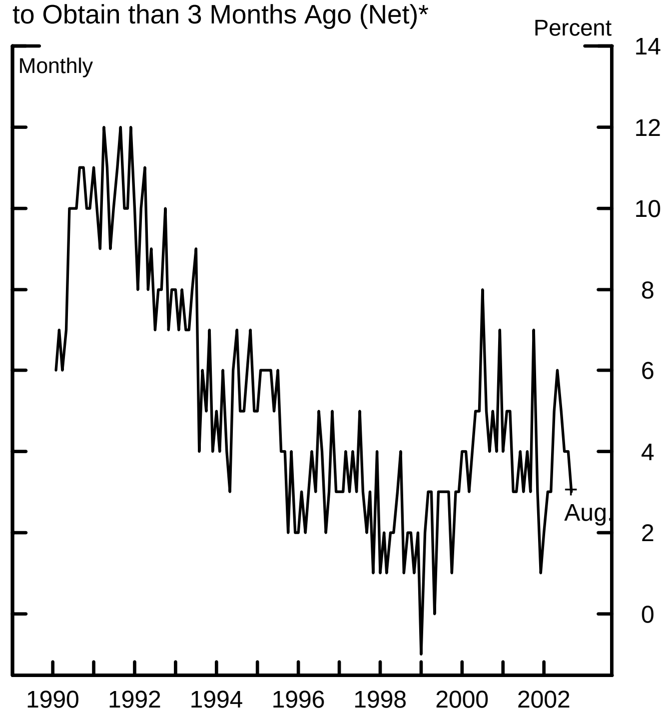
*Index with time-varying weights based on book value of long-term debt in the contemporaneous quarter (2002:Q1 values used from 2002:Q2 - 2002:Q3).
Note: Last observation is September 18, 2002.

Subordinated Debt Spreads



*Weighted-average of subordinated debt spreads of 16 banks with weights based on book value of all debt issues for the firm in the Merrill Lynch U.S. Bond Index and spreads over comparable-maturity Treasury yields.
Note: Last observation is September 18, 2002.

NFIB Survey: Credit More Difficult to Obtain than 3 Months Ago (Net)*



*Of borrowers who sought credit within the past three months, the proportion that reported more difficulty in obtaining credit less the proportion that reported ease in obtaining credit. Not seasonally adjusted.

ratio for the S&P 500 further above measures of long-term risk-free real interest rates. Judging by option-implied volatility on stock index futures, investors remain quite uncertain about the path of equity prices.

(3) On balance, the trade-weighted value of the dollar against other major currencies appreciated slightly over the intermeeting period as concerns emerged about other industrial countries, particularly Germany and Japan, regarding the momentum of economic recovery that were even more pronounced than in the United States. The dollar generally moved in narrow ranges against individual currencies, ending the period about unchanged against most, but it appreciated almost 2-1/4 percent on balance against the yen. Policy rates in foreign industrial countries were left unchanged, and most foreign long-term government bond yields declined 20 to 25 basis points. Political pressure intensified on the Bank of Japan to employ unconventional means to spur the economy and aid banks, including by stepping up purchases of government bonds. Yesterday, the Bank of Japan surprised market participants by announcing that it would explore ways to purchase equities from banks. Japanese stocks rallied after the announcement, but JGB yields rose about 15 basis points to end the intermeeting period down only slightly on net. Foreign stock prices extended prior declines, on balance, in often volatile trading; share prices in Germany sank 15 percent, pulled down by the poor performance of the insurance and technology sectors.

. The Desk did not intervene during the period.

(4) The dollar's value against the currencies of other important trading partners rose 1-1/2 percent over the intermeeting period. Brazilian financial markets were buoyed by final IMF approval of a financial support package, but concerns remain about the potential victory of an opposition candidate in next month's

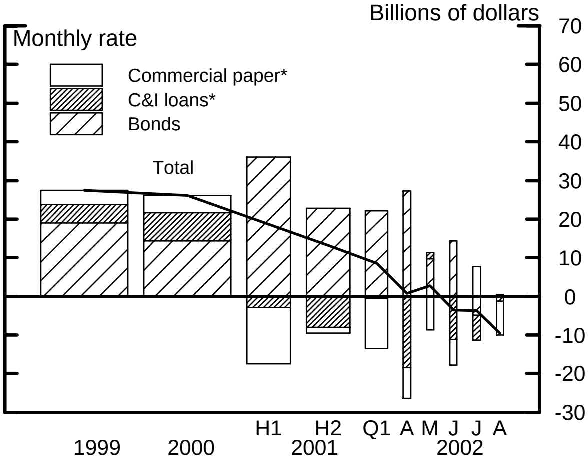
Brazilian presidential election. The Brazilian *real* declined nearly 9 percent on balance against the dollar, but Brazil's EMBI+ spread narrowed almost 240 basis points–to a still-high level. The Mexican peso depreciated about 2-1/4 percent against the dollar, and Mexico's sovereign yield spread widened a bit. In emerging Asia, equity prices in Taiwan, Singapore, and Malaysia fell 3 to 7 percent amid questions about prospects for continued expansion of the technology sector. Stock prices posted small gains in Korea, where domestic demand continued to show strength, and the Korean won appreciated slightly versus the dollar.

(5) Borrowing by businesses appears to have remained weak (Chart 4), as external financing needs apparently are very low this quarter. In recent weeks, the improved tone in the corporate bond market has prompted a modest step-up in gross bond issuance, but the proceeds appear to have been used primarily to pay down short-term debt and maturing or called bonds. As a result, commercial paper outstanding has continued to fall, although the pace of the runoff has slowed, and bank business loans have been basically flat since the end of July. In the household sector, consumer credit growth has been supported by the recent round of incentives offered by the major auto makers. Mortgage debt continued to expand briskly as low rates have propelled both home buying and mortgage refinancing.

(6) M2 growth remained elevated last month with much of the strength concentrated in its liquid components. In part, the advance in M2 likely reflects the impact of the recent surge in refinancing activity and the accompanying boost to liquid deposits associated with the temporary placement of prepayments on mortgage-backed securities in escrow deposits at banks. In addition, demands for M2 assets probably have been boosted by investors seeking a safe haven from the volatility in equity markets. Net outflows from equity mutual funds continued last month, albeit at a much slower pace than in July, and apparently halted in early September. With

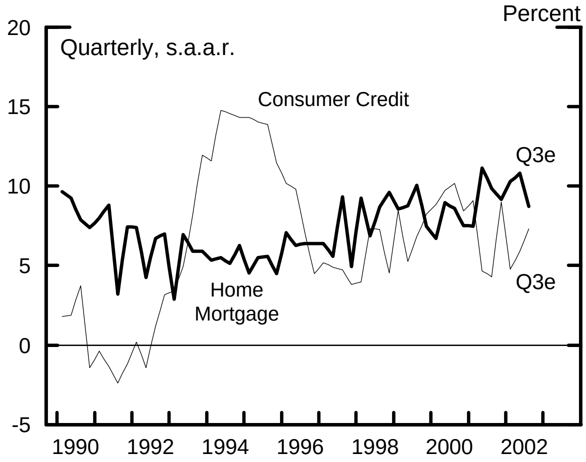
Chart 4
Debt and Money Growth

Growth of Components of Nonfinancial Business Debt



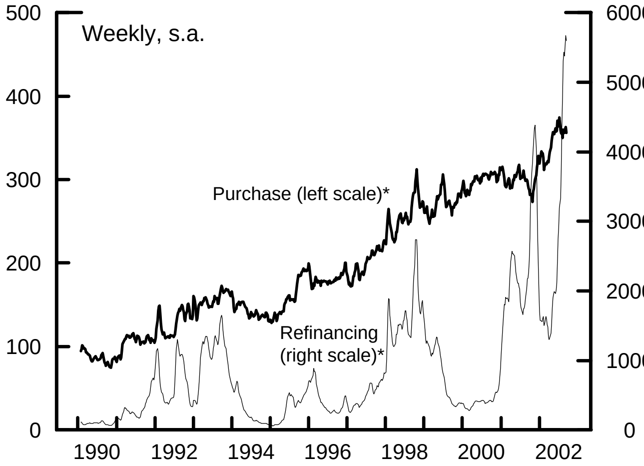
* Seasonally adjusted.

Growth of Household Debt



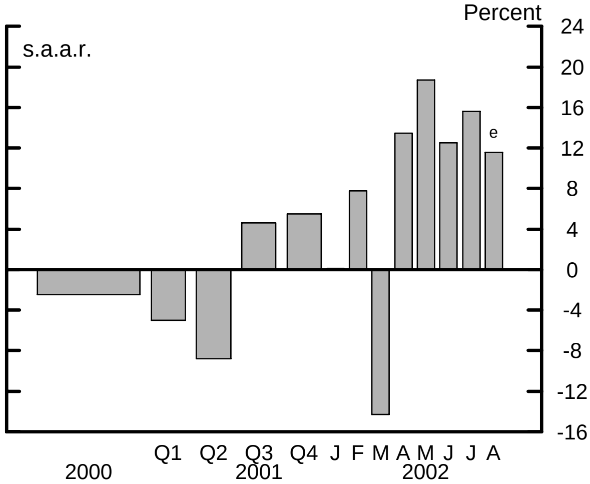
e Estimated.

MBA Residential Mortgage Indexes



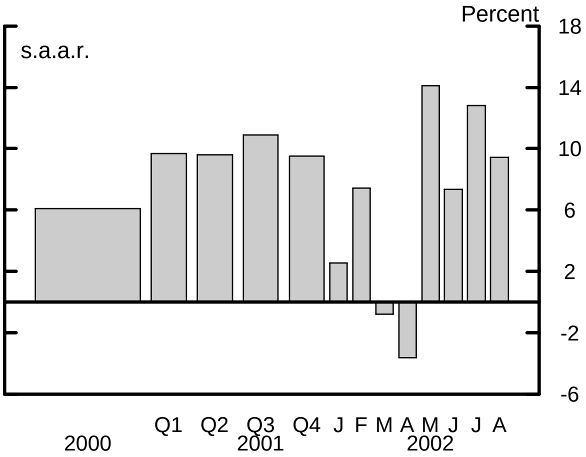
* Four-week moving average.
Note. March 16, 1990 = 100 for n.s.a. series.

Growth of Federal Debt



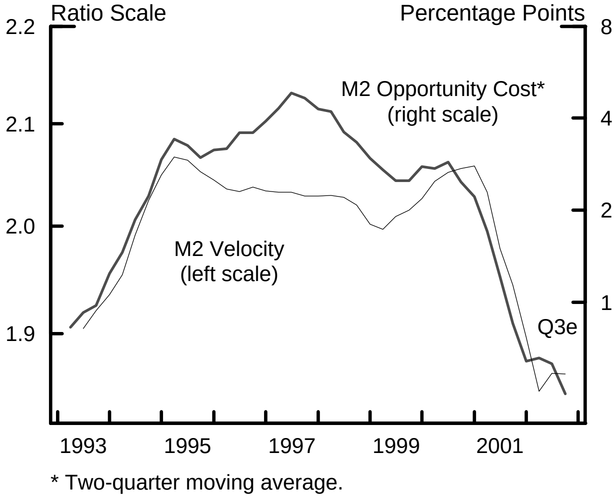
Note. Treasury debt held by the public, month end.
e Estimated.

Growth of M2



e Estimated.

M2 Velocity and Opportunity Cost



* Two-quarter moving average.
e Estimated.

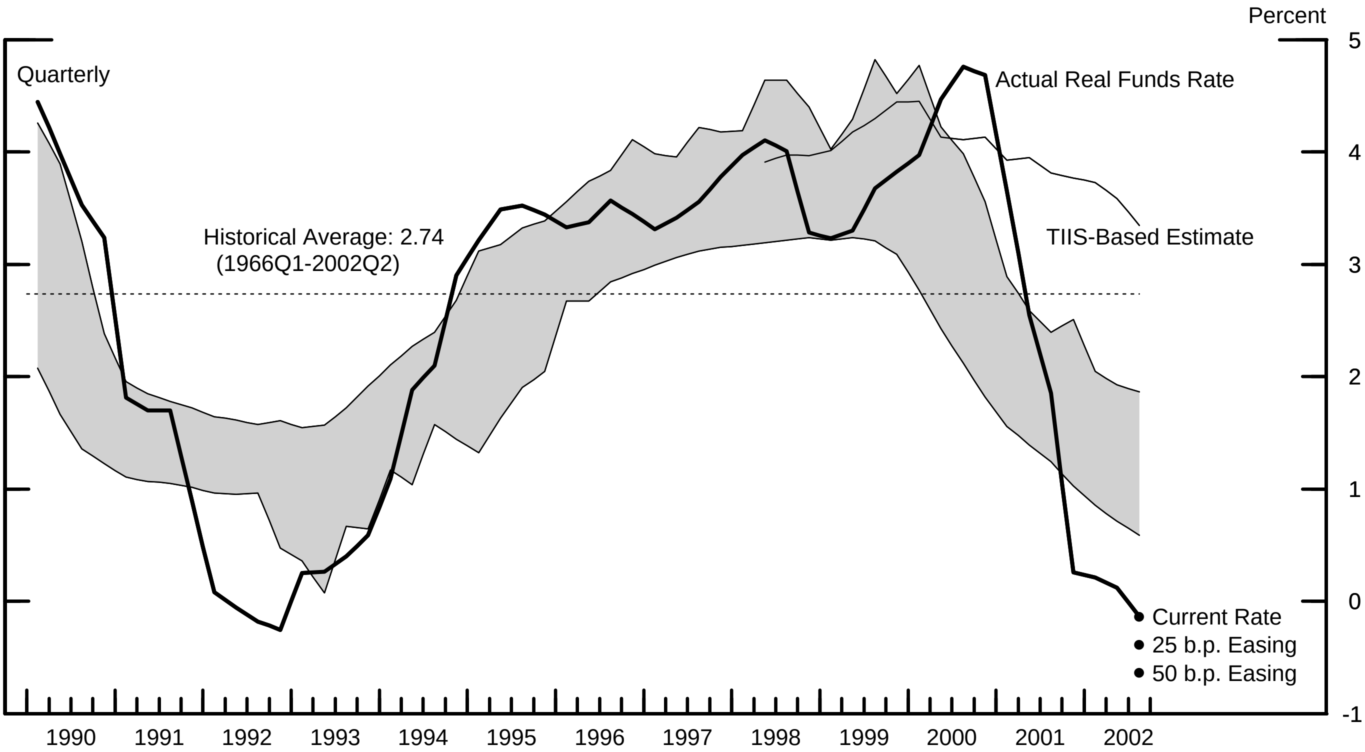
current estimates suggesting that M2 growth in the third quarter will be in the neighborhood of 10 percent, the velocity of M2 is almost certain to register a substantial decline this quarter, even though its opportunity cost changed little.

Policy Alternatives

(7) The staff has read incoming data over the intermeeting period as suggesting stronger final demand in the current quarter than projected at the time of the August FOMC meeting but as providing little reason to change its longer-term outlook. In the Greenbook, economic growth is anticipated to rise a bit above that of potential by the middle of next year and by more in 2004, leading to a gradual ebbing of the slack in resource use. In this environment, the staff has retained the assumption of an unchanged stance of monetary policy through 2003, followed by some unwinding of monetary ease in 2004. As the economy picks up steam and the onset of policy tightening approaches, Treasury yields edge higher, and corporate risk spreads narrow. Share prices rise in line with risk-adjusted returns on bonds, and the dollar is assumed to depreciate at around a 1 percent annual rate in real terms over the forecast period. The unemployment rate moves up to just above 6 percent by early next year and then gradually returns to 5-3/4 percent by the end of 2004, noticeably above the staff's 5 percent estimate of the natural rate throughout the forecast period. The effect of this ongoing slack on domestic inflation is expected to be partly offset by accelerating import prices as the dollar depreciates and by lagged impetus from this year's runup in energy prices. On net, core PCE price inflation is projected to edge lower to a 1-1/4 percent pace in 2004.

(8) If the Committee is still of the view that the current stance of policy is likely to be sufficient to foster an improving business climate over time, it may want to **keep the intended funds rate unchanged**. The Greenbook projects that the current setting of the funds rate would support economic expansion that gains strength over the next year or so. The sense that considerable monetary accommodation has been in place for some time is reinforced by the sustained low level of the real federal funds rate relative to estimates of its equilibrium (Chart 5). Indeed, the Committee may read the robust purchases of autos and other items by households and heavy mortgage

Chart 5
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 six estimates of the equilibrium real federal funds rate based on a statistical filter and the FRB/US model. Real federal funds rates employ four-quarter lagged core PCE inflation as a proxy for inflation expectations, with the staff projection used for 2002Q3.

Equilibrium Real Funds Rate Estimates (Percent)

	2000	2001	2002H1	2002Q3
Statistical Filter				
- Two-sided:				
• Based on historical data*	2.4	1.6	1.3	1.2
August Bluebook	*2.4*	*1.5*	*1.2*	*1.1*
• Based on historical data and the staff forecast	2.3	1.3	0.8	0.6
August Bluebook	*2.3*	*1.3*	*0.9*	*0.7*
- One-sided:				
• Based on historical data*	4.1	2.5	1.8	1.2
August Bluebook	*4.1*	*2.5*	*1.6*	*1.1*
FRB/US Model				
- Two-sided:				
• Based on historical data**	2.7	2.1	1.4	1.2
August Bluebook	*2.7*	*1.9*	*1.3*	*1.2*
• Based on historical data and the staff forecast	2.9	2.4	2.0	1.9
August Bluebook	*2.9*	*2.4*	*1.9*	*1.9*
- One-sided:				
• Based on historical data**	3.6	2.3	1.3	1.1
August Bluebook	*3.6*	*2.2*	*1.3*	*1.2*
Treasury Inflation-Indexed Securities	4.2	3.9	3.7	3.3
August Bluebook	*4.2*	*3.9*	*3.7*	*3.4*

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

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

activity as suggesting that aggregate demand will run stronger than in the staff forecast, implying that excess capacity will be worked down more quickly than in the Greenbook. Even if the Committee accepts the Greenbook assessment of aggregate demand as likely, it would interpret the attendant gradual decline in the unemployment rate as implying less slack in labor markets than in the staff outlook should it also have a less favorable assessment of the sustainable level of resource utilization.

(9) If the Committee views the downside risk of economic weakness to be substantial at the current setting of the federal funds rate, especially when compared with the seemingly low odds of a pickup in inflation, it probably would wish to **retain a balance-of-risks assessment tilted toward economic weakness**. The elevated threat of terrorist attack and concerns about the potential for military action in Iraq may seem to pose significant adverse risks. Even absent such developments, the Committee may consider a sustained expansion of aggregate demand as by no means assured, particularly given continuing questions about businesses' willingness to hire and spend and the fragility of key emerging markets. Market participants appear to share such qualms in that equity prices are still quite volatile and lower on balance, and corporate risk spreads remain wide. At this juncture, with financial markets quite skittish, the Committee may find it more difficult than usual to predict the market response if policy action does not match prevailing expectations. Futures market quotes indicate that investors on average place just a small probability on a policy easing at this meeting, although they appear to expect at least a quarter point cut in the funds rate by early next year. A policy decision of no change in the funds rate and a balance of risks still pointing toward economic weakness therefore would probably represent only a minor disappointment to market participants and induce just a slight backup in interest rates at shorter maturities and perhaps a modest decline in stock prices. As always, the wording of the announcement will prove important in shaping

that market reaction.

(10) The Committee may wish to **shift to a balanced assessment of risks** if it believes that the likelihood of a slide back into economic weakness, which seemed more palpable when market stresses mounted in the runup to the August meeting, has receded. Two important hurdles–the August 14 deadline for certifying financial statements and the first anniversary of September 11–passed uneventfully, perhaps suggesting that the Committee's assessment of the uncertainties surrounding its forecast has narrowed. In addition, the Committee may be concerned that a zero real funds rate will soon pose the risk of imparting excessive stimulus if the forces currently holding down the equilibrium real funds rate lift more quickly than is implicit in the staff forecast, perhaps along the lines of the alternative simulation in the Greenbook. With some measures of the equity premium at their highest levels since the early 1990s, the Committee may see good odds that the stock market and, hence, aggregate demand will rebound more than projected in the Greenbook, especially given the apparent ebbing of investors' concerns about corporate governance. Announcement of a Committee decision to shift back to balance in its risk assessment, with no change in the funds rate, would likely induce market participants to reevaluate their expectations for policy. Short-term interest rates would rise as the probabilities of policy easings by early next year were lowered. Stock prices would likely fall somewhat initially, while long-term interest rates would be subjected to the cross-currents of higher short-term interest rates but chances of a weaker economy in the intermediate run.

(11) The Committee may desire to **ease policy at this meeting** to provide more assurance that economic growth would move up to an acceptable pace. In particular, if the Committee shares the staff's assessment that the unemployment rate will decline only modestly by 2004, it might see little risk that additional policy ease will

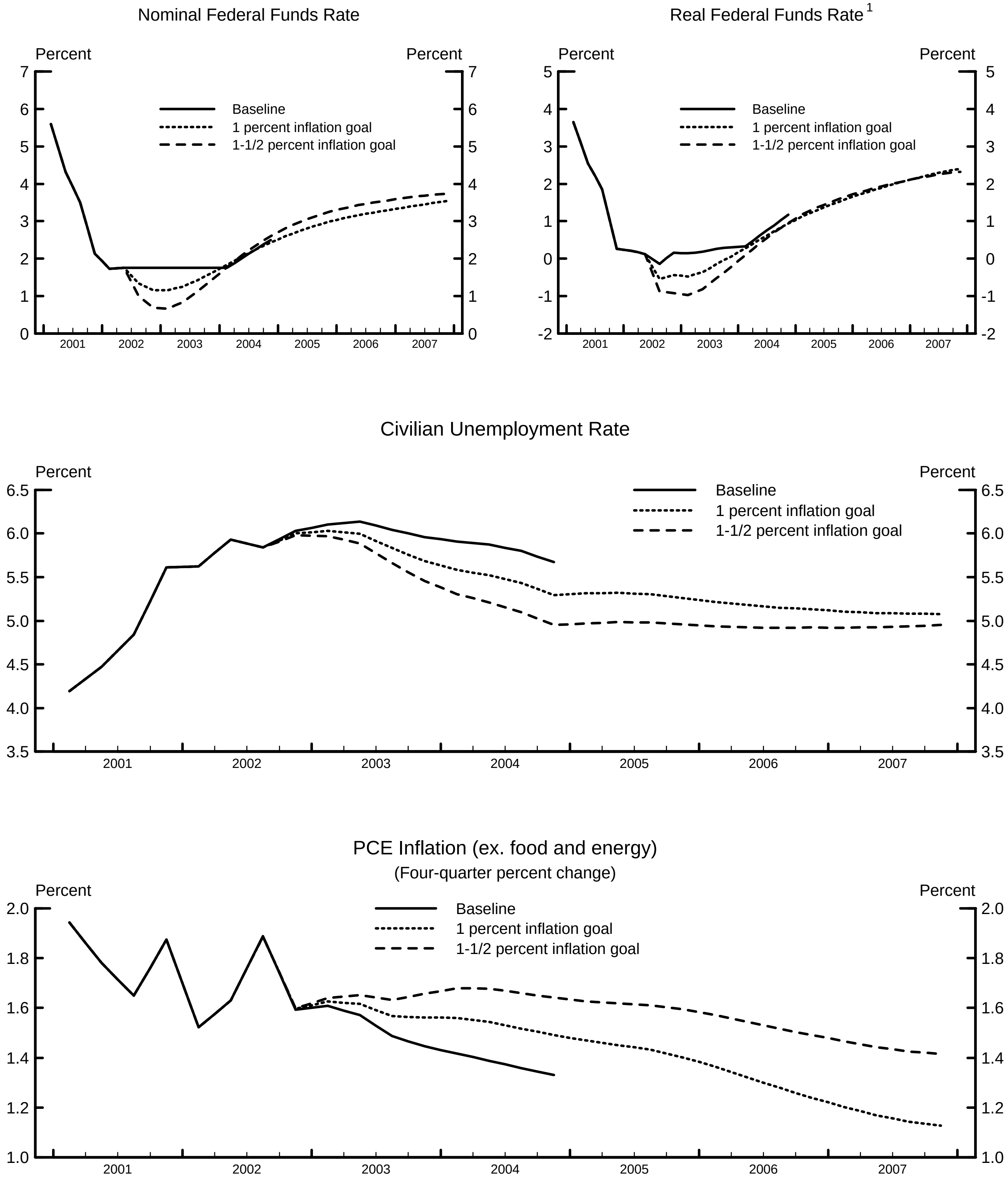
revive inflation and a particular benefit in absorbing slack more quickly. Judging by the path of the funds rate in the "policymaker perfect foresight" simulations, a 25 or 50 basis point policy easing at this meeting could be consistent with stable or even declining inflation given the staff's assessment of longer-term trends and the relationships embedded in the FRB/US model (see box and chart). The Committee may also favor policy easing at this time in light of the possibility that the lack of such a policy adjustment could risk economic weakness and further disinflation. Although household spending and a swing in inventory investment have carried economic activity along to date, the extent of the pickup in capital spending–and therefore sustainable economic expansion–remains uncertain. Indeed, declines in equity prices

"Policymaker Perfect Foresight" Strategies

The updated perfect foresight exercises have been renamed "policymaker perfect foresight" strategies in this bluebook to clarify that, while policymakers are assumed to know the structure of the economy and the shocks that will occur over the projection period, private agents in these FRB/US simulations form expectations using a small vector autoregression model. The funds rate path is chosen to minimize the sum of squares of the deviation of unemployment from its natural rate of 5 percent, the deviation of core PCE inflation from a long-run goal, and changes in the funds rate. In the extension of the Greenbook baseline beyond 2004, potential output is projected to grow at about the same rate projected for 2004 in the Greenbook, foreign GDP growth strengthens modestly, the dollar depreciates at a 3 percent real rate, and the federal budget balance gradually improves.

The dotted line in Chart 6 depicts the policy path for the funds rate with a long-run inflation goal of 1 percent, while the dashed line shows a path for a 1-1/2 percent inflation goal. The solid line depicts the Greenbook funds rate assumption through 2004, which implies a tighter policy over the next year or so than either of the FRB/US simulations. As a result, the baseline projection delivers a faster disinflation and a slower closing of the output gap than the policymaker perfect foresight strategies.

Chart 6
Policymaker Perfect Foresight Strategy for Monetary Policy



1. The real federal funds rate is calculated as the quarterly average nominal funds rate minus the four-quarter lagged core PCE inflation rate as a proxy for inflation expectations.

over the intermeeting period and reductions in longer-term interest rates may well indicate that market participants have become more doubtful on that score as well.

(12) Market participants place only small odds on a policy move at this meeting, and domestic bond and stock markets would therefore likely rally if the Committee chose to ease, particularly if the move were 50 basis points. The extent of the rally would also depend on whether market participants interpret the action as an earlier-than-expected completion of the easing already built into market prices or as a harbinger of further easings. That assessment, of course, will depend importantly on the Committee's judgment on the balance of risks and the wording of its announcement.

(13) Under the Greenbook forecast, with a flat funds rate, total nonfinancial debt and its nonfederal component are both projected to continue to grow at about a 6 percent pace over the next couple of quarters. The composition of nonfederal borrowing shifts somewhat, however, as business borrowing recovers while household debt grows more slowly. Business demands for external finance are projected to rise as profit growth is subdued while inventory building resumes and fixed investment gradually picks up. Banks and financial markets are expected to remain selective in making credit available to businesses without substantially constricting the overall prospects for capital spending. In the household sector, a moderation in auto sales should contribute to some lessening in the growth of consumer credit. Home mortgage debt is expected to decelerate from its rapid recent growth rates, reflecting moderation in housing activity and the completion of the current wave of mortgage refinancings. Nonetheless, growth in household debt is expected to continue to outpace that of disposable personal income. Reductions in mortgage refinancings should also contribute to a diminution in M2 growth in coming months. Over the four quarters of this year, M2 is projected to grow 6-3/4 percent, considerably faster

than nominal GDP, owing largely to the lagged effects of last year's decline in short-term interest rates and opportunity costs, as well as mortgage refinancings.

Alternative Growth Rates for M2

		No Change*	25 bp Ease	50 bp Ease
Monthly Growth Rates				
	Jul-02	12.8	12.8	12.8
	Aug-02	9.4	9.4	9.4
	Sep-02	7.1	7.1	7.1
	Oct-02	6.6	7.0	7.4
	Nov-02	6.5	7.3	8.1
	Dec-02	6.1	6.9	7.7
	Jan-03	4.5	5.2	5.9
	Feb-03	4.5	5.0	5.5
	Mar-03	4.3	4.7	5.1
Quarterly Growth Rates				
	2002 Q2	3.4	3.4	3.4
	2002 Q3	10.4	10.4	10.4
	2002 Q4	7.0	7.4	7.8
	2003 Q1	5.1	5.7	6.4
Annual Growth Rates				
	2001	10.3	10.3	10.3
	2002	6.8	6.9	7.0
2001 Q4	Aug-02	6.7	6.7	6.7
Aug-02	Dec-02	6.6	7.1	7.6
Aug-02	Mar-03	5.7	6.3	6.8

* 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 to be included 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 ___~~1-3/4~~ percent.

(2) "Balance of Risks" Sentence

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 [CONTINUE TO BE weighted mainly towards 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.

Strictly Confidential (FR)-
Class II FOMC

September 23, 2002

Exhibit 1

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)					
1999	1.9	6.3	7.8	11.3	7.7
2000	-1.7	6.1	8.6	17.3	9.3
2001	6.8	10.3	11.3	18.5	12.8
Quarterly(average)					
2001-Q3	16.0	11.0	9.6	8.4	10.1
Q4	2.1	9.4	11.5	18.5	12.3
2002-Q1	5.8	5.8	5.8	3.5	5.0
Q2	-0.6	3.4	4.5	3.9	3.5
Monthly					
2001-Aug.	9.1	8.6	8.4	-12.6	1.9
Sep.	55.1	25.1	16.8	21.5	24.0
Oct.	-39.1	-1.5	9.3	26.4	7.2
Nov.	3.1	10.4	12.4	21.3	13.8
Dec.	16.0	9.8	8.2	12.8	10.8
2002-Jan.	3.3	2.6	2.3	-8.4	-1.0
Feb.	1.9	7.4	8.9	4.3	6.4
Mar.	3.0	-0.8	-1.8	1.6	0.0
Apr.	-11.2	-3.6	-1.6	2.2	-1.8
May	6.6	14.1	16.1	8.2	12.2
June	7.2	7.4	7.4	4.2	6.3
July	8.0	12.8	14.2	-1.3	8.3
Aug. p	-13.8	9.4	15.7	12.5	10.4
Levels ($billions):					
Monthly					
2002-Apr.	1176.3	5483.0	4306.7	2574.4	8057.4
May	1182.8	5547.4	4364.6	2592.0	8139.5
June	1189.9	5581.4	4391.6	2601.0	8182.4
July	1197.8	5641.1	4443.4	2598.2	8239.3
Aug. p	1184.0	5685.5	4501.5	2625.2	8310.6
Weekly					
2002-Aug. 5	1178.1	5669.6	4491.5	2609.7	8279.3
12	1168.2	5673.5	4505.3	2611.5	8285.1
19	1182.6	5687.9	4505.3	2638.1	8326.0
26	1197.4	5698.5	4501.2	2639.3	8337.8
Sep. 2p	1207.9	5699.2	4491.3	2623.3	8322.5
9p	1178.9	5699.9	4521.0	2624.5	8324.4

p preliminary

Exhibit 10

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
01 -- High	5.99	3.66	5.51	5.30	5.96	6.12	4.91	5.11	5.68	5.99	3.59	3.61	8.20	5.65	7.24	6.86
-- Low	1.74	1.69	1.69	1.77	1.79	1.76	2.47	3.66	4.58	5.06	2.65	2.96	7.62	5.20	6.45	5.06
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	1.62	1.61	1.61	1.58	1.65	1.62	1.98	3.02	4.14	4.94	1.48	2.25	7.40	5.15	6.05	4.28
Monthly																
Sep 01	3.07	2.67	2.69	2.71	2.87	2.96	3.19	4.18	5.05	5.58	2.92	3.19	8.03	5.34	6.82	5.57
Oct 01	2.49	2.27	2.20	2.17	2.31	2.40	2.79	3.93	4.86	5.41	2.75	3.10	7.91	5.34	6.62	5.28
Nov 01	2.09	1.99	1.91	1.93	2.03	2.03	2.83	4.05	4.94	5.34	2.91	3.19	7.81	5.30	6.66	5.20
Dec 01	1.82	1.71	1.72	1.82	1.83	1.84	3.12	4.52	5.40	5.77	3.28	3.54	8.05	5.56	7.07	5.23
Jan 02	1.73	1.67	1.68	1.77	1.74	1.70	3.03	4.45	5.32	5.71	3.14	3.45	7.87	5.48	7.00	5.18
Feb 02	1.74	1.74	1.76	1.86	1.82	1.76	3.01	4.36	5.24	5.62	2.91	3.32	7.89	5.43	6.89	5.03
Mar 02	1.73	1.79	1.82	2.05	1.91	1.78	3.52	4.80	5.60	5.93	2.94	3.36	8.11	5.61	7.01	5.06
Apr 02	1.75	1.72	1.75	1.97	1.87	1.76	3.40	4.69	5.49	5.87	2.64	3.16	8.03	5.59	6.99	4.96
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	2.23	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	1.80	2.51	7.58	5.30	6.29	4.38
Weekly																
Jul 19 02	1.73	1.72	1.72	1.74	1.79	1.72	2.54	3.89	4.92	5.61	2.20	2.90	7.94	5.34	6.49	4.50
Jul 26 02	1.72	1.72	1.70	1.70	1.77	1.74	2.28	3.61	4.73	5.52	2.06	2.76	7.80	5.31	6.34	4.31
Aug 2 02	1.73	1.71	1.69	1.69	1.77	1.75	2.24	3.59	4.76	5.53	2.06	2.76	7.78	5.34	6.43	4.45
Aug 9 02	1.72	1.68	1.62	1.58	1.70	1.70	2.03	3.35	4.61	5.37	1.86	2.60	7.69	5.36	6.31	4.37
Aug 16 02	1.74	1.67	1.64	1.62	1.70	1.71	2.12	3.33	4.47	5.21	1.70	2.45	7.53	5.26	6.22	4.39
Aug 23 02	1.71	1.68	1.64	1.66	1.73	1.72	2.18	3.41	4.53	5.24	1.81	2.48	7.55	5.30	6.27	4.34
Aug 30 02	1.78	1.70	1.68	1.68	1.76	1.72	2.17	3.35	4.48	5.19	1.77	2.46	7.51	5.25	6.22	4.34
Sep 6 02	1.79	1.68	1.65	1.62	1.75	1.72	1.98	3.08	4.25	5.01	1.54	2.31	7.40	5.16	6.15	4.35
Sep 13 02	1.73	1.70	1.69	1.68	1.77	1.73	2.09	3.16	4.29	5.04	1.56	2.31	7.43	5.15	6.18	4.32
Sep 20 02	--	1.68	1.69	1.68	1.77	1.72	2.02	3.02	4.14	4.94	1.48	2.25	--	--	6.05	4.28
Daily																
Sep 3 02	1.87	1.69	1.64	1.63	1.76	1.72	1.97	3.09	4.26	5.00	1.57	2.34	7.37	--	--	--
Sep 4 02	1.74	1.70	1.63	1.60	1.74	1.71	1.98	3.07	4.24	4.99	1.54	2.31	7.36	--	--	--
Sep 5 02	1.75	1.66	1.61	1.58	1.74	1.73	1.91	3.01	4.19	4.97	1.49	2.28	7.38	--	--	--
Sep 6 02	1.71	1.68	1.70	1.66	1.75	1.72	2.05	3.16	4.32	5.08	1.54	2.31	7.47	--	--	--
Sep 9 02	1.76	1.71	1.69	1.69	1.76	1.73	2.09	3.17	4.32	5.06	1.57	2.33	7.46	--	--	--
Sep 10 02	1.74	1.72	1.68	1.68	1.77	1.72	2.08	3.15	4.29	5.05	1.54	2.30	7.43	--	--	--
Sep 11 02	1.72	1.71	1.69	1.69	1.77	1.73	2.15	3.23	4.35	5.10	1.60	2.34	7.49	--	--	--
Sep 12 02	1.74	1.70	1.69	1.68	1.77	1.73	2.08	3.14	4.27	5.03	1.56	2.31	7.43	--	--	--
Sep 13 02	1.72	1.67	1.69	1.68	1.77	1.73	2.05	3.09	4.20	4.97	1.53	2.27	7.36	--	--	--
Sep 16 02	1.83	1.68	1.71	1.69	1.77	1.72	2.06	3.08	4.18	4.96	1.51	2.26	7.37	--	--	--
Sep 17 02	1.72	1.70	1.70	1.69	1.78	1.73	2.04	3.04	4.15	4.94	1.52	2.26	7.38	--	--	--
Sep 18 02	1.68	1.70	1.68	1.68	1.77	1.70	2.03	3.03	4.14	4.96	1.47	2.24	7.37	--	--	--
Sep 19 02	-- p	1.63	1.65	1.64	1.77	--	1.93	2.95	4.09	4.91	1.44	2.22	--	--	--	--

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

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

September 19, 2002

	Treasury Bills			Treasury Coupons						Federal Agency	Net change total	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 (-)	outright holdings [4]	Short-Term [6]	Long-Term [7]	Net Change
1999	---	---	---	11,895	19,731	4,303	9,428	1,429	43,928	157	43,771	2,035	8,347	10,382
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
2001 QII	3,097	7,476	-4,379	6,611	8,592	2,047	3,573	6,656	14,167	---	9,788	639	-2,186	-1,547
QIII	3,965	1,543	2,422	1,619	5,854	1,691	1,535	5,723	4,976	---	7,398	3,832	2,587	6,419
QIV	4,659	---	4,659	5,761	2,577	982	1,632	473	10,479	---	15,138	-4,223	10,847	6,624
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
2002 Jan	2,772	---	2,772	---	2,872	---	582	---	3,454	---	6,226	1,115	-4,871	-3,756
Feb	1,042	---	1,042	2,894	1,101	334	1,054	---	5,383	---	6,425	-3,647	-1,401	-5,048
Mar	3,013	---	3,013	1,455	2,181	637	291	---	4,564	---	7,577	-1,866	-276	-2,142
Apr	1,047	---	1,047	2,709	1,142	1,670	210	---	5,730	---	6,777	1,211	-3,714	-2,503
May	3,524	---	3,524	2,826	1,439	259	---	---	4,524	---	8,048	-2,091	133	-1,958
Jun	3,656	---	3,656	---	---	542	---	---	542	---	4,198	79	-833	-754
Jul	4,838	---	4,838	1,104	1,755	577	63	---	3,499	---	8,336	-2,434	-1,296	-3,730
Aug	529	---	529	445	1,921	690	80	---	3,136	---	3,665	-527	-4,645	-5,172
2002 Jun 26	---	---	---	---	---	---	---	---	---	---	---	3,832	---	3,832
Jul 3	421	---	421	---	1,039	---	---	---	1,039	---	1,460	2,985	---	2,985
Jul 10	608	---	608	---	716	---	---	---	716	---	1,324	-3,895	---	-3,895
Jul 17	367	---	367	---	---	110	---	---	110	---	477	-2,565	---	-2,565
Jul 24	3,572	---	3,572	1,104	---	467	63	---	1,634	---	5,206	-154	-1,000	-1,154
Jul 31	---	---	---	---	---	---	---	---	---	---	---	-2,731	-3,000	-5,731
Aug 7	---	---	---	445	475	---	---	---	920	---	920	2,667	-1,000	1,667
Aug 14	64	---	64	---	---	---	---	---	---	---	64	-3,630	-1,000	-4,630
Aug 21	250	---	250	---	721	568	80	---	1,369	---	1,619	7,217	---	7,217
Aug 28	139	---	139	---	725	122	---	---	847	---	986	-5,686	---	-5,686
Sep 4	185	---	185	---	---	---	---	---	---	---	185	9,085	---	9,085
Sep 11	236	---	236	---	---	---	---	---	---	---	236	-6,152	---	-6,152
Sep 18	205	---	205	1,286	---	51	---	---	1,337	---	1,542	77	-1,000	-923
2002 Sep 19	---	---	---	---	---	---	---	---	---	---	---	-2,035	---	-2,035
Intermeeting Period														
Aug 13-Sep 19	1,079	---	1,079	1,286	1,446	741	80	---	3,553	---	4,632	4,726	-1,000	3,726
Memo: LEVEL (bil. $)														
Sep 19			226.2	93.2	175.7	51.4	81.7		402.0	0.0	402.0	-18.2	11.0	-7.2

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 matched sale-purchases.
6. Original maturity of 15 days or less.
7. Original maturity of 16 to 90 days.

MRA:HRM