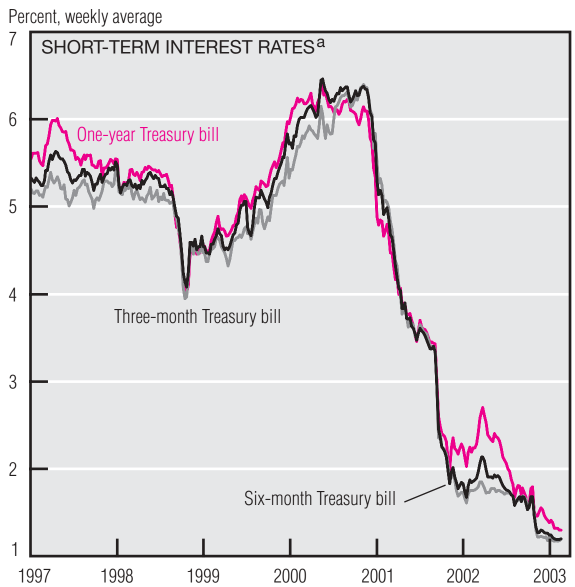
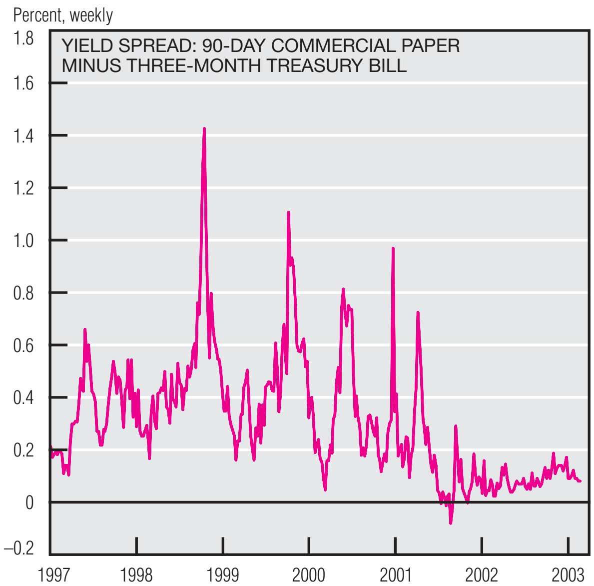
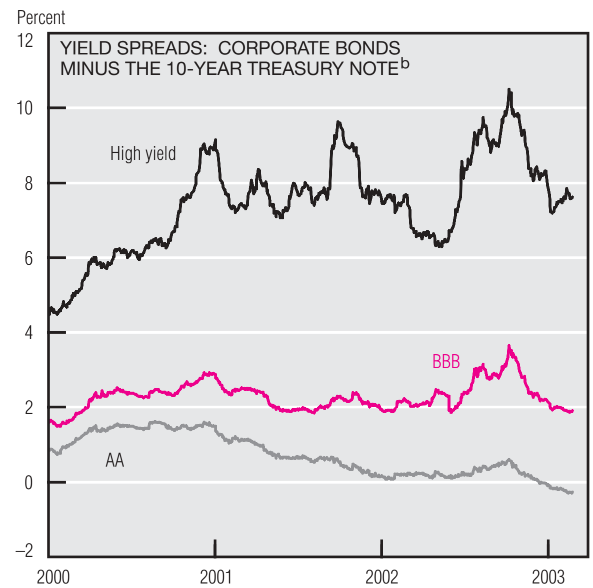
Money and Financial Markets







a. Yields from constant-maturity series.
b. Merrill Lynch AA, BBB, and High Yield Master II indexes, each minus the yield on the 10-year Treasury note.
SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; and Bloomberg Financial Information Services.

At the short end of the maturity spectrum, interest rates tend to follow the federal funds rate closely. With the fed funds rate unchanged through much of 2002, the three-month Treasury bill held fairly steady. However, all short-term rates fell markedly when the fed funds rate was cut 50 basis points in November. Risk spreads in the commercial paper market barely increased during 2002 and remain low, probably because lower-quality issuers are exiting the market. The amount of commercial paper outstanding dropped nearly one-third in 2002 and continues to decline this year.

Long-term interest rates have fallen modestly since late last year, probably as a result of lower long-term inflationary expectations. After peaking in the summer of 2002, risk spreads on corporate bonds retrenched near the end of the year. Risk spreads on speculative-grade corporate bonds have increased in the last few months and remain at historically high levels, reflecting low recovery rates for bonds in default as well as lingering concerns over corporate governance. On the other hand, interest rates on AA-rated corporate bonds have fallen below those on 10-year Treasury notes.

Although increasing home prices have added to household wealth over the last couple of years, declining equity prices have more than offset this effect. The wealth-to-income ratio

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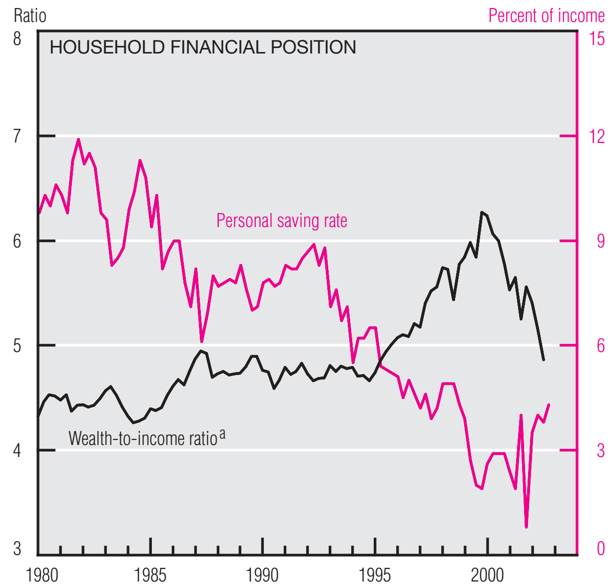

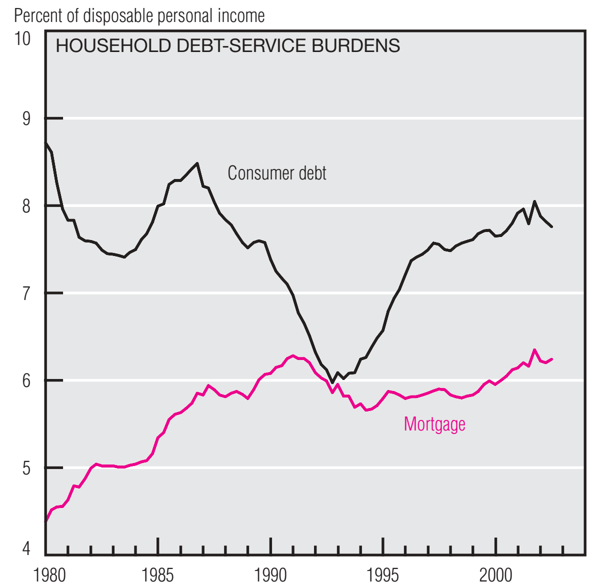

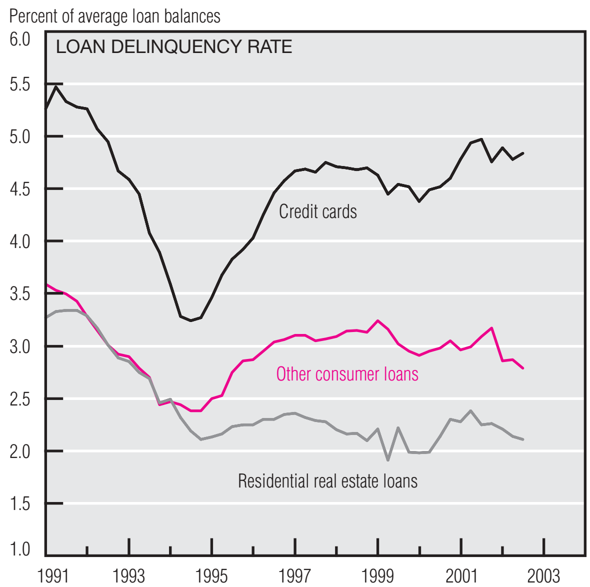

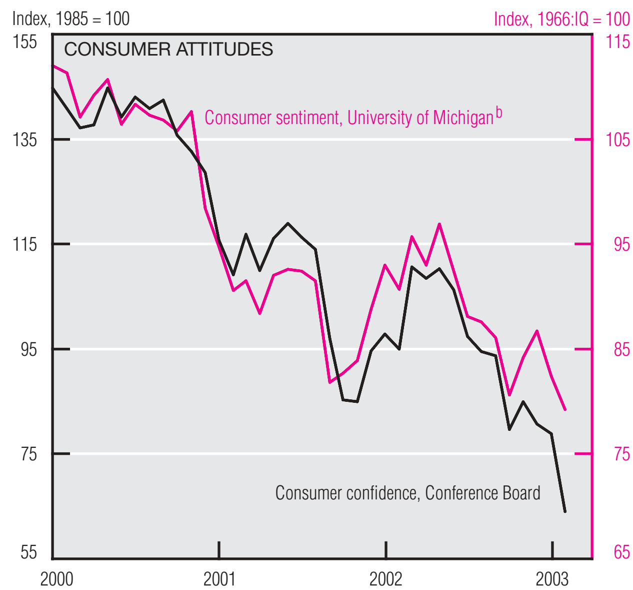

a. Wealth is defined as household net worth. Income is defined as personal disposable income. Data are not seasonally adjusted.
b. Data are not seasonally adjusted.
SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," H.15, "Household Debt-Service Burden," and "Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks," *Federal Reserve Statistical Releases*; University of Michigan; and the Conference Board.

has fallen more than a percentage point since its peak in late 1999. The last two years have witnessed tremendous volatility in the personal saving rate, caused partly by savings' adjustment to the phase-in of tax cuts implemented by the Economic Growth and Tax Relief Reconciliation Act of 2001.

Household borrowing expanded swiftly in 2002—overall consumer debt levels rose more than 9% during the year, the largest increase since 1989. Mortgage debt grew more than 11% in 2002. Despite these increases, the debt-service burden, expressed as a percent of disposable income, did not rise appreciably. Large gains in disposable income and low mortgage rates helped to contain debt-service burdens.

Consumer loan quality at commercial banks continues to improve. During 2002, delinquency rates on credit cards, residential real estate loans, and other consumer loans fell. However, delinquency rates on credit cards continue to be elevated at nearly 5%. Despite the overall strengthening of credit quality, loan officers at commercial banks report tighter credit conditions for consumer loans.

The Conference Board's Index of Consumer Confidence and the University of Michigan's Index of Consumer Sentiment fell in February. Although they have reached the lowest levels seen since late 1993, both indexes remain somewhat higher than they were in the early 1990s.