MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, December 14, 1971, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Clay
Mr. Daane
Mr. Kimbrel
Mr. Maisel
Mr. Mayo
Mr. Mitchell
Mr. Morris
Mr. Robertson

Messrs. Coldwell, Eastburn, Swan, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Heflin, Francis, and MacLaury, Presidents of the Federal Reserve Banks of Richmond, St. Louis, and Minneapolis, respectively

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Bernard and Molony, Assistant Secretaries
Mr. Hackley, General Counsel
Messrs. Axilrod, Eisenmenger, Garvy, Gramley, Hersey, Scheld, Solomon, and Tow, Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Melnicoff, Deputy Executive Director, Board of Governors
Mr. Altmann, Assistant Secretary, Office of the Secretary, Board of Governors

Messrs. Wernick and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Bryant, Associate Adviser, Division of International Finance, Board of Governors
Mr. Wendel, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors
Mrs. Rehanek, Secretary, Office of the Secretary, Board of Governors

Mr. Craven, Senior Vice President, Federal Reserve Bank of San Francisco
Messrs. Boehne, Hocter, Snellings, and Green, Vice Presidents, Federal Reserve Banks of Philadelphia, Cleveland, Richmond, and Dallas, respectively
Mr. Bowsher, Assistant Vice President, Federal Reserve Bank of St. Louis
Mr. Supel, Senior Economist, Federal Reserve Bank of Minneapolis
Mr. Dill, Financial Economist, Federal Reserve Bank of Atlanta
Mr. Cooper, Manager, Securities and Acceptance Departments, Federal Reserve Bank of New York

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on November 16, 1971, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee on November 16, 1971, was accepted.

Chairman Burns noted that Messrs. Daane and Solomon had accompanied him to the Rome meeting of the Group of Ten that began

on November 30. He asked Mr. Solomon to summarize developments at the meeting.

Mr. Solomon remarked that a breakthrough had been achieved at the Rome meeting in the difficult discussions that had been going on since August 15. For the first time the U.S. delegation was willing to discuss exchange rates on the hypothetical assumption that the dollar might be devalued in terms of gold, and that willingness permitted a start to be made on serious discussion of a realigned pattern of exchange rates. However, the group fell far short of reaching a consensus on a new pattern that would be acceptable to the United States, even if "acceptable" were taken to imply a balance of payments swing smaller than the $13 billion this country had said was needed. At the same time, the U.S. delegation had gone into the meeting determined that some progress be made on trade policy issues. It had taken several hours of hard bargaining to get the Seven--the Common Market countries plus Britain--to agree to establish a mechanism for trade negotiations with the United States. Whether that mechanism was working well appeared questionable, judging from reports received from Brussels last weekend. However, this morning's papers indicated that Secretary of State Rogers had accepted the mechanism that had been established.

Mr. Solomon observed that the Washington meeting of the Group of Ten later this week would focus on the same two issues--trade policy and exchange rate patterns. The problem of exchange rates was complex and difficult because of the interlocking relationships among various countries. France, Italy, and Britain formed a group in which one country's unwillingness to see its currency appreciate against the dollar by more than a given amount might hold back the other two. The amount of change in the exchange rates of those countries--particularly France--would affect the extent to which Germany was willing to see its rate appreciate; and that, in turn, would affect the attitudes of Belgium, Holland, and Switzerland on the one hand, and Japan on the other.

Although the problem was complex and difficult, Mr. Solomon continued, it was nevertheless soluble, either at the Washington meeting or at a subsequent G-10 meeting in January. When and if the exchange rate problem was solved, it was almost certain that there would be agreement on wider margins around the new rates--whether those rates were described as "parities," or as "central" or "official" rates. Up to now, at least, the U.S. delegation had held firmly to the position that this country would not agree to convertibility of the dollar into reserve assets during the interim period in which balance of payment

flows were adapting to the new pattern of exchange rates and a longer-run reform of the international monetary system was being worked out. The only exception to that position that had been mentioned was the willingness of the United States to participate in operations needed to permit the International Monetary Fund to function--particularly to make it possible for countries in debt to the Fund to repay those debts.

Chairman Burns observed that in his opinion Mr. Solomon's suggestion that a settlement might be reached at the December meeting of the Group of Ten reflected a degree of optimism which probably was not justified. On the basis of information available at this time, it appeared that at least one more meeting would be required.

Mr. Morris said it was not clear to him whether U.S. officials currently were thinking in terms of an interim settlement on exchange rates or whether they were planning to work toward a resolution that would be viable for the long run.

Chairman Burns said it was hoped to arrive at a new set of parities that would be viable. However, any settlement reached now might be considered to be an "interim" arrangement in the sense that an element of guesswork was involved in deciding what pattern of rates would prove viable. More generally, it was reasonable to hope for agreements in the near future on the U.S. gold price, on a new pattern of exchange rates, on wider bands,

and on arrangements needed to enable the IMF to function. How the question of convertibility would ultimately be resolved was in doubt at this point; all kinds of opinions were being advanced. It was clearly understood, however, that convertibility would not be feasible within the next 18 to 24 months. Presumably some provision for convertibility would be made when a longer-run reform of the international monetary system was agreed upon.

In reply to a question by Mr. Mayo, the Chairman said he would expect a near-term settlement to include an agreement by the United States to remove the import surcharge.

Mr. Robertson asked whether consideration was being given to arrangements that would facilitate changes in currency parities as soon as it became clear that existing parities were out of line.

The Chairman expressed doubt that agreement on that matter would be reached very soon. Presumably the Group of Ten--or perhaps both the Group of Ten and the IMF--would be working on the problem in connection with the longer-run reform of the monetary system.

In response to a question by Mr. Brimmer, Chairman Burns said it was the U.S. position that a resolution of the trade policy issue should be an integral part of any immediate settlement. He did not think it was likely that the U.S. delegation would depart from that position in the current negotiations.

The Chairman noted that a memorandum from Mr. Brimmer regarding the recent meeting of the Economic Policy Commission had been distributed to the Committee and would be included in the record of this meeting.[1/] He then invited Mr. Daane to report on developments at the Basle meeting from which the latter had just returned.

Mr. Daane remarked that the meeting this past weekend had been rather uneventful, since the governors felt they were marking time between the Rome and Washington meetings of the Group of Ten. Most of the governors recognized--and some noted explicitly--that the decisions to be taken were essentially of a political nature, and that their roles as central bankers would therefore be limited. They were looking toward the Washington meeting without any great sense of optimism regarding the outcome.

On Sunday afternoon, Mr. Daane continued, the principal business was a "tour d'horizon" of various countries. Nothing really new emerged from the discussions; as one governor put it, it was "the same story as last time, only more so." The British representative reported that his country's surplus on current account in 1971 was now expected to be more than $2-1/2 billion, which was larger than had appeared likely earlier. The French

1/ A copy of the document referred to is appended to this memorandum as Attachment A.

expressed satisfaction with their control system in even stronger language than in November, and they minimized reports that France had experienced sizable inflows of dollars. The Germans, Swiss, Dutch, and Italians were very concerned about their domestic economies and about the possibility--in the case of Italy, the fact--of a recession. The Germans were the most vocal with respect to the relationship between international uncertainties and their domestic economic situation. The conclusion of the group was the same as that reached at the November meeting--namely, that there was a real risk of a world recession and a repetition of the developments of the 1930's, with the current international uncertainties at center stage.

Mr. Daane said he would mention a few other matters that had come up Sunday afternoon. Mr. Larre presented a progress report of the Standing Committee on the Euro-dollar market, of which he (Mr. Daane) was a member. Mr. Larre noted that the Standing Committee planned to meet again in January to (a) review developments with respect to central bank placements in the Euro-dollar market since the abandonment of the formal commitment to avoid such placements, and (b) finalize the report of the Standing Committee on the subject of central bank swaps with commercial banks More importantly, at the January meeting the Standing Committee would begin discussion of whether and how to influence the direct

operations of commercial banks in the Euro-dollar market, including looking into the question of how such operations could be influenced by regulatory action on reserve requirements.

Mr. Daane noted that there also had been some discussion on Sunday afternoon of a report regarding the possible establishment of a multilateral mechanism for effecting international payments. The report had been prepared in a meeting of a group of experts in which the Federal Reserve had participated.

Mr. Daane observed that the Sunday night session of the governors had been devoted entirely to a discussion of the subject of convertibility. In his own comments he had held fast to the U.S. position as described by Mr. Solomon earlier today. Perhaps Mr. Coombs, who was also present, might have something to add.

Mr. Coombs said he thought Mr. Daane had covered the highlights of the meeting. He might note that in the discussion on Sunday night two or three of the governors seemed to be pressing the case for convertibility.

The Chairman observed that a kind of mischievous logic was being employed in that area. Everyone concerned understood that, in view of the state of U.S. reserves, convertibility was simply out of the question for the near future and that it would not be in the interest of any country to attempt to restore convertibility now because of the risk of an early breakdown. But

the representatives of some countries--while accepting that conclusion as essentially correct--nevertheless thought it was important to know what form convertibility would ultimately take before they could feel comfortable with any interim arrangement. He considered that logic to be mischievous because it could produce a situation in which no early settlement on exchange rates would be possible. His own judgment was that common sense would prevail--that the countries in question would accept general assurances from the United States that convertibility would be reestablished in some form and that gold would not be dethroned completely.

Mr. Daane remarked that in the Sunday night discussion at Basle at least two of the governors present had pointed out that the intense concern about convertibility on the part of some countries probably reflected their expectation that an adjustment of parities would not be sufficiently large to resolve the problem of continuing dollar accumulations. Thus, those governors taking this point of view had noted that there was a basic inconsistency in the views of those pressing for convertibility.

Chairman Burns observed that there seemed to be an underlying hunger for immediate convertibility. There was one way to satisfy that hunger--to have an appreciation of other currencies much larger than the United States had suggested and certainly much larger than other countries were willing to accept, in order to assure dollar inflows to the United States.

Mr. Winn asked whether the Chairman was confident that a settlement would be reached in January.

The Chairman replied that the outlook was particularly cloudy at the moment. Perhaps it would be clarified when word was received about the outcome of today's meeting between Presidents Nixon and Pompidou.

Mr. Daane noted that the Ministers of the Common Market countries had issued a communique with respect to the trade aspects of the problem early Sunday morning, after considering the matter in a session that lasted through most of Saturday night. Apparently their position had not been very forthcoming.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period November 16 through December 8, 1971, and a supplemental report covering the period December 9 through 13, 1971. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs said that, as he had suggested at the last meeting, those exchange rates which were free to move were then tending to stabilize around levels reflecting market hedging on a gold price increase of 5 or

6 per cent, plus a substantial widening of the band around the new parities. On November 18 those market expectations were abruptly altered by the report that Representative Reuss and Senator Javits had introduced a bill calling for a gold price increase up to a maximum of 10 per cent. Rates on the mark, yen, guilder, Swiss franc, and Belgian franc immediately moved up sharply, and they strengthened still further on reports from the Rome meeting that a 10 per cent increase in the U.S. gold price was one of the hypothetical changes being considered. Those exchange rate movements were accompanied by very heavy speculative inflows into Canada, France, the United Kingdom, Italy, and Japan, and by further tightening of French and Italian exchange controls.

As a result of that new wave of speculation against the dollar, Mr. Coombs continued, the U.S. official settlements deficit so far in 1971 had now moved up to $30 billion. He would not be surprised if more than $20 billion of that total represented speculative positions waiting to be reversed by profit-taking on the new parities. In effect, conditions might now be moving towards the eye of the speculative hurricane, which would reverse its direction and gain even greater intensity as soon as some deal on parities was made. Much would depend, of course, on the credibility of any new parity realignment. In that connection he would be inclined to think that inclusion of a gold price change in the bargain would probably enhance its short-run credibility. But more generally,

it seemed to him that the irritations, frustrations, and fears that had built up in the exchange markets over the past four months had now reached such a pitch that any reasonably plausible settlement was likely to generate a burst of euphoria and profit-taking on a massive scale. Furthermore, he would guess that the timing of the return flow of such speculative money might well be compressed within a relatively short period. For example, when the Germans revalued the mark in 1969, profit-taking on speculative positions totaling $5 billion was concentrated in less than two months' time.

On the other hand, Mr. Coombs said, European central bank officials had cited two factors which might tend to temper or delay the return flows. First, if the band around the new parities was widened to 5 or 6 per cent and if the European central banks, with profit-taking, allowed their rates to fall to the new floors--as he thought they would be inclined to do--European currency rates could subsequently move up by 5 or 6 per cent without a change in parity; and that speculative possibility could deter profit-taking. Secondly, some European central bank officials believed that an outright devaluation of the dollar would permanently impair confidence in the dollar and would encourage the major international corporations to maintain a larger percentage of their liquid balances outside the dollar area. In effect, some of the speculative placements of the past year would be retained; that would be particularly likely if European interest rates tended to be somewhat higher than U.S.

rates. On balance, however, in light of the severe inflationary and other problems being suffered by the United Kingdom, the Netherlands, and Italy, he was inclined to think that a 7 or 8 per cent revaluation of their currencies arising out of an increase in the dollar price of gold could easily expose the vulnerability of their positions to speculative attack. In effect, he thought there was a real chance that the speculative pendulum might well swing back beyond dead center.

Mr. Coombs reported that in operations during the period the System Account paid off another $55 million of its Belgian franc debt, reducing the total to $505 million; the amount outstanding on August 15 had been $635 million. The standby swap arrangements had been renewed for a full year's term with the central banks of the United Kingdom, Austria, Denmark, Japan, Mexico, Norway, Sweden, and Switzerland, and with the Bank for International Settlements. The lines with the Common Market countries and Canada remained to be renewed, but he had received no indications suggesting that they would be against renewal when the present arrangements matured.

Mr. Mayo referred to Mr. Coombs' suggestion that the bands around parity might be widened to 5 to 6 per cent. Noting that there had been considerable opposition to that step earlier on the part of some countries, he asked whether attitudes had changed.

Mr. Coombs replied that a substantial majority of European countries now favored wider bands. He thought that was because of the uncertainty regarding the appropriate new parities; wider bands would allow some experimentation in an interim period. It seemed clear, however, that wider bands against the dollar would produce great technical difficulties for European countries in connection with their exchange rates against one another, since they probably would find it necessary to maintain a much narrower band among themselves--perhaps 1.5 per cent.

Mr. Mayo asked whether a widening of the bands was now considered preferable to the "crawling peg" approach.

Mr. Daane said he thought the two approaches were not necessarily mutually exclusive, and in fact wider margins could accommodate small and more frequent changes. For the period immediately ahead the current thinking tended to emphasize wider margins, with suggestions ranging from a low of 2 per cent on either side of parity to a high of 3 per cent. However, small and more frequent changes, or even a so-called "crawling peg," were not being ruled out as a possibility for the longer run.

Mr. Solomon concurred with Mr. Daane's observation. He added that the need was more widely recognized now than before the crisis for greater exchange rate flexibility and for changes in parities when early signs of disequilibrium appeared. Moreover, the fact that there was a great deal of uncertainty about the pattern

of exchange rates that would prove viable indicated that the need for flexibility itself was greater now than earlier.

> By unanimous vote, the System open market transactions in foreign currencies during the period November 16 through December 13, 1971, were approved, ratified, and confirmed.

Mr. Coombs reported that five System swap drawings on the National Bank of Belgium, totaling $145 million, would mature in the period from January 3 through January 28. The individual drawings had been variously renewed once, twice, or three times before; and he would recommend that they be renewed again unless it proved possible to repay them before maturity--as seemed quite likely in the case of the $50 million maturing on January 3. Since the System had been making continuous use of the Belgium line for more than a year, express action by the Committee was required if the drawings were to be renewed.

> By unanimous vote, renewal of the five System drawings on the National Bank of Belgium maturing in the period January 3-28, 1972, was authorized.

Mr. Coombs then noted that three System drawings on the German Federal Bank, totaling $50 million, would mature for the second time on December 30, 1971. He recommended renewal of those drawings.

> Renewal of drawings on the German Federal Bank maturing on December 30, 1971, was noted without objection.

Chairman Burns then suggested that the Committee turn to the domestic economic situation. At the outset, he might note that he had been asked why the Board had acted to approve reductions in discount rates last Friday. The answer was quite simple: between the November meeting of the Committee and today's meeting the Board had taken two strong actions--reducing margin requirements as well as approving discount rate cuts--because it had concluded that a more aggressive policy stance was required by the current economic situation, as the Board assessed that situation.

The Chairman then called for the staff report on the domestic economic and financial situation, supplementing the written reports that had been distributed prior to the meeting. Copies of the written reports have been placed in the files of the Committee.

Mr. Gramley made the following statement:

> Information becoming available over the past four weeks has not led to major changes in the staff's view of the outlook for 1972. We still see an improvement in real economic growth to a rate around 6 per cent--beginning in this quarter and sustained throughout next year. But the probability that such a pace of economic expansion will develop has, I believe, increased in the past few weeks.
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> Until recently, there has been only a limited amount of evidence supporting the upturn in business fixed capital spending that we and other forecasters have been projecting for 1972. New orders for capital equipment as yet have shown little growth, and the uncertainties faced by the business community four weeks ago seemed to pose a substantial threat to investment spending plans. We have since learned, however, of a

sharp upturn in manufacturers' new capital appropriations during the third quarter, and the most recent Commerce-SEC survey of planned capital expenditures, which reflects anticipations as of late October and early November, suggests significant gains in outlays in this and the next two quarters. Furthermore, production of business equipment rose again in November to a level 4 per cent above the May trough. Thus, a revival in business capital spending now seems a strong likelihood.

There has been clarification, also, of the near-term prospects for stimulus from fiscal policy. The 1971 Revenue Act, together with previous tax provisions, will reduce total tax liabilities in calendar 1972 by about $11 billion--which is in line with what we had been assuming in our projection. Businesses and consumers now have assurance that fiscal policy will be moving on a number of fronts to stimulate spending--with the investment tax credit and accelerated depreciation to encourage business capital outlays, the reduction in auto excise taxes to bolster demand for new cars, and changes in the individual income tax to increase disposable income and sustain consumer buying.

It is of more than passing interest, I think, that the financial press has not interpreted this new tax bill as evidence of reckless abandon in our fiscal affairs, even though the Federal deficit is already large. There appears to be general agreement that fiscal actions of this magnitude were needed, and are desirable.

While a good recovery in real activity seems more likely now, there is nothing in the cards yet to suggest that the pace of expansion is about to take off into the stratosphere. Business loan demands at banks remain weak. Demand for labor is still comparatively sluggish. Industrial production did show a healthy rise last month--0.8 per cent over all and about 0.6 per cent after allowance for the end of the coal strike--but the pace of advance in recent months has lacked the zip we usually see in recovery periods.

A note of caution and conservatism continues to prevail in the business community--an attitude that has been particularly noticeable with regard to inventory policy, as the latest red book[1/] clearly underlined.

1/ The report, "Current Economic Comment by District," prepared for the Committee by the staff.

In October, the book value of total business inventories rose by a little less than the annual rate in the third quarter. Total new orders received by manufacturers of durable goods, furthermore, showed only a small increase in October and are still below their third-quarter level. The current economic recovery is already a year old, and inventory investment has yet to make any contribution to real economic expansion.

For reasons we do not fully understand, businessmen still seem unconvinced that the surge in consumer spending since mid-August is for real. True, retail sales in October were not as strong as we had earlier thought--total retail sales excluding autos showed no change in October, instead of the 1.2 per cent rise indicated in the advance report. And sales of domestic cars in November tailed off progressively over the course of the month to a level of just under 9 million units during the last 10-day selling period. But this was surely to be expected. Furthermore, the advance report for November indicates that total retail sales excluding autos were relatively robust--increasing about 1-1/2 per cent. Our staff, therefore, continues to expect a relatively strong performance from the consumer during this and coming quarters--strong enough to persuade businesses that larger additions to inventories will be needed reasonably soon.

We also continue to expect--perhaps hope is the better word--that Phase II controls will work out in ways that convince businesses and consumers that the objectives of the control program for 1972 will be realized. Available information relating to decisions of the Pay Board and the Price Commission is still fragmentary and of dubious significance. Thus, we know that of the 1,500 firms that must prenotify the Price Commission to raise prices, only about half have done so thus far. We also know that for those firms that have prenotified, and whose intentions have been assessed, requested price increases average about 4 per cent on specific products. We don't know, however, when the same firms may return to ask for price increases on other product lines, or when firms not now intending to raise prices may decide to do so, or what is happening at firms that do not have to report at all--firms that account for roughly half of business sales.

In my view, however, the critical issue that will determine the success or failure of the Phase II control program will be the ability of the Pay Board to hold

wage rates close to the 5-1/2 per cent target. That issue still remains to be decided. It was clear from the outset that the coal miners settlement might greatly exceed the guidelines, that retroactivity would be a thorny issue, and that large increases might well be approved in specific cases--such as for the railroad signalmen--which would be difficult to resolve within the framework of the guidelines. The forthcoming decision in the North American Rockwell--UAW areospace case--where the contract calls for a 12 per cent first-year pay increase--could be indicative of the ability of the Pay Board to influence settlements on major new contracts. But, in general, it is still much too early to write off the Pay Board as an exercise in futility or to offer congratulations.

I see no reason, therefore--either in terms of developments affecting the prospects for real economic growth or in terms of the probable outcome of employing direct controls to help curb cost-push inflation--why the appropriate long-run course for monetary policy should be defined any differently now from four weeks ago. As Mr. Partee indicated at the last meeting, the course that the staff thought appropriate then was--broadly speaking--a continuation of moderate rates of expansion in the monetary aggregates, with a return relatively soon to a growth rate of about 6 per cent or so in the narrowly defined money stock. Such a rate of monetary expansion, we think, would be consistent with approximate stability in long-term interest rates. That still seems a reasonable prescription. I would not be concerned, however, if growth in M_1 temporarily rose somewhat above a 6 per cent rate in the first three months of next year.

The Chairman said he had found Mr. Gramley's report to be compact and lucid. He suggested that in addition to expressing their views about the state of the economy the Committee members might want to put questions to the staff to clarify particular points.

Mr. Morris remarked that the Board staff's GNP projections were still running higher than those prepared at the Boston Bank.

The difference appeared to arise almost entirely in the consumer nondurable goods sector. Not only were the Board's projections for that sector above his Bank's, but they also implied a growth rate for the year considerably higher than historical experience suggested would occur in the second year of a cyclical expansion. He wondered if there were some special considerations that the Board's staff had taken into account in making its projections.

Mr. Gramley noted that the Board's staff had projected an increase of 9.7 per cent from 1971 to 1972 in consumer spending on nondurable goods, and a rise of 8.4 per cent in disposable income, as shown in the green book.[1/] Equality in those growth rates would not have been an unreasonable expectation. However, a somewhat larger increase was shown for nondurable goods because, according to present estimates, the rise in that spending category in 1971 was a relatively moderate 6 per cent, in contrast to an 8 per cent gain in disposable income. It was quite possible that the Boston Bank's projection would prove more nearly correct than that of the Board's staff, but he thought the latter was not beyond the range of reasonable expectation.

Chairman Burns remarked that while he had not studied the question in detail, he was inclined to share Mr. Morris' view. At

1/ The report, "Current Economic and Financial Conditions," prepared for the Committee by the Board's staff.

first glance, at least, the green book projection of the rise in nondurable goods spending looked high in light of past experience.

The Chairman then said he had two factual questions. First, what part of the 4 per cent increase from May to November in the production of business equipment was accounted for by output of trucks?

Mr. Wernick replied that excluding trucks the increase over that period was roughly 3 per cent.

The Chairman observed that his second question related to the sharp third-quarter upturn in manufacturers' new capital appropriations to which Mr. Gramley had referred. That rise appeared to be particularly encouraging since it was the first large increase in about two years. In view of the large discrepancy at present between the attitudes of economists and businessmen about the outlook, it would be interesting to know whether the underlying information had been supplied by economists of the firms surveyed or by financial officers. Perhaps the practice varied so much that it was impossible to generalize.

Mr. Gramley said it was his impression that the figures usually were supplied by financial officers. That was only an impression, however; to his knowledge, the staff had never discussed the matter with the National Industrial Conference Board, which conducted the appropriations survey. On the more general

question which presumably underlay the Chairman's inquiry--as to whether capital spending was turning up despite the cautious attitudes of the business community--the evidence favoring a positive response was becoming quite strong. In addition to the findings of the NICB survey, it included those of two private surveys as well as the Commerce-SEC survey. Also, there were data indicating a pick-up in construction contracts for new commercial and industrial buildings, measured in terms of floor space. To his mind, there was a very strong likelihood that capital outlays were rising.

Mr. Coldwell commented that in his view the recovery was proceeding at a pace consistent with sustainable progress and perhaps with some reduction in inflationary pressures. Acceleration of the recovery would require a resolution of the many present uncertainties, particularly those prevailing in the business community. At a meeting of the Dallas Bank's Board last week a number of business directors had commented on present attitudes--specifically, on why businessmen were not pushing ahead more rapidly on new investment in light of the tax credit and other incentives. Their answer was that such expenditures were not economical, considering the substantial volume of unused capacity, the heavy cost of pollution controls, and the limited returns foreseen. Their thinking was that in the short run the new tax credit was not of any real value, and that even in a longer-run context

investment decisions would be based mainly on needs for additional capacity and on estimates of the prospective return and would not be greatly influenced by the tax credit.

Thus, Mr. Coldwell continued, despite some of the statistics that were being reported it seemed that businessmen were still sounding a cautious note. As he had suggested, he thought optimism would not return until current uncertainties--with respect to both Phase II and the international monetary crisis--were resolved, or at least until businessmen had a better view down the road. A pattern of improved business optimism would be appealing in the short-run, because it would mean that the outlook for reducing unemployment also had improved. However, if the stimulation of increased capital spending were added to that of rising consumer spending and heavy Government deficits, it might prove difficult over the longer run to contain the resulting acceleration of the economy without the use of controls. On balance, he would expect the recovery to continue at a moderate rate.

Chairman Burns then said he would interrupt the discussion to read a news report just received over the ticker. The report read as follows: "President Nixon and French President Pompidou have agreed on the need for a prompt realignment of exchange rates through a devaluation of the dollar, a joint statement said. The joint U.S.-French statement said the two Presidents reached 'a

broad area of agreement' on measures necessary to achieve a settlement at the earliest possible date for an immediate solution of the problem of the international monetary system. In cooperation with other nations they agreed to work towards a prompt realignment of exchange rates through a devaluation of the dollar and revaluation of some other currencies, the statement said."

After some discussion of the news report, the Committee's discussion of the economic situation resumed.

Mr. Mayo said he would like to pursue the matter of business confidence a bit further. At the Chicago Bank's regular monthly meeting with business economists on December 8, the attitudes expressed were still cautious, but the general tone of the discussion was more optimistic than at any such meeting earlier this year. The increased optimism did not appear to represent a widening of the gap between the attitudes of economists and businessmen; rather, it stemmed from very recent indications of increasing demands, and from a general feeling that the cloud of uncertainty was lifting slightly as the effects on expectations of the initial actions of the Pay Board approving large pay settlements wore off. At least in the midwest it appeared that uncertainty was diminishing as the new year approached.

Mr. Mayo then referred to the comments regarding the situation in the auto industry that he and others had made at the previous

meeting of the Committee and noted that the auto makers apparently were still holding to their production schedules. It appeared that output would remain steady in December; in contrast with most years, very few plants would be closing this year. As he had indicated at the previous meeting, the auto companies seemed to prefer a steady rate of production; they were willing to see current inventories decline rather than risk massive inventory adjustments and plant shutdowns later in 1972 that not only would hurt the industry but perhaps would also impair consumer confidence.

Mr. Heflin said that like Mr. Gramley he had been encouraged by the economic information that had become available since the Committee's last meeting. Conditions were not exuberant but they seemed to be moving in the right direction. Up until now, of course, much of the strength in the economy had come from the consumer sector, including residential construction, but at long last it appeared that the businessman was about to make a substantial contribution. It seemed to him that the most important contribution the System could make would be to foster the growth of business confidence and to reduce uncertainty. That would require demonstrating that the System was ready to supply the money needed to finance the recovery, and that it had the fortitude to keep from going too far.

Mr. Francis remarked that the tempo of economic activity might be slower during 1972 than he had thought earlier. In contrast

to the projections in the green book, the St. Louis Bank's model, using estimated money figures for December, indicated less expansion next year than earlier runs had. For example, with a 6 per cent rate of money growth after the current quarter, the model now suggested an annual rate of increase in nominal GNP of about 6 per cent for the second quarter of next year. Earlier, the model had projected a 7-1/2 per cent growth rate of GNP in the second quarter, with a 6 per cent rate of money increase after the third quarter of this year. The slower rise of spending translated into a sluggish growth in real output and little, if any, improvement in the unemployment rate next year.

Mr. Francis observed that actual economic developments might be stronger than those projected since more realistic exchange rates, which the model did not consider, should cause an expansion in net foreign sales. Nevertheless, the St. Louis Bank's studies indicated that the pause in money growth since July was already having depressing effects on the economic expansion next year. In addition, doubt regarding the workability of the Phase II program was probably causing a slower growth in net private investment than would have occurred without the program. In sum, he was inclined to think that the St. Louis projections might be undershooting the mark but that most other projections, particularly those suggesting an increase in nominal GNP of 9 per cent or more, were high.

Mr. Francis added that in visiting with businessmen in the community he had found a rather interesting conflict of views. Retailers were optimistic; sales were good and they expected them to continue to be good. Some major retailers were cutting their inventories to the bone, but they expected their suppliers to help them avoid empty shelves. On the other hand, manufacturers were more pessimistic. Most of those with whom he had talked remained hesitant about undertaking capital investment because of uncertainty about the workings of the Pay Board and Price Commission and about the implications for corporate profits. There were some indications of an increase in demand, however. He had heard a good deal of comment recently about the rate of monetary expansion, and many people were asking whether the Federal Reserve had not become much more restrictive over the past few months. It was his guess that business attitudes would be changing, in light of the strength of retail sales and the fact that Congress had now acted on the tax credit. He agreed that capital investment had been held down by the uncertainty existing in the business community.

Mr. Hayes said it was always heartening to him to find the New York Bank's view of the economy coinciding with that of the Board's staff. That had been the case in the last few months and it was again today. He saw the outlook very much as Mr. Gramley had described it, and like the latter he hoped for improvement in

the areas of capital spending and inventory investment. He did not expect much near-term improvement in the unemployment situation, but for the full year 1972 his Bank's projections were similar to those of the Board's staff.

Like others, Mr. Hayes continued, he had been puzzled by the discrepancies between the attitudes of businessmen and economists. However, he thought there had been some improvement in confidence over the past few weeks. The improved outlook in the international financial area had certainly played a role in that connection, and if the agreements between President Nixon and President Pompidou reported in the ticker story bore fruit the outlook would be further enhanced. There still were many uncertainties connected with Phase II, but he was encouraged by the fact that the Pay Board seemed to be taking a stiffer approach in its recent decisions than it had earlier. Given that development, and the fact that there was considerable slack in the economy which was likely to persist for a while, he was optimistic that real progress would be made with respect to prices over the coming year.

Mr. Hayes added that it was important for the Committee not to underestimate the likely volume of reflows from abroad that would be associated with an international settlement. It should do what it could to prevent those reflows from having undesired effects on domestic markets while simultaneously keeping control over bank reserves.

Mr. Brimmer recalled that a question had been raised at the last meeting of the Committee about the validity of the staff projection of productivity, and it had been observed that unemployment might be higher than the staff suggested if the rise in productivity had been underestimated. He noted that no change had been made in the projection, and asked whether the staff had reexamined it in the interim.

Mr. Gramley replied that the staff had reexamined the projection in question--which indicated a rise in output per man-hour in the private nonfarm economy of a little over 3-1/4 per cent between the fourth quarters of 1971 and 1972--but had found no strong reasons for modifying it. While he was not sure other staff members would fully agree, it was his view that if the projection of productivity gains was wrong it was more likely to be too low than too high. At the same time, he considered it to be the best modal estimate.

The Chairman said he would agree that if the figure was wrong it was likely to be on the low side.

Mr. Brimmer said he believed the projection was too low and therefore that the staff's estimate of the decrease in unemployment was too optimistic. If so, the situation during most of 1972 might well be one of substantial unused capacity and very little reduction in unemployment. In light of the lags in the effects of monetary

policy, the Committee should give careful thought to the possibility that the course recommended by the staff might be inappropriate and that more stimulation might in fact be needed. He had not yet reached that conclusion himself, but he believed the question required exploration.

Mr. Winn remarked that there was considerable gloom in the Cleveland area at the moment. A number of his Bank's directors had reported last week that their companies had received few or no new orders in recent weeks. While orders received by machine tool manufacturers in the Fourth District had not declined recently, they had shown no tendency to rise.

In the judgment of the directors he had mentioned, Mr. Winn continued, a settlement of the international monetary situation was far more crucial to the outlook than was the course followed by monetary policy. The directors also were concerned about the way in which Phase II would be implemented. While he personally thought their concern was not wholly warranted, it clearly was a significant element in their thinking. Several indicated they would not consider expanding their work force until their sales volume had increased by more than 10 per cent. He had been quite sobered by their attitude. His personal view of the economic outlook was more in line with the staff's projections; perhaps the difference reflected the current discrepancy between the thinking of businessmen and economists.

Chairman Burns asked whether a recent survey by the Cleveland Bank had not indicated that manufacturers in the Fourth District were planning to increase capital outlays in 1972.

Mr. Hocter replied that the Bank's semi-annual capital spending survey had suggested a large increase in dollar outlays by manufacturers in the Cleveland and Cincinnati areas. A similar finding had been made in the previous canvass last spring. It appeared, however, that the survey was subject to some serious statistical problems, and that the results were unreliable. The Bank had decided to discontinue the survey.

Mr. MacLaury said it was his impression that the gap between the thinking of businessmen and economists was narrowing. Such a conclusion appeared warranted by the reaction of directors of the Minneapolis Bank to the staff's economic projections, which did not differ greatly from those of the Board's staff. At an earlier meeting such projections had been met by strong demurrers, but this time the directors appeared to accept them as at least possible of attainment.

Mr. MacLaury then referred to Mr. Gramley's observation that, in the staff's judgment, a 6 per cent growth rate for M_1 would be consistent with approximate stability in long-term interest rates if nominal GNP rose at about the rates projected. According to estimates made at the Minneapolis Bank, growth in M_1 would have to

be considerably more rapid than 6 per cent in the first half of 1972 if long-term interest rates were to be stable at the indicated rates of growth in GNP. He found the difference to be puzzling because his staff had used an equation from the Board-MIT model for estimating purposes and had introduced assumptions similar to those used at the Board regarding an increase in short-term rates.

Mr. Gramley commented that a detailed comparison of simulation techniques probably would be required to explain the difference in findings. One possibility was that different money demand equations had been employed; two such equations had been developed for use in connection with different types of analyses.

Mr. Swan said his view of the economic outlook was generally similar to that set forth today, and he agreed on the importance of the prevailing uncertainties. He did not know whether those uncertainties would be resolved in the near future, but if they were their effects might quickly be reversed. For example, if a settlement were reached in the international monetary area, the reaction might be sudden--and perhaps even more favorable than warranted. Similarly, there could be a mass shift in opinion regarding the workings of the Pay Board and Price Commission. Under such circumstances a very different atmosphere could develop with respect to inventory policy and capital equipment spending.

Mr. Maisel recalled that he had raised a question about the staff's projection of productivity at the previous meeting.

After considering the matter further he still believed that the rise in productivity was probably understated and, consequently, that the projected decline in the unemployment rate was somewhat optimistic. Secondly, the record for recent years indicated that the increases in real GNP had tended to be smaller than expected and the increases in prices larger than expected. Forecasters had done a particularly poor job in projecting changes in the GNP deflator. In general, if the staff's projections of nominal GNP proved accurate he thought it was likely to be found that the rise in the deflator had been understated and that in real GNP overstated. In light of those two considerations he believed the staff probably was overestimating the likelihood that the economy would be approaching its potential by the end of 1972. If so, a more aggressive monetary policy could be pursued with less fear of going too far.

Mr. Kimbrel remarked that businessmen in the Sixth District were becoming somewhat more confident about the success of Phase II; in particular, they believed that the initial wave of approvals of large pay increases was a thing of the past and that the future decisions of the Pay Board would involve smaller increases. Judging from the red book, it seemed that Sixth District businessmen were more optimistic than those elsewhere in the nation--and with good reason, since the District economy appeared to be performing better.

A higher rate of economic expansion in the District than nationally was suggested by banking figures; at the end of November total deposits in the District were 15 per cent higher than a year earlier and total loans 14 per cent higher, compared with increases of 12 and 9 per cent, respectively, for the country as a whole.

At the same time, Mr. Kimbrel continued, staff members at the Atlanta Bank appeared to be less optimistic than others in the Federal Reserve. In a list of projections of GNP for the fourth quarter of 1972 made at the Reserve Banks and at the Board, there was a $40 billion spread between the highest and lowest and the projection of the Atlanta Bank was far down in the list. Something was to be gained by noting that wide divergence of views, since it underscored the tentative nature of all economic projections. While the Committee could not avoid the responsibility for looking ahead, it could not afford to shift to an automatic pilot for monetary policy. Instead, it should undertake at all times to supply the volume of funds that appeared to be needed to support orderly growth in the economy.

Mr. Eastburn observed that projections made earlier at the Philadelphia Bank had implied more growth than seemed to be suggested by a reading of business sentiment. Recently, the Bank's projections had been indicating that the rate of growth in the first part of 1972 would be somewhat less than the Board's staff anticipated. He suspected that the Bank's projections now were

underestimating the likely vigor of consumer spending; there were some straws in the wind to suggest that Christmas sales could be very strong in the Philadelphia area. In general, he was inclined to accept the Board staff's projections.

Mr. Eastburn then referred to the observations about the economic outlook that had been made today by Messrs. Brimmer and Maisel and to the Chairman's earlier comment about the Board's reasons for reducing the discount rate. He asked whether the Board's action reflected a desire for a faster rate of economic growth than that contemplated by the staff's projections.

Chairman Burns said the Board's action reflected a judgment that a more aggressive monetary policy was required. He could not say whether individual Board members had reached that conclusion because they thought the growth rates projected by the staff would not otherwise be attained or because they believed higher growth rates were desirable in the interest of reducing unemployment; each would have to speak for himself on the point. The Board members were not monetarists and they attached importance to several aggregates, not just M_1. However, they did not believe M_1 could be ignored, and they noted that it had hardly increased since July.

Mr. Maisel said it was his personal belief that a more aggressive monetary policy was needed to validate the staff's projections of real GNP than the policy actually followed in the past two or three months. Secondly, he thought any errors resulting

from a further relaxation of policy were less likely to have an unwanted effect at this time than ordinarily, largely because of the amount of unutilized capacity existing and projected.

Chairman Burns then noted that a continuation of the news report he had read earlier concerning the joint statement by Presidents Nixon and Pompidou was now available. Following the reference to the agreement to work toward a prompt realignment of exchange rates through a devaluation of the dollar and revaluation of some other currencies, the report read: "The joint U.S.-French statement said 'This realignment could, in their view, under present circumstances be accomplished by broader permissible margins of fluctuations around the newly established exchange rate.' The two Presidents also are aware of the importance of trade for a lasting equilibrium of the U.S. balance of payments, the statement said. The announcement said that Pompidou 'confirmed that France, together with the governments of other Common Market countries, is preparing the mandate which would permit the imminent opening of negotiations with the U.S. in order to settle short-term problems currently pending and to establish the agenda for the examination of fundamental questions in the area of trade.' This appeared as a concession by Europeans to the U.S. demands for lower trade barriers on a number of products, especially agriculture products."

Chairman Burns commented that the situation apparently was back to where it had been at the conclusion of the Rome meeting,

which was progress in a sense. Indeed, matters were further along on the question of an increase in the price of gold, since this was the first time that President Nixon had made a statement on the devaluation of the dollar.

The Chairman went on to say that he had been somewhat discouraged by reports in the past few days which suggested that the Europeans were less willing than it had appeared earlier to hold immediate discussions on trade issues. Apparently, however, President Pompidou had wanted to have the matter held in abeyance until he had an opportunity to talk with President Nixon. The situation now looked hopeful, and he (Chairman Burns) believed that progress would be made at the forthcoming Washington meeting. However, he was still inclined to think that one more meeting would be required before a settlement was reached.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period November 16 through December 8, 1971, and a supplemental report covering the period December 9 through 13, 1971. Copies of both reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Holmes made the following statement:

> Since the last meeting of the Committee, System open market operations have aimed progressively at a

modest relaxation of money market conditions. Despite the fact that the aggregates were in excess of the blue book[1] paths--substantially so in the case of the credit proxy--the continued sluggish growth of M_1 made it appear appropriate by the close of the period to aim at a Federal funds rate slightly below the midpoint of the 4-1/4 to 4-7/8 per cent range specified at the last meeting. Generally, over the period, there seemed to be some strengthening in confidence in the economic outlook for the months ahead and in the possibility of a reasonable success for Phase II. At the same time the apparent progress at the Rome meeting of the Group of Ten towards a settlement of the international monetary situation helped to relieve some of the apprehension in the equity markets--and the business community generally--that was so evident at the time of the last meeting.

Treasury bill rates rose rather sharply early in the period, as had been anticipated, in view of the Treasury's need to raise new cash--which made for bill auctions on three successive days prior to Thanksgiving. Subsequently, however, bill rates retraced their path, partly as the result of resumption of large-scale buying of bills for foreign official accounts, the counterpart of another speculative surge against the dollar as the foreign exchange markets began to envisage a somewhat larger _de facto_ devaluation of the dollar than had earlier been anticipated. All in all, foreign central banks were net buyers of $2.7 billion Treasury bills over the period. In yesterday's regular Treasury bill auction average rates of 3.94 and 4.14 per cent were established for 3- and 6-month bills, down 18 and 11 basis points from the auction just preceding the last Committee meeting.

The Federal Reserve was a heavy supplier of reserves over the period. In addition to $4.5 billion of repurchase agreements, outright purchases of both Treasury bills and coupon issues were in excess of $600 million. The purchase of coupon issues and an additional $160 million of Federal agency securities, while needed to supply reserves, were also helpful in reducing dealer inventories from the uncomfortably high levels they had reached before the period began. Generally speaking, the long-term bond markets had somewhat heavy sailing

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1/ The report, "Monetary Aggregates and Money Market Conditions," prepared for the Committee by the Board's staff.

early in the period but improved towards the close. The discount rate cut on Friday and the prime rate changes yesterday acted as a further stimulus to the bond markets.

I believe the written reports to the Committee have adequately covered the rather peculiar developments of the week ending November 24, when we were not successful in achieving the desired money market conditions. To summarize, a combination of consistent reserve shortfalls from expectations, the slowness of banks to cover their reserve needs, and a $400 million error in computing vault cash led to a firmer funds market than we wanted. Heavy member bank borrowing on the final day of that week carried over the Thanksgiving holiday, with the result that the banks accumulated massive excess reserves in the December 1 week, with the Desk making only a token resistance to a rather sloppy funds market late in the week. Subsequently, the money market settled down, with Federal funds trading in a range of 4-1/4 to 4-1/2 per cent in the past two business days.

It should be noted that throughout the period there was a plethora of corporate and other nonbank money available to dealers on repurchase agreements at low rates. At times the ability of the Desk to make repurchase agreements at the 4-3/4 per cent discount rate was circumscribed by this competitive source of funds. Had we been required to make RP's late in the period we would undoubtedly have had to use a rate well below the discount rate. If this situation persists, we may--in the period ahead--have to drop the RP rate even below the 4-1/2 per cent discount rate established by four Reserve Banks last Friday.

As far as the aggregates are concerned, M_1 in November was $700 million above the weak November blue book path, while M_2 and the credit proxy turned out to be $500 million and $1.8 billion over the higher growth paths anticipated at the time of the last meeting. The December outlook is for substantially greater excesses over the paths thought likely at the time of the last meeting. Despite the fact that M_1 was growing faster than the path, the annual rate of increase in November was a minuscule 0.5 per cent, with a 3 to 4-1/2 per cent rate anticipated for December. It would be most helpful to the Desk if, in reaching a policy decision today, Committee members would comment on the desirability of the M_1 path specified for the various directive

alternatives[1/]--and also on the weight they would want to put on M_2 and the credit proxy, both of which have been growing more rapidly than the narrowly defined money supply. As usual, it would be helpful to know how aggressive the Committee would want the Desk to be in responding to deviations from path or from desired levels of aggregate growth or to interest rate developments in other markets.

Looking ahead, there is considerable uncertainty about the potential impact on domestic markets of the substantial reflow of funds to this country that is anticipated after an exchange rate settlement is effectuated. To be brief, we would expect (1) substantial pressure on the Treasury bill market as foreign central banks turn from large buyers to massive sellers--pressure which could be compounded if the Treasury has to raise additional cash to redeem special certificates issued to foreign central banks earlier this year; (2) a considerable churning in both the domestic and international money markets as dollars flow into the Euro-dollar market, into the U.S. stock market, and into various short-term U.S. instruments, or are used to pay off bank loans; (3) a decline in Euro-dollar rates, making borrowing in that market more attractive to foreign subsidiaries of U.S. firms and foreign borrowers, to the extent that they are not inhibited by exchange controls; (4) some downward pressure on certain short-term rates in the United States, which should mitigate the upward pressure on Treasury bill rates. One would expect equilibrium to be reestablished at a higher Treasury bill rate than has recently prevailed and perhaps somewhat lower rates on other short-term instruments such as CD's or commercial and financial paper. The major risk involved is that massive pressure on the Treasury bill market could adversely affect market psychology, leading to at least temporary upward pressure on all interest rates. The System should be alert to avoid disorderly conditions in the Treasury bill market and a great deal of flexibility in open market operations may be required. Massive System purchases of Treasury bills from foreign central banks could be necessary, requiring a suspension of the $2 billion limit specified in the continuing authority directive on changes in the System portfolio in the period between Committee

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1/ The alternative draft directives submitted by the staff for Committee consideration are appended to this memorandum as Attachment B.

> meetings. Hopefully, any unwanted reserve impact from such operations could be offset by sales of very short dated bills from the System Account--assuming there is a demand in the market--or by very large and flexibly designed matched sale-purchase transactions. The Board, however, might want--as a last resort--to consider a temporary increase in reserve requirements if the reserve impact of necessitous purchases of bills cannot be neutralized by other operations.

Mr. Brimmer said he was concerned about the risk that reflows of funds from abroad would make it difficult to attain Committee objectives with respect to interest rates and monetary aggregates. He realized that it was not possible to foresee the consequences with any precision at this point, but perhaps the Manager could amplify his comments on that subject.

Mr. Holmes replied that the effects of the reflows on interest rates obviously would depend on their pace. If $4 or $5 billion returned within a short period, Treasury bill rates were likely to rise considerably. Even with slower inflows, bill rates were likely to rise somewhat and the effect might spread to other short-term rates. However, he would not expect upward pressure on market rates generally unless there was a substantial deterioration in psychology. Views differed as to the possible consequences for the aggregates. It was his guess that the reflows would produce temporarily faster growth in M_1 than would otherwise be the case.

Mr. Brimmer noted that the blue book discussed another significant source of uncertainty about the course of the aggregates at this time--namely, the effect of a recent amendment to OFDI

regulations on the normal year-end return flow of corporate funds to comply with those regulations. Such problems raised a question in his mind as to whether the Committee should specify targets for the aggregates in a highly precise fashion.

In reply to a question by Mr. Mitchell, Mr. Holmes said the Foreign Department of the New York Bank normally had one or two days' advance notice of the intention of foreign central banks to sell U.S. Treasury bills. Also, the Desk was usually informed by the Treasury of plans of foreign monetary officials to liquidate special Treasury certificates they had purchased earlier. However, little or no advance information was available concerning the repatriation of private funds.

Chairman Burns asked whether Mr. Holmes or Mr. Coombs would be prepared to comment on the likely volume of reflows in December if substantial progress were made at the Washington meetings in negotiating new exchange rate patterns, but no final agreement was reached.

Mr. Coombs replied that he would not expect any substantial profit-taking under such circumstances; most people would probably wait until a settlement was reached. At that point, there might be massive reflows.

Mr. Mitchell asked whether the volume of reflows would not be influenced by the spread between short-term interest rates here and abroad. There would be a strong incentive to keep funds

invested abroad if that meant a return 100 or 200 basis points above the yields available in the United States.

Mr. Coombs agreed that the larger the rate spread the greater the deterrent there would be to repatriation of funds. Working in the other direction, however, was the likelihood that the dollar would look relatively attractive to investors if the realignment of exchange rates agreed upon was a plausible one.

Chairman Burns remarked that much would depend on the market sophistication of those making the decisions. He suspected that some people, at least, had moved funds abroad with an eye to profiting on changes in exchange rates, and would bring their funds back once a settlement was reached regardless of the interest rate spread. He believed the staff should follow developments in that area closely.

Mr. Brimmer reported that while in New York last week he had asked a number of commercial bankers how they expected their corporate customers to react to a settlement. In general, they expected a large reflow, for reasons similar to those advanced by Mr. Coombs.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period November 16 through December 13, 1971, were approved, ratified, and confirmed.

Mr. Axilrod made the following statement on the monetary relationships discussed in the blue book:

With the economic recovery showing signs of moving into a higher gear, open market strategy might well be directed, in general terms, at assuring that credit and money are available in ample enough quantity to sustain the expected, and desired, expansion in economic activity. In specific terms, this could mean continuation of growth in the bank credit proxy and M_2 at a moderate rate. But it would also require a pick-up in the growth rate of M_1 from the depressed pace of the past few months.

Growth in M_2 and the bank credit proxy reflects to a greater extent than M_1 shifts in the public's savings propensities, banks' investment desires, and the pattern of private and U.S. Government credit demands as they may all be influenced by, among other things, the structure of interest rates and expectations as to future interest rates. Growth in M_1 is also to a degree influenced by such developments. But the economy's need for M_1 is to a greater extent influenced by the transactions demands implicit in the growth in nominal GNP.

With the FOMC desiring and expecting a pick-up in growth of nominal GNP, it is reasonable to encourage greater expansion in M_1. If such an expansion in M_1 is not forthcoming, there is the risk that growth in economic activity could be hindered as the public in effect sells off various financial assets, and in the process generates undue upward pressure on interest rates, in an effort to secure the cash needed to sustain transactions. A rise in interest rates has not occurred during the recent months of little or no growth in M_1 because the public, partly in lagged reaction to the spring and early summer rise in interest rates, was willing to invest some of the very large amount of cash that had been built up over the first seven months of the year. But with a reasonably rapid fourth-quarter expansion of GNP in prospect, and with the lagged response to the earlier rise of interest rates behind us, much of that previous rapid build-up in cash has in effect already been absorbed by the economy.

The blue book indicates that the staff would expect, given prevailing money market conditions and assuming the GNP projection, a more normal expansion in M_1 to be resumed over the months immediately ahead. But the pattern of expansion is quite erratic as a result of an

unusually sharp decline in U.S. Government deposits anticipated between January and February, and the possible impact of newly adopted OFDI regulations. Moreover, a settlement of international monetary negotiations could generate sizable reflows of funds abroad which might distort M_1 statistics, particularly if reflows were to occur over a short period.

While there are uncertainties as to the pattern of weekly and monthly changes in M_1 to be expected in the period ahead, it would still seem desirable for the Committee--for reasons mentioned earlier--to consider instructing the Manager in such a way that a more normal growth in M_1, as well as continued growth in other aggregates, is achieved on average over the next few months. Among other things, such a course of action would appear to require more active provision of both nonborrowed and total reserves than during the past two months, when both reserve measures showed declines on balance.

What this would imply with respect to money market conditions, and interest rates generally, seems more conjectural. If the staff's analysis of monetary interrelationships is correct and the GNP forecast is accurate, the demand for money may be strong enough in the first quarter so that if the supply of M_1 is permitted to grow at no more than a 6 per cent annual rate, the odds are good that money market conditions will tighten at some point during the period, short-term rates generally will rise, and further declines in long-term rates will at least be forestalled. At a 7 per cent growth rate in M_1, it seems likely that money market conditions will remain easy; and with a greater growth rate, money market conditions may ease further.

The Committee may properly be skeptical of the staff's ability to predict these relationships with any precision. And I can assure you that the staff itself has a healthy skepticism. But we don't discount ourselves completely. We do believe that sizable transactions demands, together with the lagged effects of the lower short-term interest rates that have prevailed since mid-summer, will bring about resumed M_1 growth. And we also believe that there is some real risk that the growth rate might turn out to be higher than the Committee might want to tolerate--at an annual rate higher than, say, a 5 to 7 per cent range.

In its deliberations today, the Committee may wish to consider the desirability of providing the reserves

that will achieve a moderate longer-run growth path for the aggregates, including growth of M_1 at around 6 per cent, give or take a percentage point or so depending on what may be happening to interest rates. Under prevailing money market conditions, the staff would expect only a 4-1/2 per cent growth rate in December and even slower growth in January. The uncertainty of predicting weekly and monthly patterns might lead the Committee to want to tolerate--and perhaps actively seek--somewhat higher growth rates in those two months, particularly in view of the recent weak performance of M_1.

In carrying out such a directive, the Committee could, if it wished, instruct the Manager to start out at recently prevailing money market conditions--typified by a 4-1/4 to 4-1/2 per cent rate on Federal funds--and to permit the funds rate to ease so long as the growth rate in M_1 in December and January was below around a 6 per cent rate and so long as the other aggregates were not showing signs of undue strength. But it would seem desirable to keep any such easing of the money market to modest proportions because of the risk of generating renewed excessive expansion in M_1 later and because of the likelihood that some tightening of the money market might, in any event, be required at some point during the first quarter of next year. Indeed, the Committee might also wish to contemplate a slight tightening of the money market over the near-term if incoming M_1 statistics were extremely strong, assuming the strength was not explainable by unusual year-end churning or an international monetary settlement.

However, if M_1 appeared to be coming in so weak as to cast doubt on the likelihood of moving on to a reasonable longer-run growth fairly promptly, then a rather substantial short-run easing of the money market may be advisable. Evidence for such a substantial easing would be M_1 figures weaker than the 4 per cent short-run growth rate paths shown in the blue book for December and January under alternatives A or B. Under those circumstances, the funds rate would probably drop below 4 per cent as the Desk made efforts to keep aggregate reserves large enough to support desired growth in the various monetary aggregates.

A strategy that involves primary focus on the monetary aggregates could, of course, be encompassed under language similar to that of directive alternative B.

Chairman Burns said he would like to make a brief factual statement before the go-around on policy. As the Committee knew, the new economic program the President had announced on August 15 was designed not only to stabilize the price level but also to stimulate growth in the economy. What had been the record of monetary policy since August? If the staff's projections for December were realized, over the last four months of the year M_1 would have grown at an annual rate of 0.8 per cent; M_2 at a rate of 6.2 per cent; and total reserves at a rate of 3.5 per cent.

The Chairman then called for the go-around of comments on monetary policy and the directive, beginning with Mr. Hayes who made the following statement:

> Such modest changes as have occurred in the business outlook since our last meeting have been in the direction of more optimism and confidence, with some improvement in domestic statistical data and a significant psychological boost from greater hopes of an international settlement. Inflationary expectations may have been dampened a bit further, but the uncertainties in this area are still great. Fiscal policy remains highly stimulative. All of this suggests the need for great caution in moving in the direction of any greater monetary ease.
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> The slow growth of the narrow money supply over recent months might seem to point in the direction of a more accommodative posture. But here I am impressed by three facts: (1) For 1971 as a whole the growth of M_1 is likely to be quite adequate--perhaps around 6 per cent or more. (2) The other principal aggregates--M_2 and the proxy--show very generous growth rates for the year as a whole and adequate rates in recent months. (3) All three of these aggregates are running above their paths envisaged at the last meeting, with the excess quite large in the case of the credit

proxy. I might note that a study just published in our Monthly Review, which suggests a great uncertainty as to the length of the lag between monetary changes and economic effects, would seem to counsel the wisdom of looking at the aggregates' growth in reasonably long perspective and not getting too disturbed by the showing for any period of a few months.

We should also have in mind that the behavior of the aggregates has doubtless been affected by transitional factors related to the President's economic program and to the heavy international money flow of recent months, but these factors are impossible to quantify accurately. This might argue for a policy of giving some weight to reasonable stability in money market conditions as well as to adequate growth in the aggregates.

Any major reflow of funds resulting from a credible settlement of exchange parities could have very complex and unpredictable effects on the money and credit markets. A greater-than-usual degree of leeway for discretion on the part of the Manager would appear logical in the face of these uncertainties.

My preference is clearly for a policy of no change, though I would continue to be more concerned over a shortfall of the aggregates below current expectations than about excessive growth. It seems to me that all three of the principal aggregates should be given substantial weight. I would propose a Federal funds range of about 4-1/4 to 4-3/4 per cent, i.e., centered on the lower discount rate now in effect at four Reserve Banks, with relatively low borrowings at the discount window, and marginal reserves fluctuating around zero.

As for the directive, I like the language of alternative A, with its emphasis on rather stable market conditions, but I would aim for a funds rate, as I have indicated, between the specifications of A and B. The statement in the draft of the first paragraph that "... Federal Reserve discount rates were reduced" should be modified to make clear that the reductions were made at four of the Banks, not throughout the System.

Chairman Burns suggested that the statement in question be revised to read "...discount rates were reduced at four Reserve Banks."

There was general agreement with that suggestion.

Mr. Hayes added that, frankly, he had been surprised at last week's discount rate reduction. Procedurally, he had felt that there was a great deal to be said for taking advantage of today's meeting to exchange views on the discount rate before any action was taken. Substantively, it seemed to him that the further cut of one-quarter point could not be characterized as merely "following the market."

Chairman Burns noted that most of the recent actions on the discount rate had been intended to maintain its alignment with market rates, and the Board's announcements of those actions consequently had been neutral with respect to policy implications. However, one purpose of the latest action was to assist the progress of economic expansion, and that was made clear in the statement for the press.

Mr. Hayes remarked that to a certain degree the action was taken as a signal of greater ease, presumably to show the System's concern over the recent slow growth of the narrow money supply. As he had already indicated, he did not feel that that factor warranted a change in monetary policy to greater ease at this time.

Chairman Burns commented that the figures he had cited earlier on the recent behavior of the aggregates did not suggest to him that the System's posture was one of ease. Indeed, in

light of the behavior of the aggregates some people were now asking whether the Federal Reserve was deliberately moving to a restraining policy so as to nullify what the Administration, with the support of Congress, was attempting to accomplish.

Mr. Hayes observed that the System always was exposed to the risk of mistaken interpretations of its actions. Personally, he had been impressed by the recent evidence of strengthening in the economy, along the lines of the rather optimistic fore-casts that the staff had been giving the Committee for some time. In speaking of "ease" he had been thinking in terms of money market conditions rather than aggregates. However, he thought the recent behavior of the aggregates was reasonably appropriate in light of their very rapid growth over the first seven months of 1971. He would not like to see the recent weakness continue for long, but the staff's projections suggested that that would not be the case. Thus, even under alternative A the staff expected M_1 to grow in the first quarter at a rate of 6 per cent, which he would consider adequate. He was concerned that the main result of the discount rate cut might be to whipsaw the market, as had happened early in the year. As of the moment, he was inclined to recommend to his directors that the New York Bank stay with its present discount rate until further clarifi-cation of the outlook.

Mr. Francis remarked that monetary developments since mid-summer had been restrictive. For each week that stance was maintained, the dampening effects on total spending next spring and summer were likely to increase. While such a monetary course might shorten the period of inflation, the risks of a slower increase in production and employment indicated that a more expansive course was desirable.

Mr. Francis said he believed most members of the Committee did not favor a restrictive policy course at this time. Some probably inferred from the lower interest rates and greater availability of credit that monetary developments had become more expansive, or at least not much more restrictive. But, following most past occasions when interest rates declined while growth of money slowed markedly for five months or more, business activity did slow.

At the last two meetings of the Committee, Mr. Francis continued, the majority had desired a moderate growth in the monetary aggregates. At both meetings the Committee had issued directives which placed prime emphasis on monetary aggregates in policy implementation, rather than directives which placed chief emphasis on money market conditions. Yet, it appeared that continued reliance on day-to-day market conditions as a guide to operations had resulted in over-all attention being directed at money market patterns.

Mr. Francis said he favored a directive which had the greatest likelihood of achieving a moderate growth in money in the near future. The language of alternative B, with specifications proposed by the staff for alternative A, seemed best to him. He would like the B language even better if the words "and money market" were deleted from the statement that operations should be conducted "with a view to achieving bank reserve and money market conditions consistent with" the Committee's objective for the aggregates. He was not saying that interest rates were unimportant, but he did believe that at times they had led the Committee astray. He thought the last few months had been one of those times, and that the Committee now had to concentrate on the aggregates and not place stress on the Federal funds rate. He would not be disturbed if money market conditions moved outside the range indicated in the specifications, but he would be disturbed if the money stock continued to show little or no growth.

Mr. Kimbrel said he would certainly agree with the statement in the blue book that "Current international financial negotiations make forecasts of interest rates and monetary aggregates, and their interrelationships, much more uncertain than usual." In addition, the past experience in respect to the instability of the relationships between rates, monetary aggregates, and economic activity suggested that a cautious approach be taken to any policy change.

Personally, Mr. Kimbrel continued, he was gratified that it had been possible to experience lower short-term rates without an excessive expansion in liquidity. It seemed to him that the best chance of continuing to do so would be to place primary emphasis on the monetary aggregates in the policy directive. For the Committee to do otherwise carried with it the danger of its locking itself into an interest rate pattern that might later prove to be inappropriate.

Therefore, Mr. Kimbrel said, he would prefer a directive stated in terms of the monetary aggregates. Since a cautious approach seemed most appropriate under present conditions of uncertainty, he favored the language of alternative B, modified to indicate that the Committee "seeks to promote moderate growth in monetary and credit aggregates over the months ahead." For the Federal funds rate he would favor a range in the order of 4-1/8 to 4-3/4 per cent, overlapping the range shown in the blue book under alternatives A and B. For the other variables he preferred the alternative B specifications.

Chairman Burns said it would be helpful to the Committee if the Manager indicated how he thought the "prevailing" level of the Federal funds rate might best be described.

Mr. Holmes noted that the effective rate on Federal funds was 4-1/2 per cent early last week and again on Thursday

and Friday. Yesterday the effective rate was 4-1/4 per cent, with trading in a range from 4-1/4 to 4-1/2 per cent. Today funds probably were trading at 4-1/8 per cent. On the whole, he thought the "prevailing" funds rate might be described as in a 4-1/4 to 4-3/8 per cent range.

Mr. Eastburn remarked that in his view a 6 per cent rate of growth for M_1, such as the staff projected for the first quarter under alternative A, was an expansionary rate. He would be content with a 6 per cent growth rate and would be somewhat disturbed if it were exceeded. The risk seemed to be that growth would be faster, as a result of rising transactions demands, lagged effects of recent declines in short-term interest rates, and reflows of funds from abroad.

If the Committee sought the alternative A growth rates for the aggregates, Mr. Eastburn continued, there might be some backup in the short-term interest rates. That would not disturb him as long as long-term rates were reasonably steady. Also, it would be desirable for short-term rates to evidence some flexibility in order to avoid any impression that the System was trying to freeze them. That raised the question of the relationship between market rates and the discount rate. He, too, had hoped that the Committee would discuss the discount

rate in some detail at this meeting, since use of that policy instrument was closely related to Committee decisions on open market policy.

Chairman Burns remarked that comments on the discount rate would be highly useful, looking to the future as well as the past.

Mr. Eastburn said he planned to recommend to the directors of his Bank at their meeting on Thursday that they follow the action of the four Banks that had reduced the rate. For the directive he favored the language Mr. Kimbrel had suggested, indicating that the Committee "seeks to promote moderate growth in monetary and credit aggregates over the months ahead." He would define "moderate growth" as growth at the rates associated with alternative A in the blue book.

Mr. Winn said he thought the Committee should avoid emphasizing either interest rates or the aggregates at the expense of the other; he would give due weight to both in the directive language and specifications. He leaned toward the specifications of alternative B rather than toward those of A.

Mr. Brimmer said he would first comment on his own reasons for voting to approve discount rate cuts at four Reserve Banks last Friday. His focus had not been primarily on the recent behavior of the narrowly defined money supply; he agreed that it would

not be wise to repeat the experience of early 1971 when the Committee had tried to compensate for an earlier shortfall in M_1. He had been concerned mainly about the prospective behavior of the economy--specifically, about the possibility that the growth of real GNP in 1972 might be inadequate.

Mr. Brimmer remarked that it was obviously desirable to mesh the various instruments of monetary policy for which responsibility was divided among different bodies within the System. In that connection, he agreed with the Manager that a temporary increase in reserve requirements might prove useful in the near-term.

In general, Mr. Brimmer continued, he would like to see the easing stance signaled by the discount rate action of last week show through. In other words, he would not want the Committee to pursue a policy course that would offset or neutralize the effects of that action. Nor would he want to have those effects swamped by the temporary distortions that might result from reflows of funds to the United States or from other disturbances. He favored seeking the growth rates of the aggregates associated with alternative B. Looking toward the first quarter of 1972, he realized that an effort to achieve somewhat faster growth in M_1 would mean producing faster growth in M_2 also. He was willing

to incur some risk of excessive growth since he thought the Committee would have ample time to reverse course if necessary. In general, he thought leeway existed for stimulating the economy through faster growth in the monetary aggregates without undercutting the effort under Phase II to slow the rate of inflation.

Mr. Brimmer noted that the next meeting of the Committee was tentatively scheduled for January 18, 1972, five weeks hence. In view of the length of that interval and the likelihood of turbulence in financial markets during the period, he believed that the Committee should not prescribe any narrow ranges of money market conditions, and that it should give the Manager a considerable degree of flexibility. He would say, however, that at the start of the period the Manager should aim at a Federal funds rate at roughly the present level, and that he should not permit the rate to rise above that level during the period.

Mr. Maisel said he thought that at the outset of the coming period the Manager should aim at a Federal funds rate of 4-1/4 per cent, which was about where the rate was now. In his judgment the System should make clear by its actions that it was opposing any increase in short-term interest rates that might result from temporary increases in the demand for money related to churning in financial markets. The concern should be with short-term rates in general rather than with the bill rate; while

bill rates might rise somewhat, that movement should not be permitted to spread to other rates.

With respect to the aggregates, Mr. Maisel remarked that the record of the last six or seven years suggested--without any assumption as to the direction of cause and effect--that M_1 and M_2 should grow faster in 1972 than they had in 1971 if the staff's projections of GNP were to be validated. He hoped the Committee would not be trapped into setting goals for the aggregates that were too low simply because the staff's projections of M_1 and M_2 for December and January were low. At a minimum, reserves should be furnished at a rate sufficient to attain the growth rates for the first quarter associated with alternative B. He would not be disturbed if furnishing reserves at such a pace involved a declining Federal funds rate. Nor would he be disturbed if the growth rates were higher than called for by B, unless they exceeded 7 per cent for December and January combined.

As to the directive, Mr. Maisel noted that copies of an "alternative D," proposed by Mr. Daane, had been distributed. He was not sure he understood the difference between that proposal and the staff's alternative B. He was prepared to accept alternative D if he were persuaded that it was better, but otherwise he would favor B.

Mr. Daane said he agreed that the economic outlook had brightened somewhat in recent weeks. However, an adequate performance still lay in the future and the economy continued to be marked by crosscurrents. Against that background, he believed the appropriate posture for the System at this point was one of doing what it could with the policy instruments at its disposal to foster and encourage economic expansion. With that thought in mind, he had suggested alternative D for the directive, reading "To implement this policy, the Committee seeks to promote the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates over the months ahead." That language was consistent with the spirit of alternative C submitted by the staff, but in his judgment it was a clearer directive to the Manager than any of the staff's alternatives. Unlike Mr. Francis, he did not think the Committee had been led astray by focusing on interest rates and money market conditions; if it had been led astray, it was by relying on the type of analysis presented in the blue book. In effect, he thought the Manager should be instructed--without relying on the blue book analysis--to "err on the side of ease" at this juncture, and in a way that would be apparent to outside observers.

Mr. Daane added that he had been abroad at the time the Board had acted on discount rates last Friday, but had he been

present he would have joined his colleagues in voting to approve the reductions. He did not know whether the fears of world recession were fully warranted, but he thought the System should do everything feasible to avoid contributing to the possibility of such a recession.

Mr. Mitchell remarked that he had listened with interest to the earlier exchange between the Chairman and Mr. Hayes on the subject of growth in M_1. Some months ago it had been the sentiment of the Committee that a low growth rate would be acceptable for a while in light of the rapid expansion through July. At its last two meetings the Committee had expressed a desire for faster monetary growth, but the results suggested that it did not know--or was unwilling to follow--the course that would produce the desired results. Now a number of his associates were saying that the time had arrived for the Committee to become more aggressive in the effort to achieve adequate monetary growth, and even more importantly, to become more concerned about the kind of economic environment that was likely to exist in January and February. It was basically because he shared that view that he was inclined toward Mr. Daane's alternative D, which was expressed in terms of money market conditions but also reflected concern about growth in the aggregates.

Mr. Mitchell said it was likely that M_2 and the bank credit proxy would expand rapidly in the period ahead, particularly if there were large reflows of funds from Europe. He was not sure that M_1 would rise during the next six or seven weeks by as much as the staff projected. If there was a way to stimulate growth in M_1 over the longer run, however, it would be by a deliberate easing of money market conditions. A number of Committee members had expressed concern at recent meetings about the risk that such action might tend to rekindle inflationary expectations. He was not concerned about that risk now, since businessmen were skeptical about the strength of the economic outlook.

Mr. Mitchell said he thought money market conditions roughly like those specified under alternative C, which included a 3-1/2 to 4-1/8 per cent range for the Federal funds rate, would be required. He was rather surprised that the C specifications had not received more endorsement in the go-around thus far. He agreed that the Manager should be given a considerable degree of flexibility to deal with the problems that were likely to arise in the coming period.

Mr. Heflin recalled that in August, when the Committee had sought moderate growth in monetary and credit aggregates, the members had been thinking in terms of a growth rate for M_1 of about

6 or 7 per cent. He thought the Committee should continue to employ such a target, and not overreact at present to the fact that the money supply had not grown at all in recent months. It mattered little whether the specific target for M_1 growth in the first quarter was 6 per cent, as specified under alternative A, or 7 per cent, as under B; the difference was so small that it would be hard to make a case for one figure over the other.

As to directive language, Mr. Heflin continued, he had come to the meeting prepared to speak in favor of alternative A on the grounds that language oriented toward money market conditions would give the Manager the flexibility necessary to cope with the contingencies he was likely to face over the next few weeks. However, he had been assured by Mr. Holmes that the same operations could be conducted under a directive oriented toward the aggregates so long as the Committee's intent was made clear. Accordingly, he would prefer a directive along the lines of alternative B with the amendment suggested by Messrs. Kimbrel and Eastburn.

Mr. Clay said there appeared to be an unusually high degree of uncertainty with respect to some factors affecting the growth paths of the monetary aggregates during the first quarter of next year. That in turn injected a further uncertainty with respect to money market developments and the money

market specifications that should be associated with any given set of targets for the aggregates. It raised a question as to whether the Committee could make a decision today looking much beyond the interval until its next meeting. In any case, he was reluctant to accept higher future growth rates than those represented by alternative A. That alternative, modified to formulate the primary instruction in terms of the aggregates, would appear to be the appropriate choice for the directive. In view of the uncertainties faced at this time, he suggested that the Manager be given a Federal funds rate range of 4 to 4-3/4 per cent in which to implement the targets for the aggregates.

Mr. Clay then referred to Mr. Mitchell's observation that there was little risk of rekindling inflationary expectations at this time. In his (Mr. Clay's) judgment, the hesitancy of businessmen in recent months had been due in part to fears that the stimulus to be provided under the new economic program would lead to further inflation; and the recent abatement of those fears was attributable to some extent to the slow growth in the aggregates since August and to the fact that the System had not gone all out to stimulate the economy. While he favored encouraging growth in the aggregates at this point, he thought there was a real risk of fostering a new surge of inflationary expectations by moving too fast.

Mr. Mayo said he would reemphasize the view he had expressed at the previous meeting that it was undesirable for the Committee to focus narrowly on the Federal funds rate as a measure of money market conditions and on M_1 as a measure of the behavior of the aggregates. To the extent that the funds rate was relevant, however, he would specify a range of 4 to 4-3/4 per cent.

Mr. Mayo went on to say that the Manager's assurance to Mr. Heflin--that the same operations could be carried out under directives formulated in terms of money market conditions or aggregates--could be used to support a preference for the former as well as for the latter. Personally, he preferred the money market approach of alternative A. However, he would favor a modification of the draft language, to call for maintenance of "recently prevailing" money market conditions rather than the conditions "that have prevailed on the average since the preceding meeting." That change would make the language consistent with the range for the Federal funds rate that he had suggested.

Whatever the Committee's policy decision, Mr. Mayo continued, he hoped the Desk would find it possible to make a start toward providing any needed reserves early in each statement week; otherwise, there was a risk that member banks would overborrow, and also that it would be necessary to supply a large volume of reserves at the end of the week. To use Mr. Daane's phrase, he thought the Desk should "err on the side of ease" early in the statement week.

Mr. MacLaury observed that there was a wider range of views around the table today than at other recent Committee meetings. Although the economic outlook still was affected by a good many uncertainties, the latest evidence suggested that one could be more confident now than four weeks ago that the GNP growth rates projected by the staff would be realized. Accordingly, he found it difficult to understand why some members thought the Committee should move more rapidly toward ease now than it had earlier. There was widespread dissatisfaction among the members with the recent weakness in the aggregates, but the Committee's customary reaction to that kind of situation had been to ease gradually over a period of a few months.

The Chairman asked whether it was correct to say that monetary policy had been eased gradually, or at all, in recent months.

Mr. MacLaury said he recognized that that question would be answered in the negative if one used the monetary aggregates rather than money market conditions as the yardstick. Clearly, the aggregates had not been growing recently in the manner desired, despite the Committee's efforts to promote growth by easing money market conditions.

Chairman Burns observed that there was an element of ambiguity in the current situation that should be cleared up.

It was his understanding that over the past few months the Committee had desired moderate growth in the monetary aggregates--meaning by that growth in M_1 at an annual rate on the order of 5 or 6 per cent, and growth in M_2 at a somewhat higher rate. At the time of the last meeting--and here he thought the kind of analysis presented in the blue book created a problem--the staff had projected a growth rate of minus 1 per cent for M_1 in November. Clearly, that projected rate was not in harmony with the Committee's objective for the aggregates. However, the members had realized that to produce growth in M_1 at a rate around 6 per cent within a few weeks it would have been necessary for the Federal funds rate to drop sharply--perhaps to a fraction of 1 per cent. As at other meetings, the members had felt that some constraint should be imposed on the movement of interest rates, including the Federal funds rate, and the Committee had specified a range from 4-1/4 to 4-7/8 per cent for the latter. In other words, the Committee was not prepared to have the Federal funds rate fall drastically for the sake of achieving promptly its objective for the aggregates.

As the weekly figures came in, the Chairman continued, it developed that M_1, instead of decreasing at the projected rate of 1 per cent, was rising at a rate of about 0.5 per cent. At that point, two different interpretations of the Committee's intent emerged. The first was that, since the actual figures were above

the projected path, there was no reason to move the Federal funds rate towards the lower limit the Committee had specified. The second was that, since growth at a rate of 0.5 per cent was essentially no growth at all, and since the Committee desired a growth rate of about 6 per cent, the funds rate should be moved toward the specified lower limit.

In his judgment, the Chairman said, the second interpretation was the proper one; the criterion for deciding whether to move the funds rate toward the limit should be the behavior of the aggregates relative to the Committee's objective--not relative to the staff's projections. Other members might not agree with that judgment, and it was important that the matter be clarified.

Mr. MacLaury said he subscribed to the Chairman's interpretation, and he agreed that the Committee should not permit its view of the objectives to be obscured by the staff's projections. He did not think that that had in fact occurred, since the Committee had been calling for progressively easier money market conditions at recent meetings.

With respect to today's directive, Mr. MacLaury continued, in light of all the uncertainties in the international monetary area he thought it would be desirable to formulate the primary instruction in terms of money market conditions. He favored the language of alternative A, modified as Mr. Mayo had suggested.

However, he would use the specifications associated with alternative B, including a range for the Federal funds rate of 4 to 4-5/8 per cent. He believed the proviso clause should be interpreted rather loosely, but the Manager should be more sensitive to downward than to upward deviations; and the funds rate should be reduced within the indicated range if the growth rate of the aggregates failed to pick up.

In a final observation, Mr. MacLaury referred to Mr. Brimmer's comment that he would not want to see the Open Market Committee neutralize or offset the discount rate action the Board had taken on Friday. He (Mr. MacLaury) thought that pointed up the concern which Mr. Hayes and Mr. Eastburn had expressed about the recent sequence of events. He recognized that final decisions with respect to discount rate actions were the Board's responsibility, and that there no doubt were good reasons for the timing of Friday's action. Whenever possible, however, he would hope that advantage would be taken of the opportunity offered by Committee meetings for advance discussion of such actions.

Chairman Burns said it was worth noting that the cut in the discount rate to 4-1/2 per cent had initially been proposed by three Reserve Banks, on their own iniative, and that they were joined by a fourth Bank before the Board's decision was announced. As he had indicated earlier, he thought this was a good time to

discuss discount rate policy. It was quite possible that individual Reserve Banks and the Board would soon be considering the desirability of another reduction in the discount rate, and it would be helpful if the members would express any views they had on the subject.

Mr. Swan said he agreed that higher rates of monetary expansion than those of recent months were required. For the longer run he thought 6 per cent was a reasonable rate for M_1, although like Mr. Heflin he would not place much stress on the difference between 6 and 7 per cent. He preferred directive language indicating that the Committee sought to "promote moderate growth" in the aggregates, and would favor a range of 4-1/8 to 4-3/4 per cent for the Federal funds rate.

Referring to the Chairman's comments on projections and Committee objectives, Mr. Swan noted that the staff projected M_1 growth rates below 6 per cent for both December and January--4-1/2 and 3 per cent, respectively, under alternative A. He would be much less concerned about upward deviations from the projections in those months than about shortfalls, and he would not want to see any back-up of interest rates at this point. However, he also noted that growth in February was projected at a rate of 11.5 per cent. Assuming there was substance to that prospect, he was not sure the Committee would be prepared to accept the interest rate structure that would be necessary to hold growth

in February down to a 6 or 7 per cent rate. He sympathized with the thought that the Committee should not become preoccupied with projections, but he also believed it should not place a great deal of stress on the actual growth rates in individual months.

Mr. Coldwell observed that there seemed to be four key elements underlying appropriate policy at this point. They were (1) recognition of the rising level of liquidity of corporations, financial institutions, and individuals; (2) the need for balance in the cycle of money supply additions; (3) the possibility of rapid return of funds from abroad and the implications of such reflows for interest rates, money supply, and reserve creation; and (4) the need for caution in supplying reserves at rates excessive to a stable growth but balanced to ensure continued growth.

Like others, Mr. Coldwell continued, he was not happy about the recent retardation of growth in the money supply. However, in response to the Chairman's comment on that subject, he would emphasize the need to consider the behavior of money over a longer time period--including the spring of 1971, when growth had been excessive. For 1971 as a whole it appeared that the money supply would grow at about the desired rate of 6 per cent. Moreover, if the Federal funds and bill rates were kept near their

current levels--with the funds rate roughly in a range of 4 to 4-1/2 per cent--the money supply was likely to show some improvement in early 1972. He thought the Committee had overreacted early in 1971 to a slowing of money growth, and he hoped it would not overreact to the recent low growth rate.

Mr. Coldwell went on to say that he was disturbed about the current interest rate structure, and did not like the notion of moving into a recovery period with interest rates as high as they were. However, he would have some reservations about any effort to force rates down, since the Committee might lose sight of its aggregate objectives in the process. He favored an accommodative stance for monetary policy at this point, with specifications along the lines of those associated with alternative B. As to language, he liked the spirit of alternative D, but if the Committee adopted that alternative he would suggest that the goal of "greater growth in monetary aggregates over the months ahead" be interpreted as including a 6 per cent growth rate for M_1 in the first quarter of 1972. He thought the Committee should give the Manager a sizable amount of leeway and be prepared to suspend the dollar limit on operations if necessary.

As far as the recent discount rate action was concerned, Mr. Coldwell said he wondered less about the Board's reasons for reducing the rate than about the timing of the action. Perhaps

the forthcoming Group of Ten meeting dictated action last Friday rather than today or tomorrow. In any case, like Mr. MacLaury and others he hoped that whenever possible there would be advance discussions of such actions at future Committee meetings. As far as another possible rate cut was concerned, he would favor having the decision depend on market developments.

Mr. Morris remarked that he was less concerned than many members of the Committee about the slow growth in the aggregates in the last half of 1971, for two reasons. First, he thought that in retrospect the growth rate for the year as a whole would be found to be appropriate; and secondly, he believed the aggregates were already in process of accelerating. As evidence in support of the latter point, he noted that in each of the past four statement weeks all of the key aggregates--M_1, M_2, and the proxy--were at levels substantially higher than the staff had anticipated under the money market conditions prevailing. In the latest two weeks M_1 and M_2 respectively had been roughly \$1-1/2 billion and \$2-1/2 billion higher than expected. It was quite likely that over the next six months or so the Committee would be plagued with a problem of excessive growth like the one it had faced earlier this year.

Mr. Morris then said he would like to call to the Committee's attention another problem likely to arise in the next few

months--namely, that the monthly changes shown by the published money supply figures would be distorted by inadequate seasonal adjustment techniques. By way of explanation, he noted that if the Committee adopted the specifications of alternative B, M_1 would expand at rates of 4 per cent in January and 12 per cent in February, according to the projections shown in the blue book tables. However, the text of the blue book indicated that that particular pattern reflected an allowance for the effects of an amendment of OFDI regulations, and that in the absence of such an allowance the January growth rate would be about 6-1/2 per cent and that for February something less than the 12 per cent figure shown. In effect, the monthly growth rates given in the blue book table had been developed by applying adjustment factors based on the past seasonal behavior of the series to data that followed a new seasonal pattern as a consequence of the amendment of OFDI regulations. Under similar circumstances in connection with other time series, it was common practice to make an ad hoc modification of the seasonal factors. He hoped the Board would give serious consideration to such a modification for the money supply series, to avoid misleading the public about the actual growth rates over the next few months. The problem could be particularly serious in January, since--assuming the blue book projections were realized--the published figures would mistakenly indicate that the money supply was continuing to grow too slowly.

In concluding, Mr. Morris observed that he favored the specifications of alternative B. For directive language, however, he preferred alternative D proposed by Mr. Daane.

Mr. Robertson made the following statement:

> There have been indications of further economic progress since our last meeting, but that progress is far from rapid and some set-backs as well as advances have been recorded. Business attitudes are still characterized by a great deal of uncertainty, and are more than usually sensitive to shock.
>
> These circumstances, in my judgment, call for a monetary policy that is generally accommodative, and that produces gradual rather than abrupt changes in monetary conditions. I do not think that a continuation of the sluggish performance of the key monetary aggregates that has developed over the last few months could be called accommodative. While I recognize that the staff projections hold out hope for a better trend developing, I believe it is prudent and proper for us to take some further moderate steps to help insure this result. More specifically, I think we should provide a gradually more accommodative flow of reserves, in the interest of achieving somewhat greater monetary growth over time, recognizing that in the first instance somewhat more comfortable money market conditions will ensue. We must also recognize that further easing action now accelerates the chances that a reversal of policy will be called for before long.
>
> Pursuit of too aggressive an easing policy would run the risk of creating another uncomfortably large bulge in the growth rates of monetary aggregates like that we were plagued with in the spring of 1971. We can reduce that risk by moving cautiously at this time with only another moderate step in the interest of balancing our short-range and longer-range objectives. Correspondingly, we ought to be prepared to take a step backward toward moderately firmer reserve and money market conditions within a month or two, if the intervening period demonstrates that stronger monetary expansion is being achieved.
>
> With this view in mind, I believe I can vote most acceptably for alternative B of the draft directives suggested by the staff.

Mr. Robertson went on to say that the members' differences of view with respect to appropriate ranges for the Federal funds rate might best be resolved simply by agreeing to let the rate find its own level. He thought the Committee recently had been paying too close attention to money market conditions and not enough to the growth rates of the aggregates, and he would not be disturbed if Mr. Francis' suggestion--to omit reference to money market conditions from the directive--was adopted.

In a concluding observation, Mr. Robertson noted that five weeks would elapse before the date at which the next Committee meeting was tentatively scheduled, and that there could well be massive reflows of funds from abroad or other special problems during that period. In such an event it might be desirable for the Committee to hold an interim meeting to reconsider its instructions to the Desk.

The meeting then recessed and reconvened at 2:25 p.m. with the same attendance as at the morning session.

Chairman Burns remarked that it was more difficult today than usual to summarize the views that had been expressed in the go-around. Rather than make the attempt he proposed to ask the members to indicate their preferences, first with respect to directive language and then with respect to various aspects of the specifications to be associated with the language decided upon.

As to directive language, the Chairman observed that the choice seemed to lie between alternative D proposed by Mr. Daane and some version of alternative B. He suggested that the members indicate whether each of those alternatives would be acceptable to them and which of the two they preferred.

It was determined that both alternatives were acceptable to a majority but a larger number favored alternative D.

Mr. Maisel remarked that the question of the specifications to be attached to the directive language was an important one. He concurred in the Chairman's earlier observation that there had been an element of ambiguity in the instructions the Committee had issued at its previous meeting, and he hoped a similar outcome could be avoided today. Personally, he would favor instructing the Manager to provide sufficient reserves to achieve a growth rate in December and January of 5-1/2 to 6-1/2 per cent for M_1 and about 9 per cent for M_2. It would be understood that the Federal funds rate might move over a relatively wide range in the coming period, but that it would not be permitted to drop below 3-1/2 per cent.

Mr. Hayes observed that while the language of alternative D commended itself to a majority, it was his impression from the go-around that most members were thinking in terms of specifications along the lines of those associated with alternative B, including a 4 to 4-5/8 per cent range for the Federal funds rate.

Chairman Burns suggested that the Committee address itself to the range to be specified for the Federal funds rate. As background for the discussion, he noted that the Manager had indicated earlier that the prevailing rate could be taken as 4-1/4 to 4-3/8 per cent.

Mr. Mitchell said he thought the range specified should be relatively wide--100 basis points or so-- considering the environment in which the Manager was likely to be operating. If the upper limit was to be 4-1/4 per cent, he would be willing to set the lower limit as low as 3-1/4 per cent.

It was determined that a majority of members favored a range for the funds rate of 3-3/4 to 4-5/8 per cent. Some expressed a preference for figures above or below 3-3/4 per cent for the lower limit, and Mr. Robertson indicated that he would prefer not to set any lower limit.

In response to a question, Mr. Holmes said a range of 3-3/4 to 4-5/8 per cent should be ample to cope with the problems that might arise in the coming period, unless there were massive reflows of funds from abroad. Problems arising from such reflows would, of course, be separately identifiable.

Chairman Burns then suggested that the Committee consider the growth rates in M_1 it would like to see in the months of December and January. He noted that rates of 4-1/2 and 4 per cent, respectively, were shown in the blue book for those two months

under alternative B. However, those figures represented staff projections; the question he was posing concerned Committee objectives.

Mr. Brimmer observed that the growth rates for the aggregates projected under alternative B were based on the assumption that the Federal funds rate would be in a 4 to 4-5/8 per cent range. He asked how the projections would be affected by the Committee's decision to set the lower limit of the range at 3-3/4 per cent.

Mr. Axilrod replied that if the funds rate were moved down to 3-3/4 per cent rather promptly, he would expect the January growth rate in M_1 to be closer to 5 than to 4 per cent.

Mr. Daane remarked that he would prefer 6 per cent growth rates for M_1 in December and January, but would be satisfied if the rates were in a 5 to 7 per cent range.

Mr. Hayes said he preferred to formulate objectives for the aggregates in terms of periods longer than single months. He would be quite satisfied with growth rates for M_1 of 4-1/2 and 4 per cent in December and January, since the blue book indicated that expansion along such a path would be consistent with a first-quarter rate of 7 per cent.

Mr. Mitchell observed that he would have no objection to growth rates of 6 or 7 per cent in December and January. However,

he thought there was no way of knowing at this juncture whether it would be possible to achieve such rates.

Mr. Mayo remarked that the question of the growth rate in December seemed somewhat academic to him, since the month was already half over. For the subsequent period, he thought it might be easier to formulate the Committee's objective in terms of the growth rate desired for the first quarter. Waiving such considerations, however, he indicated that he would like to see growth in M_1 at a 5 per cent rate in December and January.

Chairman Burns observed that he had posed the question in terms of growth rates in December and January because he thought it desirable at this point for the Committee to focus on the behavior of the monetary aggregates in the coming inter-meeting period. Personally, he had had an objective in mind for the aggregates in November and each of the preceding months, and he would have no difficulty in indicating how he would like to see them behave in December and January.

Mr. Brimmer said that in light of the current economic outlook he would prefer to have M_1 expand at a rate of 5 per cent in December and January, in the expectation that that would be consistent with first-quarter growth at a rate of about 7 per cent.

Mr. Robertson noted that he would favor growth rates of 4-1/2 and 4 per cent in December and January, and Messrs. Kimbrel and Clay expressed a similar preference.

In response to a question by Mr. Mitchell, Mr. Robertson said that for the first half of 1972 he would prefer an average growth rate higher than 4 or 4-1/2 per cent. He thought a 4 per cent rate would be appropriate in January because he expected monetary expansion to accelerate sharply in February. He would not be disturbed if M_1 grew a little faster or a little slower than the rates he had indicated for December and January, and he believed it would be feasible to attain a higher average rate over the first half.

Mr. Morris said he found it difficult to state a preference for growth rates in M_1 because of the problem of inadequate seasonal adjustments he had mentioned earlier.

Mr. Holland noted that the M_1 growth rates desired for December and January by members who had specified their preferences ranged from about 4 to about 6 per cent and averaged about 5 per cent.

Chairman Burns suggested that the Committee next consider whether it would want to have the Desk aim at a Federal funds rate within the specified 3-3/4 to 4-5/8 per cent range regardless of the behavior of the aggregates over coming weeks, or whether it would prefer to have the target for the funds rate moved below 3-3/4 per cent--perhaps to 3-5/8 per cent--if it appeared that M_1 was expanding at a rate below, say, 4 per cent in December and January.

Mr. Brimmer said it might be desirable for the Committee to hold an interim meeting in early January, perhaps by telephone conference, to reconsider its instructions if M_1 was growing too slowly. Mr. Kimbrel expressed a similar view.

Mr. Daane noted that there might also be other reasons for a Committee meeting in the first part of January, including possible developments in the international monetary area. As an alternative to an interim telephone conference, the meeting tentatively scheduled for January 18 might be advanced to an earlier date.

The Chairman agreed that circumstances might well require a meeting before January 18. Nevertheless, he thought it was worthwhile to determine whether the Committee was prepared at this time to authorize the Manager to aim at a 3-5/8 per cent funds rate under the circumstances he had described.

Mr. Mayo noted that firm information on the growth rate of M_1 in January would, of course, not be available until after the end of the month. He asked whether the Manager would be expected to rely on the successive projections for January in making operating decisions over coming weeks.

Chairman Burns said he thought the Manager should be guided by whether data for early January suggested that the growth rate in that month was likely to fall below 4 per cent.

In the course of the ensuing discussion it developed that a majority of members favored authorizing the Manager to aim at a 3-5/8 per cent funds rate under the circumstances the Chairman had described.

Chairman Burns then asked whether the Committee's consensus could be formulated in the following way: Under the language of alternative D, the Manager was to aim at a Federal funds rate in the range of 3-3/4 to 4-5/8 per cent, with the understanding that he would progressively ease the funds rate down to the lower limit of that range before the next meeting of the Committee if the monetary aggregates were not performing satisfactorily. For the purposes of that instruction, performance of the monetary aggregates would not be considered satisfactory unless the growth rate of M_1 in December and January moved up to 5 per cent. Furthermore, if it appeared from figures for December and early January that growth in M_1 was falling below 4 per cent, the Manager would have the authority to aim at a funds rate of 3-5/8 per cent.

In response to a question, the Chairman said he assumed the Committee would want the limits it had specified for the Federal funds rate to be interpreted in terms of averages for a few days, rather than single-date figures.

Mr. Holmes noted that such a procedure would be consistent with the Committee's past practice.

Mr. Clay noted that the recent weakness in M_1 followed a period of undesirably rapid growth, and he expressed concern about the risk that strenuous efforts to stimulate monetary growth now might lead to similarly lumpy behavior of monetary policy in 1972. On the principle that a lumpy cake made a bad cake, he asked whether it might not be better to attempt to move on a smooth course toward growth of M_1 in the first quarter at a rate of about 6 or 6-1/2 per cent.

The Chairman remarked that his objective was similar to Mr. Clay's; he would like to see the monetary aggregates move onto a moderate growth path and then remain close to such a path. Several other members expressed agreement with that position.

Mr. Holmes said it might be helpful to the Committee if he were to comment briefly on the possible course of developments under the proposed instruction. The New York Bank's projections of M_1 at present were weaker than those made at the Board for both December and January but stronger for subsequent months, indicating a first-quarter growth rate of about 7 per cent. While he did not put much stock in either set of projections, for operating purposes he tended to average the two. Thus, at the beginning of the coming period he would be looking at M_1 figures for December and January that were somewhat weaker than those shown in the blue book. Unless the outlook for monetary growth changed significantly, an instruction of the kind the

Chairman had described probably would require a fairly rapid reduction in the funds rate toward 3-5/8 per cent over the next few weeks. He did not mean to imply that that would be a desirable or undesirable development, but only to indicate that it was likely.

Mr. Mitchell remarked that he felt a certain uneasiness about expressing the Committee's objective in terms of M_1 for December and January because he was not sure there was much that could be done at this stage about its growth rates in those months. It was for that reason that he would want to specify a floor for the Federal funds rate. In his judgment, a reduction in the funds rate to 3-5/8 per cent would do no serious damage; and while it might not stimulate the desired growth in M_1, it should lead to a good rise in M_2 and to lower short- and long-term market interest rates. He would be satisfied with such an outcome.

Mr. Coldwell observed that M_1 was projected to grow at a 12 per cent annual rate in February under the 4 to 4-5/8 per cent funds rate associated with alternative B; with the lower range for the funds rate under consideration, a still higher growth rate presumably would be projected. He asked whether the Committee was contemplating any upper limit on M_1.

Mr. Mitchell noted that the instructions under consideration applied to the next five weeks and that the Committee would have an opportunity at its January meeting to consider the prospects for the aggregates in February and succeeding months.

Mr. Daane added that the Manager would have leeway to raise the funds rate within the indicated range if money supply growth turned out to be much stronger than desired in the coming period.

Mr. Maisel agreed. In his judgment, the Desk should no longer continue to move toward easier conditions if the growth rate in money appeared to be exceeding 5-1/2 or 6 per cent, and it should reverse course if growth was significantly stronger.

Mr. MacLaury remarked that the instructions under consideration struck him as a fairly radical departure from the way the Committee had operated in the past. If the Federal funds rate was reduced to 3-5/8 per cent in the next few weeks, and if growth in money was as rapid in February as the projections implied, the Committee might soon be finding it necessary to move aggressively toward firmer money market conditions.

Mr. Daane remarked that he personally favored greater flexibility for money market rates, and did not propose that the Manager be told to maintain the funds rate at any specific level. He would state the objective simply as that of erring on the side of ease in order to enable an increased rate of growth in the monetary aggregates.

In reply to a question by Mr. Hayes, Chairman Burns said it was not his intention to have the Manager focus solely on M_1, to the exclusion of the other key aggregates.

Mr. Maisel observed in that connection that the recent growth rate of M_2 had been quite low relative to the experience at similar stages of past cycles. Accordingly, he thought the Manager should not react to rapid growth in that series unless the rate was very high--say, above 10 or 12 per cent.

Mr. Daane noted that the range for the Federal funds rate under consideration extended from near the lower end of the range shown in the blue book for alternative C to the upper end of that for alternative B. The projected growth rates for M_2 under alternative B were 8-1/2 and 7-1/2 per cent, respectively, for December and January; under alternative C, the projected rate was 8-1/2 per cent for both months. In light of those figures, he thought it would be reasonable to anticipate an M_2 growth rate of about 8-1/2 per cent.

Messrs. Maisel and Brimmer concurred in Mr. Daane's observation.

In response to a question, Chairman Burns said he assumed that the Committee would want to have the 5 per cent figure he had mentioned for money supply growth interpreted as the midpoint of a range. Thus, he concurred in a suggestion that the statement of the consensus he had proposed earlier be amended to indicate that performance of the monetary aggregates would not be considered satisfactory unless growth in M_1 in December and January moved up "into a range centering on 5 per cent."

In response to Chairman Burns' question, a majority of the members signified that the Chairman's statement of the consensus, with the indicated amendment, was acceptable to them.

The Chairman noted that the Committee had agreed earlier on a revision of the language referring to discount rates in the staff's draft of the first paragraph of the directive. He proposed that the Committee vote on a directive consisting of the first paragraph as drafted except for that change, and of alternative D for the second paragraph, on the understanding that the directive would be interpreted in accordance with the statement of the consensus that he had set forth.

Mr. Mitchell asked whether the language of alternative D might not be improved by avoiding the reference to the conditions "essential" to greater growth in the aggregates. One means of doing so would be to state that the Committee sought "to achieve greater ease in bank reserve and money market conditions with a view to promoting faster growth in monetary aggregates."

Mr. Hayes said he preferred the original formulation of D to the version Mr. Mitchell had suggested. After further discussion, it was agreed to retain the original language.

Mr. Clay said he planned to cast an affirmative vote for the proposed directive, but would do so reluctantly.

Mr. Robertson said he also would vote favorably but with considerable reluctance. He had serious doubts about the wisdom of the proposed course and was concerned about the risk that it would lead to difficulties at a later time.

> By unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

The information reviewed at this meeting suggests that real output of goods and services is increasing more rapidly in the current quarter than it had in the third quarter, but the unemployment rate remains high. Increases in prices and wages were effectively limited by the 90-day freeze, which ended in mid-November. Since then some wage and price increases have occurred, but other increases requested have been cut back or not approved by the Pay Board and the Price Commission. The narrowly defined money stock changed little in November and has not grown on balance since August. Inflows of consumer-type time and savings deposits to banks remained rapid in November and the broadly defined money stock continued to increase moderately. Expansion in the bank credit proxy stepped up as U.S. Government deposits and nondeposit liabilities increased on average. After advancing in the latter part of November, most market interest rates have been declining recently, and discount rates at 4 Federal Reserve Banks were reduced by an additional one-quarter of a percentage point. The U.S. foreign trade balance was heavily in deficit in October. In recent weeks net outflows of short-term capital apparently have been substantial, market exchange rates for foreign currencies against the dollar on average have risen further, and official reserve holdings of some countries have increased considerably. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions consistent with the aims of the new governmental

> program, including sustainable real economic growth and increased employment, abatement of inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.
>
> To implement this policy, the Committee seeks to promote the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates over the months ahead.

Chairman Burns then noted that two memoranda from the Secretariat, regarding release of the 1966 Committee minutes, had been distributed on December 7, 1971.[1/] He asked Mr. Broida to comment.

Mr. Broida said the staff recommended that the Committee authorize the release of its minutes for the year 1966 in the same manner as had been employed for earlier minutes. Specifically, the original signed copies would be transmitted to the National Archives, where microfilm copies would be offered for sale to the public, and bound volumes of reproductions would be placed in the libraries at all Federal Reserve offices. Because several months would be required for reproduction and microfilming, the staff recommended that a few "work copies" be made available for inspection at the Board and the New York Bank in the interim--a procedure that had been followed in the past.

1/ The first of the two memoranda mentioned, from Mr. Broida, was entitled "Release of 1966 FOMC minutes." The second, from the Secretariat, was entitled "Passages recommended for deletion when 1966 minutes are initially released." Copies of both documents have been placed in the Committee's files.

As the Committee knew, Mr. Broida continued, when the 1962-65 minutes were released certain passages which had been deemed sensitive were withheld--almost all of them in the area of foreign currency operations. Each deletion was identified by a footnote which indicated the general nature or subject of the omitted material. On the assumption that the Committee would want to follow a similar procedure now, staff at the Board and the New York Bank had reviewed the 1966 minutes. In addition, the minutes had been read by a representative of the U.S. Treasury Department--who had no deletions to propose; and certain passages concerning the affairs of the Bank of England had been discussed with officials of that Bank.

As a result of this review work, Mr. Broida observed, the staff had identified eighteen passages which it recommended be withheld when the 1966 minutes were initially released. Those passages were shown in the second of the two memoranda that had been distributed, together with proposed explanatory footnotes. All were in the foreign currency area, and all fell under two of the criteria for deletion that had been employed in the past: either they contained information relating to the affairs of a foreign institution--in this instance the Bank of England--which that institution wished to have held in confidence, or they were of such a nature that their publication was considered not to be in the interests of good international relations. Certain additional potentially sensitive passages in the minutes for June 28,

1966 had been identified at a late stage of the review, as shown on the pages from those minutes that had been distributed today. He understood that Mr. Coombs had discussed those passages with Bank of England officials at the Basle meeting this past weekend and was prepared to comment.

Mr. Coombs reported that the Bank of England had asked that certain passages on the affected pages, which he described, be withheld at this time.

Mr. Daane asked whether the text of the deleted passages was being retained so that they could be released at some time when they no longer were considered sensitive.

Mr. Broida replied affirmatively.

Mr. Holland added that a periodic review of the deleted passages, to determine whether they could be released, was contemplated. As noted in the Secretariat's memorandum, such a review had recently been made of all passages that had been withheld when the 1962-65 minutes had been released, but none was recommended for release at this time.

Mr. Brimmer said he thought it would be desirable to modify two of the explanatory footnotes shown in the Secretariat's memorandum in order to give a clearer idea of the nature of the passages withheld at those points.

After discussion, the Committee agreed that the footnotes in question should be modified along the lines suggested by Mr. Brimmer.

The Chairman commented that he had some misgivings about the process of withholding certain passages when the minutes were made public, and he wondered whether the better course might not be to release the record for a year in full at a time when none of its contents was deemed sensitive. However, he would not urge the Committee to change its procedure at this point.

> By unanimous vote, transfer to the National Archives of the minutes of the Committee for the year 1966, on the basis described in a memorandum from the Secretariat dated December 7, 1971, was authorized.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, January 18, 1972, at 9:30 a.m.

Secretary