<u>MEMORANDUM OF DISCUSSION</u>

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, July 17, 1973, at 9:30 a.m. As indicated below, only a limited number of staff members were in attendance during the first part of the meeting.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Balles
Mr. Brimmer
Mr. Bucher
Mr. Daane
Mr. Francis
Mr. Holland
Mr. Mayo
Mr. Morris
Mr. Sheehan

Messrs. Clay, Kimbrel, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. MacLaury and Coldwell, Presidents of the Federal Reserve Banks of Minneapolis and Dallas, respectively

Mr. Broida, Secretary
Mr. Altmann, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Bryant and Reynolds, Associate Economists
Mr. Sternlight, Deputy Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Melnicoff, Deputy Executive Director, Board of Governors
Mr. Coyne, Assistant to the Board of Governors

Mr. Gemmill, Adviser, Division of International Finance, Board of Governors

Messrs. Black and Willes, First Vice Presidents, Federal Reserve Banks of Richmond and Philadelphia, respectively

Chairman Burns noted that the first part of today's meeting would be concerned with developments in foreign exchange markets and with System operations in that area. In view of the nature of the material to be discussed, he had thought it best to limit staff attendance at this part of the meeting to those persons whose presence was most urgently required.

The Chairman then invited Mr. Daane to open the discussion with a report on developments at the July 8 meeting of central bank governors in Basle.

Mr. Daane said he thought it was fair to characterize the atmosphere at the July Basle meeting as rather tense and uneasy. In opening the afternoon session Chairman Zijlstra expressed the view that the present was a serious and even dangerous moment in the history of the functioning of the international payments system--if it could be called a system; he thought "chaos" might be a better word. He then pointed clearly toward official intervention in foreign exchange markets by saying it was his firm belief that the time for action, including action by the United States, had come. In responding, Governor Carli of the Bank of Italy read passages from the Paris communique of last March, in which it was

said that the Ministers and governors had "reiterated their determination to ensure jointly an orderly exchange-rate system" and had "agreed in principle that official intervention in exchange markets may be useful at appropriate times to facilitate the maintenance of orderly conditions." Governor Carli indicated that he was speaking for many of those around the table in saying that the moment had arrived for the monetary authorities to demonstrate that they understood the market and had the means to control it. Sentiments similar to those of Messrs. Zijlstra and Carli were echoed by all others present. The only significant variation was in comments by the French representative, who placed the blame for existing conditions on the failure of the United States to act sooner. In replying to that assertion he (Mr. Daane) reminded the group that at the June Basle meeting, held only 3 weeks earlier, the consensus was that the time for intervention had not yet arrived. Near the close of the afternoon session President Zijlstra said he was reminded of the criticisms that had been directed during his academic days at the actions of monetary authorities in the 1930's. He expressed the belief that those authorities were intelligent men who had been overtaken by developments, and he hoped that the monetary authorities of today would be able to act in advance of developments. The session adjourned with an understanding that consideration would be given at the dinner session

to a possible communique intended to offer reassurance to the exchange markets.

Mr. Daane noted that the draft communique presented at the evening session would have indicated clearly that intervention was imminent. That draft was highly acceptable to everyone present except himself; he declined to concur in it in light of Chairman Burns' view, expressed to him earlier, that it would be desirable for any statements on intervention to be similar to those of the March communique. After an extended discussion, agreement was finally reached on a text which repeated the March statement regarding the usefulness of official intervention at appropriate times and added that the necessary technical arrangements were in place to implement that approach.

Mr. Daane said he might report two other interesting developments at the meeting. First, the British, who earlier had been reasonably complacent about the sterling float, no longer were; they indicated that the float was hurting badly in terms of international payments, domestic inflation, and difficulties in current labor negotiations. Secondly, it was suggested during the afternoon session that market sales of some gold by one or two countries would support the objectives of intervention, and a question was raised as to whether there would be objections to such sales. It was the consensus of the group that there would be no objection to

some official sales of gold. However, a number of speakers indicated that if any such sales were made they would reserve the right to reappraise the status of the two-tier system adopted in March 1968., and one or two indicated that they would advise their governments that the two-tier system was no longer in effect.

Chairman Burns asked Mr. Coombs if he had any supplementary comments regarding the Basle meeting.

Mr. Coombs said he would note only his general impression that the governors of European central banks had come under strong pressure from their governments to get agreement on action in the foreign exchange area, on the ground that the depreciation of the dollar had gone so far as to threaten an undermining over time of the competitive position of European industry. It seemed to him that the governors were hoping for a commitment that the U.S. Treasury would undertake negotiations on the matter with its European counterparts.

In reply to a question by the Chairman, Mr. Coombs said that impression was not based on explicit statements by Europeans. Rather, it was an inference drawn from their numerous comments about the impact of excessive depreciation of the dollar on future trade relationships, coupled in a number of cases with questions regarding the attitude of the U.S. Treasury.

Chairman Burns remarked that Mr. Coombs' inference struck him as quite plausible. In view of the rather sudden change in the attitudes of the European central bankers toward intervention, it seemed quite likely that there had been consultations before the Basle meeting among their respective governments. If the United States had been involved in those consultations, its representatives at the Basle meeting undoubtedly would have received more explicit instructions, and it was possible--he would like to think probable--that the United States would have agreed to a stronger communique than the one issued.

At the Chairman's request, Mr. Broida reported briefly on developments at the telephone conference meeting the Committee had held on July 9, 1973. Near the end of his report he noted that the members had concurred in a suggestion that, in light of the new monetary environment, the staff should be asked to reappraise the Committee's foreign currency authorization and directive and to develop tentative drafts of revised instruments for the Committee's consideration.

Chairman Burns said he was designating the following to serve on a staff committee to conduct the desired review: Messrs. Bodner, Gemmill, and Broida, with the last serving as chairman.

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 June 19 through July 11, 1973, and a supplemental report covering the period July 12 through 16, 1973. Copies of these reports have been placed in the files of the Committee.

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

> The progressive breakdown of confidence in the dollar beginning in early May degenerated during the first week of July into a major international crisis. By Friday, July 6, the dollar had plummeted to discounts from February parities of 18 per cent against the Dutch guilder and Belgian franc, 21 per cent against the French franc, and 29 per cent against the German mark. We witnessed that day, in effect, a market panic in which the dollar found few takers at any price. So, far from facilitating the adjustment process, the uncontrolled float of the dollar had instead become converted into an engine of inflation, not only for us but for all other countries still pegging their currencies to the dollar. Since March, 22 different countries have broken their ties with the dollar in order to protect themselves against such imported inflation, and many more are approaching similar decisions. Perhaps even more ominous, the dollar was driven down to a point of serious undervaluation against the currencies of many of our trading partners, with dangerous implications for both trade and political relationships.
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> I don't think that the Watergate hearings and all of the other bad news during the past 2 months suffice to explain the virtual collapse of confidence in the dollar during that first week of July. As I have suggested to the Committee before, I am persuaded that at least one fundamental fact influencing market behavior

is that traders can see all the other G-10 currencies being officially defended against sudden bouts of selling pressure. Official support operations in these currencies since mid-March now total more than $8 billion. Against this background, the continuation of an absolutely free float for the dollar left market holders of dollars with a feeling of nothing but air under their feet and a general impression of a lack of confidence by the U.S. Government itself in the future of the dollar. Over the last few months, the market has been listening to a widely publicized debate in which the Federal Reserve has been repeatedly warned by Congressmen, prominent bankers and businessmen, and the press against incurring heavy losses through intervention in the exchange market. To traders in the market, this has meant just one thing: If the U.S. Government and prominent U.S. bankers and businessmen don't have enough confidence in the future of the dollar to be prepared to defend it, why should anyone in the market have confidence enough to hold it?

In the normal functioning of the exchange markets, there is generally a certain willingness of traders to take long positions temporarily in all the major currencies; such willingness to hold working balances in national currencies is part of the market balance of supply and demand. The dollar was a major beneficiary of that willingness for a good many years. But if fear of the dollar's future reaches such a state of despondency that nobody wants to hold it and, conversely, everyone welcomes the mark, the Swiss franc, and so on, the structure of the market becomes grotesquely distorted with the disastrous results that we saw in early July.

This was the background for the decision last Monday to increase our swap lines and to resume intervention to defend the dollar. Fortunately, the BIS meeting happened to be scheduled for the weekend following the peak of the crisis, Friday, July 6, and over the weekend we were able to make the necessary arrangements for enlarging and reactivating the swap lines. Meanwhile, reports from Switzerland of prospective new intervention by the Federal Reserve were in themselves sufficient to bring about a strong rally of the dollar by Tuesday morning of last week. Announcement of the swap line increases around one o'clock in the afternoon on Tuesday helped to consolidate the recovery of the dollar, and the stage was set for a demonstration of forceful intervention by the Federal Reserve.

In July of last year, as you will remember, such forceful intervention tactics, accompanied by an equally forceful statement by the Chairman, enabled us to bring about a significant recovery of confidence in the dollar at the cost of no more than $12 million of marks actually sold. This time, however, we were unable to secure Treasury agreement to anything more than secret intervention through commercial bank agents, with the further proviso that our intervention should be strictly limited to minor operations and only if required to keep the dollar from falling back too sharply. On Wednesday, in the absence of any overt appearance by the Federal Reserve in the market, the recovery of the dollar quickly faded. By the New York opening, the dollar was again subject to selling pressure and over the day we doled out $53 million of marks, French francs, and Belgian francs through our commercial bank agents by secretly hitting bids for these currencies in the market. This technique of hiding our operations seemed to us on the Trading Desk to be a fairly inefficient way of handling the confidence problem. Accordingly, I strongly recommended to the Chairman and to the Treasury that the veil of secrecy be lifted, at least to the extent of allowing our commercial bank agents to reply to questions from the press that it was obvious that the System was in the market.

The next day, on Thursday morning in Europe, we had another illustration of the relative inefficiency of secret operations. The German Federal Bank that morning did $20-odd million in secret intervention, but the dollar nevertheless continued to slide, the same thing we had seen happen in New York the day before. However, at the German fixing that day--around 1 p.m.--the German Federal Bank suddenly switched tactics by openly buying $5 million at the fixing. The market immediately turned around, the dollar recovered sharply, and we were able to cut down our intervention in New York that day to $24 million.

On Friday morning, the Treasury agreed to my strong recommendation that our commercial bank agents should now be allowed to acknowledge that the System was probably in the market, and this may have facilitated a further settling down of the market that day, with the result that we were able to reduce our intervention still further--to $12 million--last Friday. But yesterday again, with further slippage of dollar rates

in Europe that carried over into New York, we had to spend an additional $18 million on such rear-guard defensive tactics for an over-all total so far of $109.5 million, mainly concentrated in German marks and French francs.

Reviewing our experience since we resumed intervening, I think it fair to say that the increase of the swap lines plus our intervention have temporarily succeeded in restoring orderly markets. Against the background of what happened on Friday, July 6, I think the operations were clearly worthwhile, and in the end we may make a profit on them as well. On the other hand, I think that we could have gotten a great deal more mileage out of our operations if there had been a forceful official statement, such as the Chairman provided last July, that the Federal Reserve was now intervening with the explicit objective of protecting the dollar against speculative raids. A certain disillusionment is now setting in and the atmosphere is deteriorating. Secondly, I think that we should not be limited to purely defensive operations, which leave the market with the feeling that we will continue to back away even under minor pressure and which thus perpetuate the one-way street that the speculators are still enjoying. At some stage in the game, and hopefully sooner rather than later, we should be able to take advantage of an opportunity such as we had last Wednesday to push the dollar up, and thereby recreate in the market a sense of risk that the dollar can go up as well as go down. This is what we accomplished in our operations a year ago and the beneficial effects lasted for nearly six months. Finally, we must reach an understanding and a pragmatic working arrangement with the German Federal Bank, the Bank of France, and the National Bank of Belgium on our respective responsibilities for intervening. So far, the Germans have more or less matched our intervention, while the Bank of France and the National Bank of Belgium have done nothing--mainly owing, I think, to problems of getting the approval of their Treasuries. Nor do I think that they will get the approval of their Treasuries until our own Treasury has clarified how far it is prepared to go in intervening to defend the dollar. What is needed, in effect, is a meeting of minds and some working agreement among the Treasuries concerned.

Chairman Burns observed that he concurred in the views Mr. Coombs had expressed. He would, however, like to raise a question--without intending any criticism of Mr. Coombs--about the wisdom of intervening in currencies of countries whose central banks were not yet prepared to intervene. Specifically, he wondered whether the central banks of Belgium and France would not have some additional incentive to undertake operations in dollars if at this time the System were to limit its operations to marks.

Mr. Daane noted that the French had been skeptical about the willingness of the Federal Reserve to intervene. The desirability of dissipating that skepticism might in itself justify the small operations the System had conducted in French francs.

Mr. Coombs remarked that the French were unlikely to conduct operations in dollars in the absence of a commitment from the United States to intervene when the dollar was under pressure. Without such a commitment, they had to allow for the possibility that U.S. intervention would be discontinued at any moment.

Mr. Brimmer observed that the System's objective in foreign exchange markets was not to defend any particular exchange rate but to correct disorderly market conditions. He wondered whether the European authorities tended to make the

same distinction. He might note, in that connection, that he had seen some news reports recently in which French officials were quoted as saying that the United States was "supporting" the value of the dollar.

In reply, Mr. Coombs said he thought that the Europeans were quite aware of the distinction made by the U.S. authorities, and that they were inclined to make the same distinction on their own account. He could not recall any recent conversation in which a European official suggested that some particular rate be defended; on the contrary, they often had commented on the importance of avoiding such an approach. He might note that the Europeans in general had not urged intervention until the market situation had become thoroughly disorderly. Moreover, since the Germans, French, Belgians, and Dutch had agreed to share equally in any losses the System incurred while operating in their currencies, and since European central banks in general bore the full risk of loss in any operations of their own, they certainly had no interest in defending unrealistic exchange rates.

Mr. Hayes commented that when an exchange rate was declining sharply in a disorderly market, it was natural to refer to official operations directed at checking the decline as "supporting" or "defending" the rate, without implying that the objective was to defend any particular level of the rate.

In reply to a further question by Mr. Brimmer, the Chairman said there had been no ambiguity about U.S. objectives at the March meeting of Finance Ministers and governors; the U.S. representatives had stated explicitly that this country was not willing to commit itself to the defense of a particular exchange rate. Indeed, they had objected when the French representatives used the word "defend" during the discussion, and the latter had accepted the objection. He suspected that the difficulty was largely semantic.

Mr. Morris asked for an amplification of Mr. Coombs' comments regarding the position of the U.S. Treasury on System operations.

In reply, Mr. Coombs said the Treasury had asked that the System operate secretly, in minor amounts, and only when the dollar came under pressure and the rate was slipping.

Chairman Burns remarked that the Treasury's approach to this subject had been quite cautious. The thinking of Treasury officials was still in process of evolution, and he doubted that they would hold to their present position very long.

Mr. Francis observed that, as the members knew, he was not enthusiastic about intervention in foreign exchange markets. Once intervention was undertaken, however, he would prefer not to keep that fact secret. Mr. Francis then referred to Mr. Coombs' comments

about the effects of the Treasury's restrictions on System operations last Wednesday, and asked what objectives Mr. Coombs would have had in view that day if he had been freed of those restrictions.

Mr. Coombs replied that he would have sought to give the dollar an upward push, in the expectation that that might have kept the recovery of confidence going for a while longer. It was widely agreed, not only in the market but also among the central banks concerned, that the dollar was presently seriously undervalued relative to its equilibrium level--wherever that might be. Thus, while he would not have had any specific rate objective in mind, it seemed clear that a rise in the rate for the dollar would move it in the direction of equilibrium.

Mr. Winn asked whether anything was known about the main sources of the recent speculation against the dollar.

Mr. Coombs replied that the major selling pressure came from the large corporations and from others financed by banks. However, the phenomenon had become widespread; a large proportion of those in a position to do so were speculating. As to central banks, except for Europe and Japan there appeared to be a generalized effort to diversify. That was the case in Latin America, Africa, and the Far East, and it was very much the case among the oil-producing countries.

In response to a question about the magnitudes involved, Mr. Coombs observed that there could, of course, be no net movement

out of dollars so long as the dollar was floating freely. Efforts to shift into other currencies resulted in declines in the exchange rate, and at some point the rate would have depreciated far enough to put a temporary check to those efforts. That process, however, involved serious costs--political as well as economic.

Mr. Francis noted that Mr. Coombs had described the check imposed by declines in the exchange rate as "temporary". He asked whether any effects of intervention operations in reversing that process might not also be temporary.

In reply, Mr. Coombs said he thought some part of the suspicion about the dollar that had been created by the events of the past 2 or 3 years would be lasting. On the other hand, if some buoyancy could be created in the rate--perhaps as a result of some favorable developments in the news and with the help of exchange market operations--there could be a certain recovery of confidence in the dollar. At that point many market participants might conclude that the rate had hit bottom and that profits could be made, or at least some losses recovered, by holding dollars. That, he believed, was the main hope.

By unanimous vote, the System open market transactions in foreign currencies during the period June 19 through July 16, 1973, were approved, ratified, and confirmed.

Chairman Burns then called for comments by Mr. Bryant, who made the following statement:

I would like to supplement the Special Manager's report with a discussion of some important background considerations that have to be taken into account in deciding where we go from here with our intervention in exchange markets.

Perhaps the most fundamental consideration is the state of the U.S. balance of payments, and more generally the world payments situation as a whole. Last month in the chart presentation we gave you what can be characterized as a fairly hopeful projection for the longer run. We foresaw gradual, continuing improvement in the U.S. trade balance, carrying on through the rest of this year, 1974, and into 1975. This improvement, we thought, could well go far enough to bring a significant trade surplus by 1975. We also thought there was a good chance that much of this improvement in the trade position would carry over into the balance on current account and long-term capital transactions--the basic balance. The main factor that led us to make this hopeful projection of the evolution of the U.S. balance of payments was the very sharp improvement in the U.S. competitive position that has resulted from the successive depreciations of the dollar against other major currencies in the last 2 years.

We have not received any new information since the chart show that would lead us greatly to alter this broad picture of the longer-run outlook. The May trade figures did revert to a deficit after the very favorable April figure, but that was not surprising and it had been built into our projections. The April-May average deficit at an annual rate of $1-1/4 billion was still substantially less than the rate of deficit in the first quarter, which in turn was markedly lower than the $7 billion rate of deficit in the fourth quarter of 1972. The major new information of the past month, in fact, has been the sharp further depreciation of the dollar against European currencies. So long as this excessive depreciation persists, it will tend to hasten the basic adjustment in our balance of payments. Recent evidence from the Japanese balance of payments also supports the hypothesis that adjustment of some of the world's most serious payments imbalances is finally taking place.

While it is true that the longer-run outlook continues to be hopeful, we also have to remember that there is a long road ahead before the U.S. balance of payments actually gets

to a satisfactory position. In the meantime, there remains a large deficit on current account and long-term capital transactions that has to be financed. This basic-balance deficit was roughly $5 billion at an annual rate in the first quarter of 1973, down from roughly $9 billion for 1972. Our preliminary guess is that the basic deficit in the second quarter may have been somewhat larger than the $5 billion rate of the first quarter. The supply of dollars that this underlying deficit casts onto foreign exchange markets is sizable; presumably this factor has contributed, and will continue to contribute, to a short-run weakness of the dollar in the exchange markets.

Exchange markets are, of course, not only affected by payments imbalances, which are flow disequilibria. They are also influenced by--at times even dominated by--disequilibria in the stocks, or inventories, of assets that economic units wish to hold. Given all the shocks to confidence in the dollar and in the U.S. Government that have occurred in recent months, some sizable net shifting out of dollar assets by foreign and U.S. portfolio owners may have been attempted. I say "attempted," because with the exchange rates of major currencies floating against the dollar, and in the absence of official intervention in dollars, no net shifting out of dollar assets by private transactors as a whole can occur. What can happen, however, and apparently what did happen in recent months, is that very large swings in exchange rates become necessary to induce individuals to hold the existing stocks of dollar assets. As Mr. Coombs has pointed out, we have certainly had plenty of additional evidence in the last 2 months as to how important shocks to confidence and other psychological factors can be in determining the behavior of markets in the short run.

Still another consideration to bear in mind as background is the state of the discussions on international monetary reform. Is it likely that the present uncertainty about the exchange rate regime and other institutional aspects of international monetary arrangements will get resolved fairly speedily--if not by the Nairobi annual meetings of the IMF, then reasonably soon thereafter? As best I can judge the situation, the prospects for moving ahead promptly in the Committee of Twenty discussions do not seem bright. The possibility of the major countries returning to maintenance of par values and of the United States restoring convertibility seems about as remote as it did 3 months ago. Independently of whether one is relaxed or apprehensive about the prospect, therefore, it looks very much as though the current exchange rate arrangements will be with us for some months to come.

As one delegate to Working Party 3 put it 2 weeks ago in Paris, paraphrasing Winston Churchill's remark about democracy: Nobody has much enthusiasm for the current exchange regime; in the present circumstances it seems to be the worst system, except for all the known alternatives.

When you put these balance of payments, confidence, and institutional considerations all together, what do they imply about the short-run outlook in exchange markets? The range of possibilities is, of course, quite wide. At the cheerful end of the range, there could be little or no further downward pressure on dollar exchange rates from the current depressed levels. Very shortly, the basic adjustment of the balance of payments could begin to show through still more clearly in the trade figures and over-all statistics. Market confidence could feed on the encouraging balance of payments figures and the dollar could, quite on its own steam, gradually but steadily strengthen in the market. Toward the other, more pessimistic end of the range of possibilities, one has to imagine that the underlying adjustment in the balance of payments would come much more slowly, that market confidence could remain weak for some time ahead and continue to be buffeted periodically by shocks such as setbacks to the U.S. anti-inflationary program, imposition of additional export controls by the United States and reactions to them by foreign governments, or--perhaps most important of all, if they were to occur--new political developments in the United States that lead to a further decline of confidence here and abroad.

If actual experience turns out to be more like the cheerful picture, there will probably not be any major policy question about how to conduct Federal Reserve operations in exchange markets. Little intervention will be needed, or seem desirable.

But what if actual experience is less favorable? In that case, what kind of guidelines should govern market intervention? The main issue here is what sort of short-run rate target, if any, should be aimed at. One possible objective would be to try to turn market confidence around and to strengthen the dollar until market exchange rates reach a range thought to be more realistic and reasonable for the longer run. This objective would imply what might be termed an Active-Appreciation strategy. Intervention would aggressively push market rates in the first instance, and keep pushing even if market resistance were strong. An alternative possible objective would be to prevent, or at least to resist strongly, further depreciation of the dollar

from present levels, but to refrain from actively trying to push market rates up to the level thought to be reasonable for the longer run. This objective might be called a Defensive-Floor strategy. A third possible approach would be to intervene when necessary to ensure orderly market conditions, but to foreswear short-run rate targets altogether. This strategy might be labeled Market-Smoothing. If desired, rough rules of thumb for such smoothing could be utilized: for example, intervention in a particular currency up to an amount of $X million could be initiated whenever the exchange rate moved further than Y per cent on any given trading day.

Each of these three general strategies--Active-Appreciation, Defensive-Floor, and Market-Smoothing--has its merits and demerits. Moreover, there is no need to select one set of guidelines and follow them to the exclusion of any other. As market conditions change, an alteration in strategy may also become appropriate.

In circumstances such as the present, where both market confidence and the underlying payments position are still weak, the Active-Appreciation strategy carries the greatest risk of failure. An initial success in driving rates to a higher level, perhaps accompanied by some good news, could give way to a subsequent reversal of market sentiment; massive intervention might then be required to keep rates from weakening from those higher levels. Conversely, the commitment of funds and the risk of getting into a tight spot are smallest if operations are limited to Market-Smoothing.

The Committee is sailing into relatively uncharted waters in carrying out exchange market intervention in a situation such as the present. What is more, the weather conditions look to be fairly uncertain. All things considered, therefore, it would seem to me the prudent course to proceed slowly--relying, at least initially, on a strategy of smoothing out large short-run fluctuations in rates and trying to prevent disorderly market conditions such as we had on Friday, July 6, but not going much further than that.

Chairman Burns then called for a general exchange of views regarding intervention.

Mr. Daane remarked that intervention was, of course, a matter of direct concern to the Committee. He believed, however, that the nature of the Government's domestic program, which he understood

would be announced shortly, and of general stabilization policy--including monetary policy--might prove to be far more important in affecting foreign exchange market developments than intervention on the rather modest scale that Committee members presumably were contemplating.

Mr. Black observed that the economics literature, including the writings of Professor Friedman, suggested a simple test of whether intervention in the exchange market was warranted--namely, whether the official operations proved profitable. If the judgment that the dollar was substantially undervalued was correct, a profit was likely to be earned in current operations. He believed that smoothing operations of the kind described by Mr. Bryant would be appropriate.

Mr. Hayes said it was worth emphasizing that the existing undervaluation of the dollar was a major factor contributing to the problem of domestic inflation, the most serious problem facing monetary policy at this time. On the subject of intervention, he had found Mr. Bryant's description of the three alternative strategies to be valuable. With respect to the "active appreciation" strategy, he thought it was useful to consider a variant--analogous to what was called "probing" in the domestic area--under which the Desk would stand ready to pull back if it appeared that the objective could be attained only by operating on an unacceptably large scale.

In any case, he would be interested in the Special Manager's views about the practical implications of the various strategies mentioned.

Mr. Coombs remarked that there would seem to be a time and place for each of the strategies discussed by Mr. Bryant; their relative usefulness would depend on the flow of events and the market conditions prevailing at the time. It would be highly undesirable, in his judgment, for the System to get locked into some particular philosophy that would prevent it from taking advantage of favorable opportunities. It also would be unfortunate if the System operated in a manner suggesting to the market that it was fearful, that it had no confidence in the future of the dollar, and that it was prepared to back away at the first sign of pressure. Such an approach would be calculated to defeat the purposes of the operation and to lose money.

Mr. Black asked how likely it was that the Treasury would become more favorably inclined toward intervention.

Chairman Burns noted that, as he had indicated earlier, the thinking at the Treasury was still in the process of evolution. He did not believe that Treasury officials would agree in the near future to the strategy Mr. Bryant had referred to as "active appreciation." He would, however, expect them to look with much more favor on strategies of the two other types. He might add that in practice the alternative strategies would shade into one another.

Mr. Brimmer said he would favor market smoothing operations, perhaps as part of a mixed strategy. At the same time, he was concerned that under present circumstances intervention operations might facilitate the outflow of a large volume of short-term funds, offsetting whatever benefits the operations might yield. In that connection, he had heard reports that in the C-20 discussions the U.S. position regarding the adjustment process was being criticized as placing too much emphasis on the current account. He asked whether the U.S. representatives were in fact being urged to give more consideration to the capital account, and in particular whether they were being pressed on the matter of capital controls.

Mr. Daane observed that he planned to report on the recent meeting of the C-20 deputies later today. In response to Mr. Brimmer's question, however, he might note that the problem of disequilibrating capital flows was one of the subjects under discussion in connection with the work of the C-20 on international monetary reform. He thought it was fair to say that there was substantial sentiment among the non-U.S. delegations for the use of controls in dealing with the problem. The U.S. delegation, which was philosophically inclined against controls, had taken the position that at a minimum no country should be forced to use them.

Mr. Brimmer said he had no real expectation that the question of capital movements would be resolved in the near future. Nevertheless, it was important to distinguish among the different forms of

adjustment and to recognize the danger that intervention could stimulate movements of capital.

Mr. Hayes said he had gained the impression during visits to a number of European countries this summer that the fundamentals favored a rather strong flow of capital to the United States, particularly into the equities market. However, such a flow was being inhibited by the great uncertainty about the dollar. It seemed to him that some improvement in exchange rates for the dollar, or even temporary stability in those rates, could have a marked impact on that psychology.

Mr. Balles remarked that in the course of his excellent presentation Mr. Bryant had commented on a point that had been of concern to him also--the difference between the rate of exchange that would equilibrate payments flows and the rate that would equilibrate flows plus desired changes in stocks. It seemed clear that the dollar was undervalued if one considered flows alone. It was not clear, however, that the same conclusion was warranted when one allowed also for the rather widespread desire among private investors--and possibly some central banks as well--to reduce their dollar holdings in an effort to diversify their assets. That raised the question of whether efforts were being made to develop means for funding the large volume of dollar holdings overhanging the market.

Mr. Bryant remarked that means of funding outstanding official dollar balances had been considered in the C-20 discussions in connection with long-run reform, and also to some extent as a possibility for the short run. One difficulty was that the most likely candidates for a bilateral funding operation were the central banks whose dollar holdings were more or less firm; it would be more difficult to work out funding arrangements with the central banks that were trying to diversify their assets, such as those of oil-producing countries and developing countries. Even if that problem could be resolved, a major difficulty would remain in connection with the huge volume of liquid dollar holdings in the hands of private foreigners. And, of course, individuals resident in the United States--although not U.S. corporations or banks--were relatively free to transfer assets abroad. He had not heard of any proposals for funding private balances that seemed at all reasonable. Accordingly, he thought the problem of large volumes of liquid assets shifting back and forth among currencies would persist as long as there were expectations of sizable changes in rates. The hope--and he thought it was a reasonable one--was that once the current account and the long-term capital account of the U.S. payments balance began to adjust, a stabilizing change in expectations would be generated.

In reply to a question, Mr. Bryant said that a desire by investors to shift from dollar assets to assets denominated in other currencies could be met in either of two ways. If central banks did not intervene, exchange rates would have to move far enough to induce investors to hold the available supply of dollars. If central banks did intervene they could, at the limit, absorb the excess supply of dollars with no change in exchange rates.

Mr. Coombs remarked that the problem of the "dollar balances" was not a new one; the British had dealt with the similar problem of "sterling balances" throughout much of the 1960's. The British experience suggested that, once confidence in a currency was restored, the problem more or less took care of itself. The best hope at present was to try to stabilize the situation by restoring confidence in the dollar. The alternative--allowing the problem of dollar balances to work itself out through movement of exchange rates--would have a severe inflationary impact on this country; it would mean sacrificing imports and disposing of exports at low prices; and it would create serious problems in trade relationships and trade negotiations with other countries.

Mr. Balles observed that in light of the stock problem he agreed with Mr. Bryant's conclusion that the Committee would be well advised to proceed slowly, engaging in smoothing operations rather than one of the more active strategies. He would favor

following such a course until there was some better evidence regarding the levels of exchange rates that would be viable and until there was somewhat more action in the direction of funding both official and private dollar holdings abroad. He would be disappointed if no effort was made to pursue possibilities along that line, since he thought funding operations might well be an essential element in resolving the current problem.

Chairman Burns remarked that there were severe limits to the possibilities for funding foreign dollar holdings. It might be suggested, for example, that the Treasury should issue dollar-denominated securities to foreigners that bore a higher rate of return than the securities available to domestic purchasers. In his judgment such a procedure would be politically unacceptable.

Mr. Daane noted that the funding proposals that had been made thus far in the C-20 discussions were quite unreasonable from the point of view of the United States; they called for this country to issue securities to foreigners that offered exchange rate guarantees, instant liquidity, and an extremely high rate of return.

In reply to a question by Mr. Balles, Mr. Daane said the United States had not made any counter-proposals. Of course, the best way of dealing with the problem of dollar balances would be to absorb them by running payments surpluses. Perhaps the next best way would be to provide for some consolidation at the time

the new international monetary system was put in place. However, the procedures used would have to be clearly consistent with U.S. interests, and not amount simply to placing the whole burden on this country.

Mr. Coldwell said he approached the subject of intervention with the belief that the problem of domestic inflation was aggravated to an important degree by the international problem, and that it was necessary to make some headway in the latter area if progress was to be made in curbing inflation. For that reason, he would prefer a more active intervention strategy than simply a smoothing operation. In addition, he thought something had to be done about volatile dollar balances abroad. He recognized the problem the Chairman had noted with the proposal for the Treasury to offer foreigners a security bearing a higher return than it paid to domestic investors. He was not persuaded, however, that that consideration should be overriding when weighed against the alternative of permitting continued depreciation of the dollar, with all of the implications for domestic inflation. If the longer-run outlook for the U.S. payments balance was as hopeful as Mr. Bryant had indicated, a funding operation of the kind proposed would need to be only a temporary undertaking.

Mr. Daane observed that, despite the merits of Mr. Coldwell's argument, he agreed with the Chairman that it would not be feasible

for the Treasury to offer securities to foreigners that carried a higher return than those it issued domestically. He shared Mr. Coldwell's preference for a more active intervention strategy. Like Mr. Coombs, he believed that recent exchange market developments had been injurious to the U.S. interest and that the basic problem was a psychological one of confidence. Without prejudging the question of where exchange rates should eventually settle, he would expect visible System operations to have effects that would be helpful in terms of both the domestic economy and the U.S. position abroad. At the same time, he wanted to stress a point he had touched on earlier: that System intervention operations could be meaningful only if accompanied by effective domestic programs.

Mr. Coldwell concurred in Mr. Daane's final point.

Mr. Clay remarked that some of the previous comments reminded him of earlier System discussions of ceiling rates on time deposits, in which it had been argued that it would not be feasible to establish higher ceilings for large-denomination CD's than for instruments of smaller denomination. If the present problem of dollar balances was as severe as it seemed to be, he suspected that the Treasury could be persuaded to offer higher returns on securities sold abroad than at home.

Mr. MacLaury expressed the view that, even apart from political considerations, the proposal to fund foreign-held dollar

balances by offering higher yielding Treasury securities to their owners would not be feasible. He had in mind the technical difficulties that would be faced in restricting ownership of such securities to foreigners.

Mr. Hayes agreed, noting that the availability of such securities could generate an outflow of funds from the United States to take advantage of the higher yield. With respect to intervention strategy, he concurred in the view of Messrs. Daane and Coldwell that a relatively active approach would be desirable. He also shared their position concerning the importance of effective domestic policies.

Chairman Burns observed that there had been a considerable expansion recently in "Euro-mark" holdings. He asked whether it might be feasible for the Treasury to absorb some foreign dollar balances by offering securities denominated in marks.

In reply, Mr. Coombs noted that proposals for such offerings had been made from time to time. The market for Euro-marks was still relatively thin, so that a substantial offering by the Treasury would probably have an undesirably large impact on interest rates in that market. However, an offering of moderate size--say, $1-2 billion--could have a helpful effect on psychology. The readiness of the Treasury to incur a liability denominated in a foreign currency would reflect a certain degree of confidence in the future of the exchange rate of the dollar against that currency.

Mr. Coldwell asked whether there had been any discussion in the C-20 meetings of the possibility of funding official dollar holdings by special issues of SDR's.

Mr. Daane replied that that possibility had been mentioned in the Deputies' sessions but there had not been an interchange of views on it among the C-20 Ministers.

Mr. Holland said it might be worth noting that in discussing intervention strategy the Committee was talking about matters of high national policy on which the power of decision lay with the Treasury and ultimately the President. The Committee's primary function in this area was to formulate views that its representatives could convey to those responsible for the decisions. In his judgment, comments made by others this morning constituted good advice, and he would like to add some comments of his own.

First, Mr. Holland continued, he would underscore Mr. Bryant's observation that intervention now amounted to sailing into relatively uncharted waters. There was a technique that had proved effective under similar circumstances in connection with certain domestic policy problems: that of describing the expected results of an operation before it was undertaken and then contrasting the actual outcome with those expectations. He thought it would be quite helpful if Mr. Coombs would regularly indicate what he hoped to accomplish with each operation, so that it would be possible later to assess

the extent to which the objectives had been achieved. That would be a harsh discipline and it would be incumbent on the Committee to exercise the same kind of tolerance for wrong guesses as it had developed on the domestic site for "misses" in the staff's projections of monetary aggregates.

As a case in point, Mr. Holland observed, it seemed clear that intervention operations over the past week or 10 days had not turned out as well as had been hoped. He intended no criticism of anyone; those operations were launched on uncharted waters, and information had been gained through them that should provide clues to a better course for future operations. His own conclusion--and he offered it in the spirit of a possible suggestion to those who had to make the decisions--was that better results would have been achieved had the intervention been undertaken in larger bites, even within a basic framework that might be described as a market-smoothing strategy. Intervention in larger bites would have a disproportionately larger effect on attitudes; it would bring to an end the one-way, no-risk-of-loss, all-risk-of-gain situation facing speculators. It would be consistent with the approach developed to deal with disorderly markets in domestic securities by committees on which, incidentally, Messrs. Daane, Volcker, and Sternlight had served. That approach

had been employed on a number of occasions, and it had proved considerably more successful than the alternative of offering "nibbling" support to the market.

Chairman Burns said he concurred completely in Mr. Holland's conclusion. As the members would recall, when the Federal Reserve undertook exchange market operations last summer he had made a public statement to the effect that the System would intervene on whatever scale was necessary to assure orderly markets. While it would be difficult at the moment to get agreement on a similar statement, he thought that was an objective to be sought.

Mr. Kimbrel said he would not advocate intervention directed at defending any specific exchange rate. He believed, however, that the depreciation of the dollar had been contributing to domestic inflationary psychology and to uncertainty, declining confidence, and growing pessimism. For those reasons, he would favor intervention for market-smoothing purposes, on a scale adequate to restore some order to the foreign currency markets and with accompanying public statements directed at the same end. The restoration of order in the exchange markets would not only be of help in connection with the problem of domestic inflation; it would also augur well for international trade and trading relationships. He hoped that System representatives would seize every opportunity to advance such views.

Mr. MacLaury remarked that during June he had thought the Treasury was right in resisting proposals for exchange market intervention, and in retrospect he still believed that that judgment was correct at the time. In light of the developments of the last two weeks, however, he certainly favored intervention now.

Mr. MacLaury then said it might be useful to consider separately each of the various elements of the Treasury's current position with respect to intervention. First, as to the view that operations should be secret, he would agree with Mr. Coombs and others that an announcement concerning them should be made. He hoped that in any announcement such words as "protecting" and "defending" the dollar would be avoided, because they were subject to differing interpretations; it would be better to describe the objectives in terms of insuring orderly conditions, as was done last summer. Secondly, with respect to the view that the operations should be "in minor amounts," he agreed with Mr. Holland that at times, at least, they should be in substantial amounts. Finally, as to the view that operations should occur only when the dollar was under pressure and slipping, he gathered that Mr. Coombs thought that the possibility should be left open of attempting on occasion to push the rate up, although not to any particular

level. He agreed with that position. He would add, however, that he did not think such operations could appropriately be described as "market smoothing." Although others might define the term differently, he thought of "smoothing" as involving two-sided operations directed at reducing the amplitude of short-run fluctuations. In contrast, the System operations under discussion would be directed at introducing an element of risk for speculators.

Mr. MacLaury observed that the speculation against the dollar seemed to involve a relatively small number of foreign currencies--namely, the mark, guilder, and Swiss and Belgian francs. He wondered whether it might be feasible to deal with the stock vs. flow problem discussed earlier by establishing a two-tier market for exchanging dollars against those currencies, separating transactions relating to trade from those relating to capital movements.

Mr. Coombs replied that a two-tier system could be applied as effectively by the other countries involved as by the United States, and those countries had already moved some distance in that direction through controls of one kind or another. More generally, however, he thought the key to the problem did not lie in exchange controls or in politically difficult funding operations. Rather, it was to be sought in restoring confidence in the dollar.

Mr. Daane added that the European experience with two-tier exchange markets had demonstrated that the method was far from foolproof, even in smaller countries in a good position to control currency movements.

Mr. Mayo said he wanted to associate himself with Mr. MacLaury's position on intervention. Like the latter, he had been opposed to intervention earlier and had changed his mind in light of recent developments.

Mr. Mayo then remarked that a year ago the Japanese yen was commonly said to be at the center of the problem of over-valued and undervalued currencies. It was interesting to note that the yen had scarcely been mentioned today. He wondered whether that change could be explained by the fact that the yen had been floating recently. If so, the present difficulties of the dollar might be associated not so much with floating rates in general as with the joint nature of the European float.

Mr. Coombs said he suspected that the weakness that had developed in the yen during the past 3 months or so was to some extent temporary. The Japanese had experienced a tremendous boom in exports which in due course was followed by domestic inflation and an import boom. The rise in their imports had been greatly augmented by what might be called hedging or speculation in raw

materials; they had made a deliberate effort to convert as much of their dollar accumulations as possible into imports. It was his guess that the yen would reemerge as a reasonably strong currency in the fall. Nevertheless, if the U.S. trade deficit with Japan had been substantially reduced by that time the country's over-all trade problem would have been resolved, since the United States was still running a sizable surplus in its trade with Europe.

Mr. Coombs then reported that a rather large number of System swap drawings would mature soon. They included eight drawings on the National Bank of Belgium, totaling $325 million, which matured in the period from August 2 through 23; two drawings on the Swiss National Bank, totaling $565 million, which matured on August 9 and 16, respectively; and a $600 million Swiss franc drawing on the Bank for International Settlements which matured on August 14. As in the past, those drawings would be paid down if the opportunity offered, but he would recommend their renewal at maturity if necessary. Since all three swap lines had been in continuous use for more than a year, specific authorization by the Committee was required for renewal of the drawings.

> By unanimous vote, renewal for further periods of 3 months of System drawings on the National Bank of Belgium, the Swiss National Bank, and the Bank for International Settlements, maturing in the period August 2-23, 1973, was authorized.

Chairman Burns then invited Mr. Daane to report on the meeting of the C-20 Deputies that had been held in Washington on July 11-13.

Mr. Daane observed that the focus of the meeting was the so-called "revised outline of reform" which had sections dealing with the main issues the Deputies had been discussing. A plenary session on the first day was devoted to the questions of the adjustment process and the settlement system, and views remained divided on both questions. With respect to the adjustment process, the central issue was how active a role should be assigned to objective indicators and to the reserve indicator in particular. Differences of view with respect to the reserve indicator had narrowed somewhat, but the earlier division persisted with respect to the settlement system.

On the second day, Mr. Daane continued, the Deputies broke into two smaller groups. The group in which he participated discussed primary reserve assets and the quality of SDR's--specifically, the questions of the value of and rate of return on SDR's. It was the consensus of the group that SDR's should be made more attractive, but not so attractive as to have them retained by their holders and not used. The subject of gold also was discussed. The French and South Africans favored an increase in the official price of gold, or--as a fall-back position--a cut in the link altogether,

with no official price and with monetary authorities free to use gold in transactions. A third alternative, for which the U.S. representatives had expressed a preference, would involve retaining the present official price but permitting central bank sales to the market. The other group, in which Mr. Volcker was the U.S. representative, considered questions about consolidation or funding of dollar balances of the type the Committee had discussed today. As he had noted earlier, some attention was paid to the possible use of SDR's for this purpose, but there were unresolved questions about the obligations the United States would undertake if SDR's were used in that way.

Mr. Daane noted that the third day of the meeting was devoted to reports by the smaller groups and to a concluding session. The general sentiment was that the Deputies had gone about as far as they could in clarifying and restating the issues, but had not reached real agreement. As a result of the Deputies' meeting the "revised outline" would be revised further, and that document would be considered at a meeting of the C-20 Ministers and governors to be held in Washington on July 30-31. Chairman Burns would participate for the System in that meeting.

The following then entered the meeting:

Mr. Bernard, Assistant Secretary
Messrs. Andersen, Eisenmenger, Gramley, Scheld, and Sims, Associate Economists

Mr. Feldberg, Secretary to the Board of Governors
Mr. O'Brien, Special Assistant to the Board of Governors
Messrs. Keir, Wernick, and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Struble, Senior Economist, Government Finance Section, Division of Research and Statistics Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors
Mrs. Peters, Secretary, Office of the Secretary, Board of Governors

Messrs. Boehne, Taylor, and Doll, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Atlanta, and Kansas City, respectively
Messrs. Davis, Hocter, and Green, Vice Presidents, Federal Reserve Banks of New York, Cleveland, and Dallas, respectively
Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York
Mr. Broaddus, Assistant Vice President, Federal Reserve Bank of Richmond
Mr. Rolnick, Economist, Federal Reserve Bank of Minneapolis

By unanimous vote, the action of members of the Federal Open Market Committee on July 6, 1973, increasing from $2 billion to $3 billion the limit specified in paragraph 1(a) of the authorization for domestic open market operations on net changes between Committee meetings in System Account holdings of U.S. Government securities and agency issues, for the period through the close of business on July 17, 1973, was ratified.

In connection with the foregoing action, Mr. Hayes noted that the scale of System operations had expanded greatly in recent

years. Accordingly, he thought it might be desirable to make a permanent increase in the leeway, perhaps to $2-1/2 billion. He suggested that the staff be asked to explore that question and make recommendations to the Committee.

There was general agreement with Mr. Hayes' suggestion.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on May 15, 1973, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on May 15, 1973, was accepted.

Chairman Burns 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. Partee made the following statement:

The economic expansion has reached that awkward stage of its life where most over-all measures remain relatively favorable, while at the same time analysts search intensively for indications of the weakness that they expect soon to emerge. Thus, one gets sharply different views of the current situation depending on whether the emphasis is placed on the level of current operations, which is very high and pressing against capacity in many lines; or on the rate of increase in real output, which appears to have flattened a little in the last several months; or on the leading indicators of future activity, which in scattered instances seem to have been weakening recently.

The difficulty in sorting out these differing views as to the state of the economy is that each approach has something to recommend it. If we have in fact been operating at close to capacity, which is certainly the case in some

basic industries such as petroleum, steel, chemicals, paper and building materials, then it is simply not physically possible to continue the rates of increase in real output witnessed earlier. Output, not only in these industries but in the dependent finished goods industries, will necessarily be constrained. According to our unpublished capacity utilization data for 13 major materials industries, output in the second quarter was close to 96 per cent of capacity--the highest rate since the Korean War. Shortages of strategic materials and component parts are widely reported by company purchasing agents. And it is interesting to note that virtually all of the slowing of the increase in the industrial production index that has occurred to date has taken place in lines of activity that we judge to be operating at or near capacity rates.

Evidence from other sources, on the other hand, appears to indicate a slowing in the growth of demand. Retail trade, in dollar terms, was very little larger in the second quarter than in the first; with prices rising sharply, this implies a decline in real purchases of goods by consumers in the last quarter. Unit sales of new cars did taper off in the spring months, with June the lowest of the quarter, and furniture and appliance sales showed no further gain, following a large first-quarter advance. There is little evidence of shortages at retail in these hard-goods lines, although all of the particular models and designs desired may not have been readily available. Thus, data from the consumer area, at least, supports the view that it is demand, rather than supply, that has been causing the apparent slowing in economic expansion.

The various indicators of future activity also present a somewhat mixed picture. Much was made of the decline in the composite leading index in April, for example, but in May the index rebounded to its March high. Average weekly hours--and overtime hours--in manufacturing have weakened a little recently, but new orders for durable goods--and order backlogs--have continued to rise. The stock market has continued to fluctuate not far from its lows for the year, and on very small volume, but the current red book,[1] on the whole, presents a very rosy picture of business attitudes regarding the state of demand. Capital goods markets appear to be particularly strong, and a recent McGraw-Hill resurvey

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

of business plant and equipment spending intentions indicates that plans are holding firm for an increase this year of more than 19 per cent--notably stronger than the 13 per cent gain indicated by the May Commerce survey.

The current situation is further confused by the price freeze and the dimensions--as yet unspecified--of the Phase IV program of controls. The freeze has caused some distortions in current output, particularly in agriculture. It may also be causing some holdbacks in deliveries, since the transactions rule used in determining base prices for the freeze disadvantages those industries which ship products on the basis of orders placed weeks or months earlier. But most important, the freeze has locked in major distortions in the structure of business costs and prices, with prices of raw materials and intermediate products up substantially more over recent months than those for finished goods. The extent to which price adjustments to even out such distortions are permitted--or, alternatively, delayed--under Phase IV rules could have a significant influence on the willingness of business to expand production schedules and meet all existing market demand. Meanwhile, the impact of the freeze will be affecting not only the data on prices, but also on sales, inventories and, to a lesser extent, output.

In the extraordinarily confused current environment, it is exceedingly difficult to have a very precise notion as to the likely course of economic developments. Incoming data over the next couple of months must be judged with caution, too, since much of it will reflect varying components of price change and other quite temporary factors. But the staff continues to believe that the underlying thrust of the economy is toward a gradual but extended slowing in the rate of growth. Consumer demand appears already to have moderated--more than we had been expecting--and there can be little doubt that housing starts are headed downward--perhaps substantially so. Business capital spending probably has a good deal further to go, though a gradual slowing in the rate of increase is likely. And inventory investment is the wild card--it could be very large later on this year and into 1974, if businesses maintain output for a time in the face of moderating demands, or it could remain relatively modest if there is widespread concern about interest costs, credit availability and the economic outlook. Our projection assumes a middle course.

In any event, it seems clear that public policy is now exerting a dampening influence on the economic expansion. Fiscal policy is moving substantially toward restraint in

> the second half of this year, now that the tax refunds have been completed and revenues are rising rapidly in reflection of the expansion in nominal incomes. The controls program, perhaps inadvertently, is working toward restraint too, by dampening ebullient business expectations and forcing at least a temporary absorption of higher costs. And monetary policy, by permitting a substantial tightening in financial market conditions, is also bringing a marked change in expectations and undoubtedly in financing and spending plans. This is most evident in the mortgage market, where funds appear to have become much less readily available in recent months, but credit conditions must now be in the process of affecting business and local governmental plans as well.
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> The question is how far to take the process of tightening, given the fairly clear prospect over time of a much less expansive economy and the lags with which monetary policy works. We probably now are running a substantial risk of exacerbating the economic slowing that appears likely next year, and indeed the staff has slightly reduced its estimate of real growth in 1974 as a result of the unexpectedly rapid increase in interest rates. But I, for one, can see no other feasible course, so long as inflation is rampant, credit demands strong, and monetary aggregates growing at unacceptably high rates. There is a clear and present danger of further overheating in the short run, so that I believe we must be prepared to put still more pressure on financial markets. But we also must be increasingly alert to the need for a prompt and significant reversal of course at the first convincing signs the economy is beginning to turn.

Mr. Francis expressed the view that the economic expansion was extremely strong. With production now very close to capacity, a slowdown in real product growth was almost unavoidable.

Chairman Burns observed that growth in retail sales had slowed markedly following an extraordinary surge in the first quarter. He wondered whether there were any indications of

shortages in retail inventories to account for the slowdown, or whether consumer demand had fallen off, possibly as a temporary adjustment to anticipatory buying earlier.

Mr. Partee replied that shortages had developed in a few lines, including compact automobiles, food freezers, and some fruits and vegetables. However, he did not think such shortages in themselves accounted for the leveling off that had occurred in the growth of total retail sales.

Mr. Daane said he was puzzled by the disagreement between Mr. Partee's comments regarding retail sales and the assertion in the summary chapter of the red book to the effect that "Consumer spending is showing no sign of slowing."

Mr. Partee commented that almost all retailers kept their records and made comparisons in terms of year-over-year sales, and their impressions--as assembled for the red book--probably reflected current sales in relation to those of a year ago. The Census Bureau's national statistics showed a large year-over-year gain in retail sales, but they also indicated a leveling off in the second quarter after a surge in the first.

Chairman Burns suggested that the staff undertake a quick telephone survey of major retailers around the country to

determine whether supply shortages might be affecting their sales. Meanwhile, it would be helpful to have the impressions of the Committee members on the question of how the retail trade figures should be interpreted. Was demand flattening out or was it continuing to expand and not being satisfied because of supply shortages?

Mr. Kimbrel observed that shortages of several items were reported in the Atlanta District. For example, deliveries of furniture were very slow because manufacturers were experiencing difficulties in acquiring the hardwoods they needed for production. Construction materials, notably cement, were in particularly short supply. Such shortages were having a retarding effect on residential construction and were probably affecting sales of household durables.

Mr. Black indicated that construction in the Richmond District was being adversely affected by shortages of bricks, and in line with Mr. Kimbrel's observation sales of household durables were probably being slowed as a consequence.

Mr. Morris noted that for two consecutive months there had been declines in the average workweek in manufacturing and in average weekly overtime. He thought those statistics were inconsistent with the proposition that the slower growth in consumer spending was solely a function of shortages in supply.

Chairman Burns commented that, as a matter of abstract logic, one could conceive of a situation in which production in an industry was below capacity but could not be expanded because of shortages of materials. Whether such situations existed was, of course, an empirical question.

Mr. Mayo said that economists for two major retailers with nationwide sales had reported that their firms were experiencing virtually no inventory shortages. Those firms might be atypical, however, in that they were favorably situated in terms of long-term supply contracts and a strong market position. Their economists did not see any indication of a slowdown in consumer demand and indeed they anticipated a modest further increase.

Mr. Hayes reported that a survey his staff had conducted for use in the red book suggested that retail sales in the New York District remained buoyant, apparently reflecting expectations of further price increases.

Mr. Coldwell said he had received indications from some retailers in the Dallas District that they were faced with shortages in their inventory positions and were unable to bring their inventories up to desired levels, partly because of longer delivery schedules. In addition, retailers were being told by some suppliers that the high cost of credit was beginning to impinge upon their own ability to maintain inventories. He did not know how widespread or significant that development might be.

Mr. Morris reported that plant facilities producing industrial equipment appeared to be operating at capacity in the Boston District. On the other hand, new orders for consumer goods were slackening and manufacturers in most consumer goods lines were experiencing no capacity strains.

Mr. Mayo indicated that a similar situation appeared to exist in the Chicago District.

Mr. Brimmer said the fragmentary evidence that had come to his attention tended to reinforce the view that growth in consumer demand was slackening. Moreover, the latest statistics suggested slower growth in new orders for durable goods. He recognized that some shortages in inventories existed and indeed were to be expected at the top of a boom. However, he would be inclined to place more weight on reduced growth in aggregate demand, and less on supply bottlenecks, as a causal factor in the outlook for a slowing in the expansion over the months ahead.

Mr. Winn reported that some manufacturers in the Cleveland District were experiencing difficulties in obtaining certain types of plastic materials that were used in the production of consumer goods. On the other hand, available supplies of gasoline had actually increased recently, even though consumers were convinced that shortages existed in light of station closings, reduced hours, and the like.

Mr. Coldwell remarked that farmers in the Dallas District were having a problem in obtaining certain types of farm equipment. The consequence was a tendency for the normal flow of farm products to markets to be disrupted, and the resulting price increases were being resisted by consumers.

Mr. Clay reported that fears of a gasoline shortage had depressed tourism in the Kansas City District, notably in Colorado where motel receipts were off as much as 30 per cent in some areas.

Chairman Burns observed that the camping business had fallen off markedly in an area of Vermont with which he was familiar. An explanation given by camp owners was that many young people were spending their vacations abroad.

In response to a question by Mr. Winn, Mr. Partee said he had no evidence of unusual financial problems in any sectors of the economy. For example, staff inquiries had not turned up any instances of financial difficulties among real estate investment trusts.

Mr. Hayes expressed the view that aggregate demand was still excessive and seemed likely to remain so for some time. Demand pressures on wages and prices were very strong, and cost pressures were being exacerbated by diminishing productivity gains. While the pace of business activity was widely expected to slow significantly further next year, it was unusually difficult to look that far ahead in view of the many uncertainties at present.

Mr. Hayes expressed the hope that Phase IV controls would be able to make a real contribution in dampening inflationary expectations. In that regard, however, it was very disturbing to find Administration officials talking about the removal of Phase IV controls before they were even put in place. He also believed that the credibility of Phase IV would be enhanced if it could be accompanied by additional selective fiscal restraints, possibly measures directed at discouraging capital investment and gasoline consumption. There were few signs as yet that major demand sectors were being restrained by tight financial conditions, and he suspected that a fairly extended period of relatively high interest rates might be required before significant restraining effects would become clearly visible.

Mr. Black indicated that he had found Mr. Partee's presentation particularly helpful today. He might mention three points pertinent to the economic outlook. First, the coincident composite index had now declined for two months on a deflated basis. Second, he thought the Board staff projection of plant and equipment expenditures, which seemed to be based on the McGraw-Hill survey rather than on the more reliable Commerce Department survey, might be overestimating the prospective strength of business capital spending. Third, in reference to observations made by Chairman Burns in the past concerning differences in attitudes among different groups

in the economy, contacts with businessmen in the Richmond District suggested that their attitudes were shifting toward the greater pessimism displayed earlier by investors and consumers. Although businessmen were experiencing greater prosperity, they were becoming increasingly concerned about the economy and about the ability of fiscal and monetary policies and of Phase IV to restrain inflation. The changing sentiment of businessmen was something monetary policy had to take into account.

In response to a question by the Chairman, Mr. Partee said the staff's projection of investment spending in 1973 was based on a number of types of information, and not simply on the McGraw-Hill survey as Mr. Black had surmised. Among the types of information taken into account were actual spending in the first quarter and estimated spending in the second quarter, the level of new orders for capital goods, the movement of the capital goods component of the industrial production index, and the manufacturers' appropriations survey of the National Industrial Conference Board. In light of what was known about first-half developments and about business plans, it would appear virtually impossible for capital spending in 1973 to be only 13 per cent above 1972, as indicated by the latest Commerce survey. So small an annual increase would imply a nominal rate of growth in the second half and perhaps no gain in real terms, and such an outcome was quite inconsistent with the body of other evidence.

Mr. Sheehan said he believed policy makers were facing considerable risks of a marked slowdown in the pace of economic activity. There were, to be sure, only a few indications in the red book that the boom might be coming to an end, but they were troublesome. In his judgment, the relatively small size of recent increases in production and employment was due only in part to capacity limitations. He was concerned about indications of a continuing decline in consumer confidence. The American consumer, unlike his counterpart in many Latin American countries, was not yet inclined to accelerate his buying in anticipation of higher prices; instead, he tended to increase his savings when worried about inflation. The downturn in housing was in its early stages and substantial further weakening could occur if interest rates were held at current levels for the next six months. In many States usury ceilings would greatly restrict the amount of mortgages that were made. He did not expect to see a build-up of excess inventories over the months ahead because he thought businessmen, especially retailers, would be very cautious about accumulating inventories at a time when interest carrying costs were so high. Moreover, many retailers anticipated a slowdown in consumer demand, and he had heard of a decision by a major retailer to scale back substantially on orders intended for fall delivery.

Mr. Balles said he wanted to associate himself with Mr. Partee's cogent statement on the status of the economy and the implications for policy. With regard to Mr. Partee's comment about the clear and present danger of overheating in the short run, he thought it would be helpful if the Committee had some advance information, or even an informed guess, about the probable shape of the Phase IV program. Press reports suggested that an announcement concerning the program might be made within a day or two.

Chairman Burns said he might report his own expectations regarding the general outlines of the program. First, he did not anticipate any new fiscal measures to accompany Phase IV controls; no tax increase would be proposed. However, the need for continued restraints on expenditures would be emphasized. With regard to incomes policy, he expected no change in the current wage controls. He thought prices would be subject to a rather stringent mandatory program which would contain a limited cost pass-through provision. He also believed a policy would be enunciated to decontrol individual industries as quickly as possible and to try to terminate mandatory controls by the end of the year.

Mr. Brimmer referred to his earlier remarks and said he had not meant to suggest that monetary policy had nothing further to accomplish. He believed that demand pressures in the economy were

moderating, but as the data reported in the green book[1] made clear, the pace of inflation was still very high and perhaps the slowdown in economic growth was not quite enough. The real issue, however, was whether or not the time had come to switch to an easier policy posture. He did not think it had.

Mr. Mayo said he agreed almost completely with the projection presented by Mr. Partee. He was more bullish on the outlook for consumer expenditures and housing demand, but only slightly so. With regard to housing starts, on the basis of past experience one could expect Congressional action to sustain housing demand if starts were to decline significantly below the 2-million annual rate level--especially if that were to occur by early 1974, an election year. The resulting fiscal stimulus should be taken into consideration when viewing the outlook for next year.

Mr. Daane asked whether fiscal policy could be expected to support monetary policy over the next 6 months. He noted that at a recent meeting in Paris some Administration economists had expressed optimism about the outlook for fiscal policy, indicating that a surplus was projected in the high employment budget for fiscal 1974. He was not sure, however, whether fiscal policy was expected to provide a stimulus or a drag on the economy over the months immediately ahead.

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

Mr. Balles added that it would be helpful to have information on the likely stance of fiscal policy by quarters over the 1974 fiscal year.

Chairman Burns said he might note in partial response that, in terms of the unified--not the full-employment--budget, the figures to be presented by the Administration in the mid-year budget review were likely to show approximate balance, in contrast to the expectations of a deficit in January. Since there would be no new tax measures and no significant changes in expenditure targets, the shift to balance would reflect higher estimates of revenues.

Mr. Partee observed that, as reported in the green book, the Board staff currently was estimating a surplus of $100 million in the unified budget for fiscal 1974. The high employment budget projections showed a gradual but continuous movement toward surplus over the fiscal year. On a national income accounts basis, a shift was projected from the rather substantial deficit of the first half of calendar 1973 to near-balance in the second half, and then a return to some deficit in the first half of 1974. He would add that for technical reasons related to the treatment of tax refunds, the staff projection on a NIA basis understated the magnitude of the shift between the first and second halves of 1973. Accordingly, he had concluded that fiscal policy was moving substantially toward restraint in the second half of this year. As the Chairman had

indicated, the greater restraint was a consequence of larger revenues. To a large extent, the revenue increase was a consequence of inflation.

Mr. Hayes reported that the staff at the New York Bank was projecting a deficit for fiscal 1974 of around $6-$7 billion on a unified budget basis. Their projection assumed that court decisions would serve to release a larger amount of funds for pollution control than the Administration had intended to spend for such purposes. His staff was also projecting a deficit in fiscal 1974 on a high-employment basis.

Mr. Partee said the Board staff did not have any special information regarding the rate at which impounded funds might be released as a result of court decisions. The staff had projected $1 billion of extra spending beyond the Administration's estimates on the assumption there would be some slippage.

Mr. Mayo commented that there were many ways to delay expenditures, if that was the Administration's objective.

Chairman Burns observed that the budgetary outcome for fiscal 1974 could well range from a surplus of $3-$4 billion to a deficit of $5-$6 billion, and he would not want to make a point estimate within that range. He agreed with Mr. Mayo that a determined Administration policy to hold down expenditures could prove successful. That had been illustrated in fiscal 1973 when

expenditures were kept below $250 billion even though Congress had not enacted legislation to establish a spending ceiling at that level.

It was uncertain whether the same degree of success could be achieved in fiscal 1974, the Chairman continued, since there were reasons for believing that the President's power to restrain expenditures might be smaller this year than last. On the other hand, one should not overlook the sentiment in favor of holding down spending within the Congress itself. The Joint Study Committee on Budget Control had turned in an excellent and unanimous report which appeared to have considerable support in the Congress. It seemed to him that the differences between the Administration and the Congress related more to spending priorities than to spending totals. The Congress wanted to cut defense expenditures by several billion dollars and to increase expenditures on social programs. If he were to make a forecast in this hazardous area, it would be that some compromise would be reached, with defense expenditures lower than those sought by the Administration and social expenditures higher.

Mr. Coldwell observed that savings and loan associations were starting to voice their concerns about savings flows and some of those concerns might be justified. He understood that a number of savings and loan executives had met recently with officials of

the Federal Home Loan Bank Board to urge the relaxation of certain limits on advances to individual institutions by the Home Loan Banks. He wondered if the Board staff had any information about the limits in question and the outcome of the meeting.

Mr. Partee replied in the negative. He noted that advances under the current limits had been very large so far this year.

Chairman Burns observed that advances could be expected to be substantial over the balance of the year.

Mr. Coldwell agreed. He added that raising the lending limits would foster an even greater volume of advances, with obvious implications for the amount of borrowing in the market by the Home Loan Banks.

After some further discussion it was agreed that the staff would make inquiries regarding the lending limits in question and would report its findings before the end of the meeting.

Chairman Burns said he would comment on monetary policy at this point and suggest a possible approach for consideration by the members. He had no quarrel with the staff's analysis of the economic situation, but he was greatly disturbed by the very rapid rates of increase in the monetary aggregates during the last few months. One could cite a variety of special factors to explain the surge in the aggregates, but the basic reason was that the System had been supplying reserves to commercial banks at a very fast rate

this year. The rapid growth of the monetary aggregates was a most disturbing development; if it persisted there would be considerable justice to a charge that the System had fostered the inflation now under way.

In his judgment, the Chairman continued, to discharge its responsibility the Committee should maintain its restrictive policy posture for a while longer. The Committee should be prepared to reverse course quickly if it became convinced, as it might before too long, that the economy required an easier policy posture. For the present, however, he thought the objective should be to bring the monetary aggregates under control. The specific policy prescription he would put forward for Committee consideration was to adopt the longer-run targets for the monetary aggregates associated with alternative B in the blue book[1/]--namely, growth rates for the third and fourth quarters of 3-3/4, 4-3/4, and 7-1/2 per cent, respectively, for M_1, M_2, and the credit proxy; and the short-run operating ranges shown under alternative C--namely, growth rates in the July-August period of 11 to 13 per cent, 3 to 5 per cent, and 3-1/2 to 5-1/2 per cent for RPD's, M_1, and M_2. For the range of tolerance in the weekly average Federal funds rate during the inter-meeting period, he would suggest 9 to 11 per cent.

The meeting then recessed and reconvened at 2:15 p.m. with no change in attendance.

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

Before this meeting there had been distributed to the members of the Committee a report from the Deputy Manager of the System Open Market Account covering domestic open market operations for the period June 19 through July 11, 1973, and a supplemental report covering the period July 12 through 16, 1973. Copies of both reports have been placed in the files of the Committee.

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

> Since the Committee met on June 19, the Account Management has sought to apply increasing restraint to conditions of reserve availability as growth in money supply and related measures pushed above the Committee's desired ranges. Scarcely more than a week after the June 19 meeting, incoming data suggested that undesired strength in the aggregates was continuing. The Desk, which had been aiming at the time of the meeting and shortly afterward for reserve conditions that would produce a Federal funds rate around 8-1/2 per cent, began a tightening process expected to raise this rate to 9-1/4 per cent as the July 4 week progressed. That was the top of the range agreed to at the June meeting. The tightening process was aided by unusual pressures growing out of the midyear bank statement date, which induced many banks to limit their borrowings on Friday, June 29, thus building up large reserve deficiencies over the weekend that had to be settled on July 2 and 3. Funds trading on these days reached a 10 to 15 per cent range, which induced the Desk to make large reserve injections through repurchase agreements.
>
> By July 6, with aggregate data still pointing to excessive strength, Committee members approved a 1/2 percentage point increase in the upper end of the funds rate range to 9-3/4 per cent. The Desk initially aimed for reserve conditions expected to produce about a 9-1/2 per cent rate, and this was achieved in the July 11 statement week. With even greater strength showing up in the aggregates in the last few days, the Desk further adjusted its sights to aim for maximum restriction consistent with the Committee's 9-3/4 per cent ceiling.

Yesterday and today, for reasons that are not wholly clear to me, funds have traded mainly around 11 per cent despite sizable reserve injections through repurchase agreements.

The market has reacted to the tightened conditions of reserve availability--along with other measures including a discount rate rise and an increase in reserve requirements--with sharply higher short-term interest rates and moderately higher intermediate- and long-term rates, but on the whole the response has been orderly. Apart from the funds rate itself, among the sharpest rate increases have been those on CD's, with major banks now paying around 9.25 to 9.45 per cent for 90-day deposits compared with about 8 per cent or a bit higher a month ago. Treasury bill rates are up around 75 basis points, with 3- and 6-month bills auctioned yesterday at respective average rates of 7.97 and 8.02 per cent compared with 7.26 per cent for both issues on June 18. Intermediate-term yields, meantime, are up 50 basis points or so, and longer-term yields are perhaps 10 to 20 basis points higher.

In some cases the rate rise has been costly to dealers who were caught with sizable positions, but in other instances the adjustments were anticipated and a number of market participants had very light or even short positions. Dealer positions in Treasury coupon issues maturing in more than a year have come down in the past month from over $200 million to net short holdings of about $100 million, partly aided by System and other official account buying. Holdings of over one year agency issues, on the other hand, have remained in the area of $300-$400 million despite System buying as the market was fed a sizable volume of new offerings.

At times during the recent period, there seemed to be some wavering in the widespread conviction that rates would turn down within a few months--a viewpoint that has induced banks to pay up sharply for short-term money while avoiding more fundamental adjustments in lending and investment policies. But despite this wavering, and some readjustments of the timing and levels of projected peak rates, I believe the view still is predominant that the peaks will be seen within the next 2 or 3 months.

Against this background it may be difficult to achieve the slowing in bank credit and related measures that the Committee has been seeking. Perhaps the restrictive moves already undertaken will bring about the desired slowdown. Increased small-saver disintermediation, such as we have seen in recent bill auctions, could contribute to this process. But if the desired slowing does not unfold, it may be that we would need somewhat greater jolts to expectations than we have seen so far. I would not of course suggest disregarding money and credit market conditions but rather that the Committee's objectives might be better served through somewhat stronger pursuit of aggregate targets, coupled with a greater willingness to see serious market pressures.

Consider, for example, the alternatives1/ presented by the staff for today's meeting, particularly alternative B with a targeted M_1 growth rate of 3-3/4 to 5-3/4 per cent for July-August and a Federal funds range of 9 to 10-1/2 per cent. In the event that M_1 was turning out again on the high side, I can imagine the market accommodating itself over the next few weeks to a 10-1/2 per cent funds rate without market participants making the fundamental reappraisals that may really be needed to change the trend of the aggregates. It is perhaps not so much the absolute level of rates that may be critical in shaping the decisions of market participants but rather the extent of rate movement that the System is willing to see. Another factor that may be relevant is that, as rate levels rise, the significance for aggregate growth rates of, say, a 1 percentage point move in the Federal funds rate could be considerably less than it was at lower rate levels.

The execution of policy in the next few weeks could, of course, be affected by the upcoming Treasury financing, but this $4-1/2 billion rollover of private holdings perhaps need not be a serious problem, particularly if the Treasury continues to use auction techniques. The size of these quarterly rollovers has held fairly steady over the past several years while the economy and financial markets have grown, so that, relatively, even keel need be less of a constraint than in the past. In this financing, the System Account holds a modest $568 million

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

of maturing August 15 issues, which we would plan to exchange for new issues in proportions similar to those to be bought by the public.

Finally, I should inform the Committee that another firm on our trading list, duPont Walston, has decided to follow in the footsteps of Paine Webber about a month ago and discontinue dealer operations in Treasury issues. duPont had a rather small-scale dealer operation in Governments, which was losing modest amounts of money for them, and they felt in light of their over-all loss experience in stocks and other areas that the dealer operation was excess baggage.

In response to a question by Chairman Burns, Mr. Sternlight said he could recall other instances when dealer firms had discontinued trading in Government securities, but he could not remember two withdrawals in such quick succession. He did not think there was a general history of firms ceasing to operate during periods of tight money.

Mr. Sheehan observed that profit problems related to the slowdown in trading in common stocks appeared to have been the main motive for abandoning the Government securities business in the case of at least one of the firms in question.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period June 19 through July 16, 1973, were approved, ratified, and confirmed.

Mr. Axilrod then made the following statement on prospective financial relationships:

The sharp further increases in short-term interest rates of the past month have brought them generally close to or above 1969-70 peak levels. Meanwhile, municipal

and corporate bond yields remain around 1-1/2 percentage points below their 1970 highs, and rates on conventional mortgage loans offered in primary markets are about 55 basis points below their earlier highs.

While long-term rates may not yet have fully adjusted to prevailing money market conditions, the difference in the structure of interest rates in the current tight money period as compared with 1969-70 probably reflects mainly changes in the structure of financial markets. It is difficult to relate current developments in the interest rate structure to attitudes toward inflation. If anything, one would expect that inflationary attitudes are more pessimistic now than in 1969-70 and that this would raise long-term rates. Perhaps, however, inflationary attitudes are most pessimistic for the short run, thus affecting mainly short-term rates, and attitudes for the long run are influenced by the apparent potential for a downward readjustment of the economy.

However that may be, recent changes either abolishing or raising ceiling rates at banks and other institutions have, I believe, changed the structure of financial markets in the direction of placing more upward pressure on short-term relative to long-term interest rates. Banks are free to issue large negotiable CD's at a price, and now both banks and nonbank savings institutions are in a somewhat better position than they were to compete for consumer-type time and savings deposits.

Because of these changes--particularly the suspension of ceilings on large CD's--financial institutions have an increased capacity to finance at short term. As a result, they are under less pressure to, among other things, cut back on long-term investments. More importantly, banks are in a position to finance short-term credit demands of business. Thus, businesses as a whole, if they are willing to pay the price, can more readily finance short while awaiting better days in the bond market without nearly as much fear of being rationed out by banks. Businesses can avoid locking themselves into expensive long-term indebtedness to finance capital spending projects, and in that sense financial restraint is to a certain degree less onerous.

The implications for policy are several. First, and most generally, in the degree that rationing in both the business loan and mortgage markets has been reduced by ceiling rate actions, interest rates will, of course, have to be higher for the same degree of restraint as

before. Second, if significantly higher long-term interest rates than currently prevailing are required for a more effective degree of restraint, then either short-term interest rates will have to rise further to exert a substantial upward pull on long rates, given the recent changes in financial structure, or other measures will have to be taken to affect the rate structure.

Debates as to whether the rate structure can or cannot be influenced are endless and usually do not hold much promise of a permanent influence on structure if market expectations are not changed. But it is not clear how permanent we would want substantial upward pressures on long-term rates to be in view of the uncertain economic outlook. We could probably obtain at least some temporary upward pressure centered on long-term markets through debt lengthening in the forthcoming Treasury refunding.

We could possibly have a more marked and noticeable effect if the Federal Reserve took the unprecedented step of selling coupon issues in the 5-year area and beyond out of its own portfolio. This might not be possible in the forthcoming even-keel period, and it might not be possible at all except in relatively small amounts. But, even so, it strikes me as a worthwhile approach to consider from the standpoint of at least signaling Federal Reserve intent to exert more upward pressure on long-term markets. Such an approach would, I suspect, be most effective in an environment of rising short-term rates.

While there could be some strategic gain from action that would focus upward pressure on long-term rates, the basic impact of monetary policy is still through actions affecting bank reserves. The various blue book alternatives indicate a moderation in the demand for bank reserves not only because of the cumulative impact on money and liquidity demands of the already sharp rise in short-term interest rates but also because of an anticipated slowing in the rate of increase in nominal GNP. But because we have been estimating too low a funds rate over the past two months and because uncertainties about Phase III, Phase IV, and the basic economic outlook are so great, I should think that the Committee would still want the Desk to operate with a wide Federal funds rate band--at least the 1-1/2 point band suggested in the blue book.

> If the Committee were to conclude that there is a need to sop up more liquidity in order to exert sufficient upward pressure on long-term interest rates, then it might wish also to start out on the restrictive side of reserve and funds rate ranges over the next few weeks. Such an approach would also be consistent with an effort to obtain more certain control of the aggregates, even at the risk of low or no growth for a short period. Based on experience of the recent past, the forthcoming even-keel period would not forestall some modest tightening of the money market if that were necessary to accomplish reserve or over-all interest rate objectives. Needless to say, if any additional tightness over the near term were in fact to have a beneficial effect in reducing inflationary attitudes and curbing excess demands, a prompt easing of credit markets would be implied later on if monetary growth were to be maintained at, or brought back up to, a moderate and sustainable pace.

In reply to a question by Chairman Burns, Mr. Axilrod indicated that rates on Federal funds, short-term Federal agency issues, and bankers' acceptances were now above their 1969-70 peaks, while rates on 3-month Treasury bills were within 5 or 10 basis points of their earlier highs. The prime rate had reached its previous high of 8-1/2 per cent at one commercial bank.

Mr. Daane asked whether it would have been possible to keep RPD's within the range of tolerance adopted by the Committee at its June meeting and, if so, what the consequences would have been. As the Committee members knew, he had been skeptical from the beginning of the RPD approach. He had a great deal of sympathy for what he understood to be the Chairman's point regarding the

reason for the behavior of the aggregates in recent months--namely, that the actual growth in RPD's had exceeded the Committee's targets.

Chairman Burns said that he did not have in mind simply the fact that the Committee's targets had been overrun. He had not tried to differentiate between targets and results; his point was merely that reserves had been rising at a rapid rate and such expansion was undoubtedly the basic reason for the rapid growth in the monetary aggregates.

Mr. Axilrod commented that there were differences of view among the staff regarding the technical feasibility of achieving a given RPD target. Part of the problem in achieving targets--particularly when short periods of time were considered--was due to lagged reserve requirements. But a more basic reason for misses was the imposition of a constraint on movements in the Federal funds rate. In the recent interval, for example, he thought it would have been possible to come closer to the Committee's RPD target, and perhaps to hit at least the upper end of the range of tolerance, if the Desk had taken actions early in the period that resulted in a very sharp rise in the funds rate--to, say, 15 or 20 per cent. Banks presumably would have reacted by selling bills and other assets instead of borrowing to finance further increases in their loans and investments, and as a result some deposits would have been liquidated and a smaller amount of reserves would have been needed 2 weeks later. The question, of course, was whether the Committee

wanted to force an adjustment promptly or whether it preferred the less abrupt course of setting in motion forces that would produce desired results over a period of, say, 3 or 4 months.

Mr. Sternlight said he would agree that a Federal funds rate of around 15 per cent might well have been required in the recent period to approach the Committee's RPD objectives.

Mr. Axilrod added that while a rise in the funds rate to 15 per cent could be expected to have substantial repercussions on financial markets, it should not necessarily be considered unrealistic under present circumstances. Funds had traded on some recent days at around 11 per cent and the average rate for one statement week had been 10.21 per cent.

Mr. Morris asked whether Mr. Axilrod believed lagged reserves were a serious impediment to the effective implementation of monetary policy and whether he felt they should be eliminated. He (Mr. Morris) had been on the morning call in recent weeks and had concluded that lagged reserves posed more of a problem than he had thought earlier.

Mr. Axilrod replied that a staff group was presently engaged in a study of lagged reserves. While there were some differences of view within the group, it was his own tentative conclusion that the Committee would have a better chance of

hitting its RPD target in the interval between Committee meetings in the absence of lagged reserves. Over a longer period--say, 2 or 3 months--they did not pose a great problem. Whatever their other advantages might be, he believed lagged reserves contributed nothing to the implementation of monetary policy.

Chairman Burns asked that the staff complete its report on lagged reserves in time for consideration by the Committee at its next meeting. Any unresolved differences of view among the staff members could be indicated in the report.

Mr. Brimmer noted that the introduction of lagged reserves was only one of several changes made in reserve accounting procedures in September 1968 on what was then considered to be a temporary basis. Another change was the adoption of a provision permitting a carry-forward of reserve excesses and deficiencies. Since the two actions were intimately related, he hoped the staff would take account of the latter as well as of the former in its analysis.

Mr. Holland observed that a third change made at that time was the reduction of the reserve accounting period for country banks from two weeks to one week. Since some of the changes served to tighten linkages and some to loosen them, he agreed with Mr. Brimmer that it would be best to consider them together.

Mr. Axilrod said it would not be feasible to prepare a report on the implications of all three matters with any degree of thoroughness in time for consideration by the Committee at its next meeting.

Chairman Burns suggested that the staff submit a thorough report on lagged reserves by that time. It might add whatever tentative views it had on the other two matters and plan on pursuing them in more detail in a subsequent report.

Mr. Brimmer referred to the Chairman's suggestion that the Committee adopt the longer-run targets for the aggregates of alternative B and the short-run operating ranges of alternative C. He asked whether the staff believed that such objectives were likely to prove internally consistent and what implications they might have for money market conditions.

Mr. Axilrod replied that the Committee might seek to reduce growth rates in the aggregates into the alternative C ranges in the short run for the sake of bringing about a prompt slowing. At the same time, it could still be aiming at the alternative B growth rates for the second half of the year as a whole. Such an approach might mean a rise in money market rates now and some decline later, assuming the staff's estimates of the relationships proved to be correct.

Mr. Sternlight said he had nothing to add regarding the consistency of the two sets of targets for the aggregates. With respect to the Federal funds range, he could not be sure that any particular rate would produce growth in the aggregates at the pace desired. As he had suggested in his earlier remarks the process of bringing the aggregates under control might well require a further jolt to market expectations. In that connection the Committee might wish to consider allowing a greater movement in the Federal funds rate. He thought the market was pretty much attuned at the moment to a funds rate of around 10 per cent. He would not rule out a further increase to 11 per cent as unduly sharp, although such a move would have to be carefully executed to avoid excessive dislocations in the market.

Mr. Coldwell said he was disturbed by the RPD growth rates projected for the July-August period. The lowest rate, that associated with the lower end of the alternative C range, was 11 per cent. He found that to be an intolerably high rate and he wondered what would happen if the Committee decided it would not accept anything higher than 6 or 7 per cent. Was the consistency of the linkages such that the resulting performance of the aggregates could be predicted with certainty?

Mr. Axilrod replied in the negative. He noted that the staff had concluded in a recent study[1/] that estimates of the

1/ The study, entitled "Review of RPD Experiment," was distributed to the Committee on June 11, 1973. A copy has been placed in the Committee's files.

multiplier between RPD's and M_1 and M_2 were subject to substantial margins of error. In the present instance, a change in reserve requirements had made the multiplier estimates even more uncertain. The estimates had been reduced from those of a month ago, and they might well turn out to be too low. It was partly for that reason that he had raised the possibility of starting out in the coming period on the restrictive side of the RPD and Federal funds ranges.

Chairman Burns said he shared Mr. Coldwell's concern. He asked Mr. Axilrod whether he was sure that the staff had correctly computed the arithmetic of the relationships between RPD's and the money supply figures.

Mr. Axilrod replied that he was reasonably certain that the arithmetic was correct; his uncertainties related to the economic relationships.

Mr. Daane said the great uncertainties relating to the linkages between reserves and the monetary aggregates were precisely what troubled him. In his view the Desk could operate more skill-fully, and could achieve the Committee's current objectives more effectively, if it were instructed not to depend on a loose mechanical relationship but rather to focus on money and credit conditions and to tug on the reins at every opportunity, as hard as it could without precipitating dislocation in financial markets.

Chairman Burns asked Mr. Sternlight how the Desk would operate in the coming period if it were given instructions of the type preferred by Mr. Daane.

Mr. Sternlight said he assumed the Committee would still want the Desk to restrain the growth of reserves, and that it would also provide some indication of acceptable changes in the Federal funds rate. On those assumptions, he thought operations would be conducted pretty much as at present.

Mr. Daane remarked that the Manager would have more latitude if he focused on interest rates rather than on growth in the aggregates.

Chairman Burns said it was not clear how the Manager would be expected to use that latitude. More generally, if he were the Manager he would not know how to interpret such instructions. If he wanted to be on the safe side, which was a natural human impulse, he would tend to maintain existing conditions.

Mr. Hayes indicated that he did not agree with that assessment. He thought operations would be conducted in much the same manner under either set of instructions. He assumed that under the type of directive Mr. Daane had in mind the Manager would be given a range of discretion wide enough to permit him to take some risks of jolting the market as he moved in the direction of further restraint.

Mr. Daane said he would expect the Desk to operate in such a manner as to indicate clearly to the market that the Committee was continuing on a restrictive policy course. It was his feeling that operations could be carried out more delicately under his approach than under the current procedures, which could require sharp adjustments in the event of overruns or shortfalls in the aggregates. The Desk had operated for many years with the kind of instructions he had in mind.

The Chairman remarked that, according to the staff report on the RPD experiment, there had in fact been less emphasis on RPD's, and more on the funds rate, than was originally contemplated.

Mr. Coldwell observed that the Desk had not sold intermediate- and long-term Government or agency securities for a long time. He wondered if the Desk had made a deliberate effort to avoid the sale of such securities.

Mr. Sternlight replied affirmatively. Such sales were thought likely to prove unnecessarily disruptive to the market. Also, it was not clear to him what Committee objectives they might serve to implement.

Mr. Coldwell said they might help to accomplish an orderly transition to a higher level of long-term rates. Moreover, he wondered whether the dealers should be led to conclude from the Desk's abstention that such sales would never be made by the System.

Mr. Sternlight expressed the view that sales of longer-term securities would precipitate disorderly market conditions by creating a great deal of uncertainty. Dealers would not know how large such sales might become or what the System's interest rate objectives might be.

Mr. Morris remarked that Treasury officials would undoubtedly object strenuously to any such sales.

Chairman Burns added that System sales of such securities could make it impossible for the Treasury to market longer-term debt.

The Chairman then noted that in response to his request earlier in the meeting, the staff had made a survey of major retailers around the country regarding possible supply shortages that might be affecting their sales. He asked Mr. Wernick to report.

Mr. Wernick indicated that several major retailers were contacted and on the whole they seemed to be sanguine regarding their supply situations. The department stores reported shortages of only a few special items such as luxury furniture and certain wool products. They expected sales to grow over the rest of the year and they did not anticipate any significant depletion of inventories.

The Chairman asked Mr. Keir to report on the information he had obtained in response to Mr. Coldwell's earlier inquiry regarding Federal Home Loan Bank lending limits.

Mr. Keir said there were two kinds of limits on advances by the Federal Home Loan Banks to individual savings and loan associations. One was a statutory limit which stipulated that advances to individual associations could not exceed 50 per cent of their outstanding savings capital. The other was a regulatory limit which the Federal Home Loan Bank Board itself imposed on such advances, and that limit was currently set at 25 per cent of savings capital. However, both limits could be waived by the Federal Home Loan Bank Board for individual associations experiencing difficulties.

Mr. Keir added that on their recent visit to Washington mentioned by Mr. Coldwell, executives of savings and loan associations had urged that the 25 per cent regulatory limit be raised to the statutory 50 per cent ceiling. In his conversations with the staff at the Federal Home Loan Bank Board he was informed that no steps had been taken to date to raise the 25 per cent limit.

Chairman Burns indicated that the Committee was now ready for its discussion of monetary policy. He suggested that the members should feel free to express their views not only about open market operations but also about other monetary policy instruments.

Mr. Bucher said he was very concerned about inflation and about the growth in the monetary aggregates, but he also felt he

was facing a dilemma. In his readings into the history of monetary policy he had encountered frequent discussions of the difficulties which the Federal Reserve had faced when it had come to a point that appeared to be a crossroads. Today, he thought the Committee was probably approaching a crossroads in its decision-making process. The staff had commented about the outlook for a marked slowdown in economic growth and many observers outside the System were predicting an actual downturn in economic activity. To illustrate his dilemma he wanted to quote two passages from materials by contemporary authors he had been reading. The first was as follows:

> "The Federal Reserve overplayed its role in every pre-crunch period by attempting to maintain a restrictive monetary policy longer than was necessary. Yet, the Federal Reserve never intentionally sought to produce a crunch. Why did the Federal Reserve overplay its hand? The most likely answer is that the monetary authority probably did not appreciate the potency of monetary policy or have adequate knowledge of the lags between policy implementation and its effects. The Federal Reserve, in reacting strongly to contemporaneous signals such as inflation, maintained a tight posture for too long. It was difficult to ease up on policy prior to signs of significant economic slowdown and reduced inflation. Yet, in order to avoid overkill, monetary policy, because of the lags, must turn before full proof of the success of earlier restrictive policy appears. Precisely the same possibility for error exists at this time if the Federal Reserve is looking for slower monetary growth as a signal of policy success. If monetary policy is kept tight until a time of substantially slower monetary growth, overkill will have been applied."

The second passage was as follows:

> "The Fed--at least its new Board of Governors--knows that policy has a six to nine month lag, that there is no way to anticipate where the financial system will crack in its test, or just what the full effect of any crunch will be, but it must be acknowledged that at this time the new Fed is acting just like the old Fed, confidently assuring us there will be no crunch while trying just one more turn of the screw."

Mr. Bucher added that he did not want to suggest that he had adopted the philosophy or shared the conclusions of the authors he had quoted. His only purpose was to draw attention to their views early in today's discussion because they were the main basis for his dilemma at this point.

Mr. Daane said he thought there would be less danger of doing too much too late if the Committee's instructions were couched in terms of somewhat firmer bank reserve, money, and credit conditions instead of being focused on achieving a major reduction in the growth of the aggregates. Specifically, he would suggest the following for the operational paragraph of the directive: "To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve somewhat firmer bank reserve, money, and credit conditions. This would be consistent with somewhat slower growth in monetary aggregates over the months immediately ahead than occurred on average in the first half of the year."

Mr. Daane expressed the view that his approach to policy would permit operations to be conducted more sensitively in a period that would include a Treasury financing whose contours were not yet known.

He agreed that slower growth in the aggregates was desirable, but he would prefer to accept that objective as a fallout in adopting the old fashioned approach to policy that he favored. In particular, he would not want to disrupt the markets for the sake of trying to achieve specific growth rates in the aggregates. Instead, he would instruct the Desk to probe cautiously in the direction of somewhat more tightness. If he had to express his policy preference in terms of the blue book alternatives, he would favor the specifications associated with alternative B.

In response to a question, Mr. Daane said he would not impose a rigid Federal funds range in his instructions to the Manager. In the light of current uncertainties such as those related to the weakness of the dollar in foreign exchange markets and the upcoming Treasury financing, he would give the Manager the latitude to "play it by ear." He did not think domestic open market operations could contribute significantly toward strengthening the dollar in foreign exchange markets short of fostering a marked further advance in interest rates, and accordingly he would consider making use of another policy instrument for its symbolic value overseas.

Mr. Hayes, referring to the quotations read by Mr. Bucher, said he thought the Committee might have overstayed a tight policy posture on occasion. He believed, however, that a review of the whole record of recent years would also reveal a number of cases when policy was eased too soon or a relatively easy policy was maintained for too long.

Mr. Hayes said that in the interest of time he would summarize the statement he had planned to make on policy and submit the full text for inclusion in the record. He then summarized the following statement:

> It seems to me quite clear that a policy of firm restraint should be continued, in view of the severity of the inflationary problem, the likelihood that serious demand pressures will continue for some time, the critical international situation, and the undesirably rapid growth of the monetary aggregates. In fact, some further tightening may be required if the aggregates continue to exhibit excessive strength. My advocacy of a firmer monetary policy would not be affected by the type of controls program introduced under Phase IV. While the August refunding to be announced within the next couple of weeks will call for some even-keel consideration, I do not believe it will be a serious enough factor to place substantial constraint on monetary policy.
>
> For the second half of 1973 I would like to see an M_1 growth rate of 4 per cent or less, which would be consistent with the longer-run objective of around 5-1/4 per cent for the last three quarters of the year that was adopted at the June FOMC meeting. A second half target for M_2 might be around 5 per cent, and we might aim for about 7-1/2 per cent growth in the bank credit proxy. In view of the sharply higher than desired growth in the aggregates and reserve measures in recent months, I believe we should resist firmly any tendency for further overruns. Thus, while I would subscribe to most of the specifications of alternative B, I would prefer to set an M_1 objective in July-August of 1 to 5 per cent. I would support a 2 to 6 per cent range for M_2. Given the current projections, this would indicate an early move toward somewhat firmer money market conditions than the Desk has been aiming for recently. I would hope that these objectives could be accomplished with Federal funds holding in a range from 9 to 10-1/2 per cent, but if we are confronted again with significantly higher than desired growth rates I would be prepared to see a funds rate possibly as high as 11 per cent--provided this was not excessively disruptive to the market. This

further firming would be confirmed, if needed, by subsequent telephone or wire vote. I would like the Manager to be relatively tolerant of a shortfall in the aggregates, avoiding a decline in the funds rate to a level that could be interpreted as a retreat from restraint.

I would be quite willing to accept the specifications proposed by the Chairman, though I would prefer lower ranges for the July-August targets for M_1 and M_2.

The proposed wording of the alternative B directive seems satisfactory.

In the light of the fairly recent discount rate increases and regulatory changes, I would not press for a further immediate increase in the discount rate, but I think we should be prepared to consider a rise in the fairly near future, especially if it would serve a useful purpose in bolstering the impact of Phase IV. I would hope that even-keel considerations would not inhibit action that may be desirable on this front.

With reference to Mr. Hayes' comments about the forthcoming Treasury refunding, Chairman Burns recalled that Mr. Sternlight had suggested that even-keel constraints might be less important in that financing than they had been at times in the past. He asked Mr. Axilrod if he agreed with that evaluation.

Mr. Axilrod replied affirmatively.

Mr. Balles indicated that he would find acceptable the policy specifications outlined earlier by Chairman Burns. Indeed, he could accept any of the three sets of specifications shown in the blue book if there were a reasonable chance of achieving them.

Mr. Balles said he also wanted to address himself to the issue of how to get the monetary aggregates under control. He thought there were many unanswered questions regarding the Committee's procedures. As the members would recall, he had suggested some months

ago that, depending upon the outcome of the staff's appraisal of the RPD experiment, consideration might have to be given to a thorough reexamination of how the Committee formed its directives and instructed the Manager to implement them. The staff paper had indicated that the RPD experiment was inconclusive, largely because the Federal funds range was made too narrow and the RPD range too broad. It seemed to him that one of the unresolved conflicts in the Committee's deliberations was that between the funds rate constraint on the one hand and the monetary aggregate targets on the other. The basis of the difficulty was clear; just as a monopolist could not control both price and quantity, the Federal Reserve could not control both the funds rate and the growth rates of the aggregates. The Committee had spent much time and earnest thought in debating the alternative policy specifications prepared for each meeting by the staff, but those debates often turned out to be more or less academic; indeed, in six of the seven inter-meeting periods during which he had been associated with the Committee, the aggregate targets had been missed by a significant margin.

Mr. Balles said he would now formalize his earlier suggestion by proposing that a Subcommittee of the FOMC be established to undertake a thorough reconsideration of the Committee's procedures for formulating and implementing domestic policy directives. The objective of the study would be to determine how the Committee might

be able to sharpen its methodology and its operating techniques. The study might investigate such questions as whether procedures could be developed for improving the estimates of the multiplier; how to deal with the problem of potential inconsistency in the instructions involving the Federal funds rate on the one hand and growth rates in the aggregates on the other; and whether the Committee should continue to focus on RPD's or use some other measure such as non-borrowed reserves or the monetary base. On the last point, he suspected that the outcome in the first half of 1973 might have been better if the Committee had used the monetary base as an indicator of monetary influence. In any event, it seemed clear that unless the Committee came to grips with such questions, it would probably continue to experience substantial misses in trying to achieve its objectives.

Chairman Burns said he thought Mr. Balles had made a very useful proposal. He asked if other members of the Committee saw any difficulties with it.

Mr. Hayes noted that there had been several studies of a similar nature in the past, some of them lengthy. While he did not oppose a new study, he thought it would be an illusion to expect it to resolve the Committee's difficulties in a short period.

Mr. Holland observed that the proposed study was a major undertaking which was not likely to be completed within a month

or two. Since available staff resources were expected to be under considerable pressure in the period immediately ahead, he wondered if it might not be desirable to delay the start of the study for a few months.

Mr. Sheehan said that, on the basis of budgetary reviews in which he had been engaged recently, he could support Mr. Holland's comment that available staff resources were rather fully employed. Perhaps the study could be carried out under present budgets if some other projects were postponed and if efforts were made to hold down costs.

Mr. Brimmer said he would favor an early undertaking along the lines of Mr. Balles' proposal. He believed the study was of sufficient importance to warrant authorizing additional budgetary expenditures if necessary.

Chairman Burns said he also thought the study should be launched promptly. However, he was confident that it could be carried out without changes in budgets, if the pressures on staff resources were kept in mind and if no rigid deadline was established for its completion.

Mr. Daane concurred, adding that there were enough resources available within the System to do the job needed without raising budgets.

In response to a question by the Chairman, a majority of Committee members and other Reserve Bank Presidents indicated that they favored initiating the study proposed by Mr. Balles in the near future. The Chairman then noted that he would appoint the Subcommittee soon after today's meeting.[1/]

Chairman Burns asked Mr. Partee if he had any views on policy which he would like to put before the Committee.

Mr. Partee said he thought the targets that had been proposed for the monetary aggregates--the longer-term targets associated with alternative B and the July-August ranges associated with C--were reasonable. In his view, the main question facing the Committee today was how to react in the event that the aggregates proved to be stronger or weaker than was anticipated. That is, if the aggregates were coming in above path, how far was the Committee willing to have the funds rate rise? And if the aggregates were falling below path--an outcome he regarded as having a fair probability--how far was it prepared to have the funds rate decline? The B and C specifications for the July-August ranges for the aggregates were not far apart, and the choice between them seemed less important to him than the question of how much latitude should be given to the Manager or to the Chairman in consultation with the Manager with respect to the Federal funds rate. He thought the

1/ On July 19 Chairman Burns designated the following as members of the Subcommittee: Messrs. Balles, Daane, Morris, and Holland (Chairman).

proposed 9 to 11 per cent constraint on the Federal funds rate would probably provide sufficient leeway. However, he could not make that statement with great assurance in light of the experience of recent months when substantially higher than expected funds rates were found to be required in resisting overshoots in the aggregates.

Mr. Francis commented that, as he had indicated earlier, a slowdown in real product appeared to be unavoidable. However, he did not think the slowdown would necessarily develop into a recession in the period ahead. He thought the rate of monetary expansion in recent months had substantially exceeded what would be appropriate under conditions of reduced economic growth, and accordingly his main concern was to slow that expansion. He would be satisfied if the longer-run targets associated with any of the alternatives shown in the blue book were achieved. He was convinced, however, that the 2-month targets were too high to be consistent with the longer-run goals, as had also been the case in other recent months. For example, he did not think the upper limit for M_1 growth in July-August should be set as high as 5 per cent, as indicated under alternative C, given the 6-month growth target of 3-3/4 per cent proposed by the Chairman. Instead, he favored a July-August range for M_1 of 0 to 4 per cent.

Mr. Francis added that he thought the constraints imposed on the Federal funds rate had been primarily responsible for the

substantial overshoots in the monetary aggregates in recent months. In light of the urgent need to reduce the growth of the aggregates, he believed the time had arrived to suspend the funds rate constraint, at least temporarily. The Manager should be allowed to work toward achieving the Committee's goals for the aggregates without being restricted by a specific Federal funds range.

Mr. Francis said his preference for directive language would be alternative C which, in his view, was more indicative of his policy choice than the other alternatives. If the Committee were to embark on the policy course he had in mind, he believed there would be less need for a further increase in reserve requirements and perhaps even in the discount rate.

Mr. Morris commented in reference to the RPD experiment that on a number of occasions in recent months Committee members had concurred in recommendations to raise the upper limit of the range for the Federal funds rate during inter-meeting periods. In his prior experience on the Committee he did not recall any inter-meeting consultations of that nature; the reason they had been held lately was that the Committee was employing guidelines other than the Federal funds rate itself. His conclusion was the RPD experiment had given the Committee a discipline which it had not had before and which had produced a better policy, if not a perfect one.

Chairman Burns remarked that another discipline had been introduced in that the RPD experiment had undergone changes. The target range for RPD's had been narrowed, and that, too, he believed, was proving helpful.

Mr. Morris then said he was convinced that the economy had been in a period of slower growth since the start of the second quarter and that the behavior of the economic indicators was compatible with the longer-term projections presented by the staff. He wanted to call attention to two pieces of evidence not mentioned by the staff. Mr. Partee had reported that the leading indicator series had bounced back in May to its March peak. However, the series calculated on a deflated basis was still one per cent below its earlier high. Another indicator which he had found useful in the past was the vendor performance series in the purchasing agents survey; in June, for the first time this year, the number of purchasing agents reporting slower deliveries had shown a decline. The extent of the decline was small, from an index of 92 to 89, but he was impressed by the fact that there had been a decline at all.

Mr. Morris added that he found it difficult to reconcile the indicators of economic activity with the performance of the monetary aggregates. While there was much that had to be learned about that relationship, he wondered whether it would not be wise at this juncture to hold to the present very restrictive posture of policy. It seemed clear that this was too early to move toward

ease; what concerned him was whether it was not too late to take another sizable step toward restraint. Since there were risks in tightening further, he would prefer to adopt the alternative B specifications with a ceiling of 10-1/2 per cent on the Federal funds rate. He would hesitate to have the funds rate rise to 11 per cent even if the aggregates should run somewhat above path over the next few weeks. In short, he was concerned about making another sizable move toward restraint at this time.

Mr. MacLaury said he thought Mr. Partee had made an excellent presentation today, but he disagreed with Mr. Partee's assessment of the balance of risks for the economy. It was his (Mr. MacLaury's) impression that slackening demands rather than supply constraints were contributing to slower economic growth and he thought the reduction in consumer expenditure estimates for the second quarter tended to confirm his view. He expected more moderation in economic growth over the balance of the year than did the staff at the Minneapolis Bank whose projections were close to those of the Board staff. For example, he anticipated more accumulation of undesired inventories in the second half and a greater slowdown in capital expenditures as the economy moved into 1974.

Mr. MacLaury added that the Committee might be overreacting to the short-run performance of M_1 and the other monetary aggregates in two respects. First, the Committee's problem in achieving its

desired aggregate targets might be due more to a focus on unduly short time periods than to the Federal funds rate constraint. As System officials were accustomed to telling reporters, one should not make too much of the month-to-month fluctuations in M_1. Secondly, the impressions about recent growth rates in M_1 on a quarterly basis were substantially affected by the manner in which the quarterly rates were calculated--by relating the level in the last month of the quarter to that in the last month of the previous quarter. On that basis, M_1 growth rates were 8.6 per cent in the fourth quarter of 1972, 1.7 per cent in the first quarter of 1973, and 10.4 per cent in the second quarter. He preferred to average the observations for all three months in each quarter. On such a basis, growth rates for the same quarters were 7.2, 4.6, and 6.8 per cent, respectively.

Mr. MacLaury said his expectations for the economy and the desirability of avoiding an overreaction to short-run fluctuations in the money supply led him to a policy prescription close to that of Mr. Morris. He would be willing either to maintain the present Federal funds constraint, with an upper limit of 9-3/4 per cent, or adopt the 8-1/2 to 10 per cent range associated with alternative A. In any case, he would disregard the short-run performance of the monetary aggregates on the grounds that the present policy stance, as measured by short-term interest rates, was sufficiently restrictive. He believed the Committee might

have made a mistake in not tightening soon enough during the fall of last year and perhaps during the spring of this year, but he thought the tightening accomplished recently had gone about as far as was desirable. In sum, he did not want to risk overkill by overreacting to short-run movements in the money supply.

Mr. Mayo said he favored the language of alternative B and also all of the specifications associated with that alternative, rather than the specifications proposed by the Chairman. As had been noted, however, there was little real difference between the two sets of targets, given the margins of error. If the alternative B growth target for M_1 of 3-3/4 per cent was achieved in the second half of the year, the growth rate for the year would turn out to be 5 per cent--an outcome he would regard as quite satisfactory. Like Mr. MacLaury, he did not want to overreact to recent developments--developments which were not fully understood--and he believed that adoption of the alternative C specifications would represent an overreaction. It should also be borne in mind that there were lags of uncertain length in the effects of monetary policy.

Mr. Mayo said he would like to reserve judgment on the need to raise the discount rate, pending developments over the next 2 weeks. He believed that if any change were made, it should be made before the announcement of the Treasury financing later this month. In his judgment even keel considerations still deserved some attention even though the financing would be a rather routine refunding of maturing issues.

Mr. Black observed that he had stressed several negative developments in his earlier comments in order to emphasize his view that economic growth had slowed significantly and to underscore his conclusion that there was a real danger of moving to too tight a policy posture. He believed that growth in the aggregates would soon be slowing in view of the significant tightening actions already taken and that the slowdown would prove to be sufficient.

At the same time, Mr. Black continued, he recognized that that outcome was not assured, and that the major problem facing the Committee at the moment was one of confidence. He felt strongly that the Committee had to demonstrate quickly that it was trying to bring the aggregates under control, particularly in light of the attention which the market had been giving to them recently. Accordingly, he would opt for the specifications and the language of alternative B. He would not want to move the upper limit of the Federal funds range up to the alternative C ceiling of 11 per cent at this time, but if the aggregates did not show signs of slowing in the period ahead, he would be prepared to move the rate up to that level before the next meeting.

Mr. Coldwell commented that the main problem at present, which was compounded by the international financial developments discussed earlier today, was the need to get prices under control. He noted that RPD's had expanded at annual rates of 9 per cent in

the past 3 years, 10.6 per cent in the past year, 11.3 per cent in the past 6 months, and 15.8 per cent in June. While he would not want to tighten more than necessary, he thought the rate of growth in RPD's had reached an unacceptable level and that the Committee should seek slower growth and accept the consequences. He favored the specifications suggested by the Chairman. For the directive he preferred Mr. Daane's formulation, but if the Committee was going to adopt one of the alternatives suggested by the staff he would favor alternative B.

With regard to the discount rate, Mr. Coldwell said the Dallas Bank directors would probably be reluctant to raise the rate further at this time. Some directors were concerned because the next increase would bring the rate to a new historical high. He thought their reservations could be overcome, however, if a strong case for a higher rate was made. He wondered, however, whether member bank borrowings could not be held in reasonable check, if necessary, by administrative controls rather than by a discount rate increase.

Mr. Brimmer observed that he favored the alternative B specifications rather than those proposed by the Chairman. In his view the upper limit of 10-1/2 per cent for the Federal funds rate associated with alternative B would provide enough leeway for

operations. It was important to keep in mind that monetary policy exerted its influence with a lag and that a good deal of restraint was already in train.

Mr. Brimmer said he hoped the System would not repeat a mistake it had made in the past, when it had tightened monetary policy after the boom had peaked. At this juncture he was convinced that the outlook was for a slackening in demand, although prices would remain under considerable upward pressure for some time. Accordingly, he thought the Committee should hold essentially to its present policy posture, avoiding another quantum jump toward restraint that might disrupt financial markets and that quite likely would have to be reversed in the relatively near future. He added that since the five-week interval until the next scheduled Committee meeting was somewhat longer than usual, the possibility of a special meeting, perhaps by telephone conference, should be kept in mind in the event that unforeseen developments appeared to make it desirable.

Mr. Sheehan said he concurred in the views expressed by Mr. MacLaury and also had considerable sympathy for those of Messrs. Brimmer and Bucher. It seemed to him that Committee members might be feeling unduly responsible for the present economic situation, since other forces had created the existing problems. In his view both fiscal policy and incomes policy had been inadequate,

and he had misgivings about the coming Phase IV. He hoped that the announcement of the latter would not be accompanied by a statement that controls would be terminated at the end of the year. Such an announcement was likely to conjure up visions of Phase III in the minds of businessmen and one could expect a strong surge in prices when the controls were lifted.

Chairman Burns said he could not be sure about what would be announced, but the current thinking was to end mandatory controls by year-end. He believed, however, that some type of controls would be continued, possibly through wage and price review boards that would oversee oligopolistic pricing situations.

Mr. Sheehan said he expected prices to continue to perform poorly, particularly in the agricultural sector where the pricing situation was almost entirely beyond control because of worldwide shortages. He anticipated a postfreeze bulge in prices which monetary policy could do nothing to avert.

Mr. Sheehan added that he felt monetary policy had been generally appropriate over the past year or so. With the benefit of hindsight, he thought that more restraint might have been applied earlier, but as he had suggested on a number of occasions such a policy could well have precipitated a legislative freeze on interest rates. He certainly would have preferred a slower rate of growth in the aggregates during the second quarter but not if that had

required a Federal funds rate of 15 or 20 per cent. He could not be sure about the impact that so high a funds rate would have had on financial markets, but he suspected that it would have created a panic.

Inflation was a fact of life, Mr. Sheehan remarked, and the issue at the moment was whether monetary policy should finance it or starve the economy and precipitate a recession. Experience suggested that the Government could not permit the kind of recession that might serve to bring inflation under control without giving rise to political pressures that would result in a massive Federal Government deficit. He, for one, did not want to incur the risk associated with a relatively deep recession.

Monetary policy had already tightened a great deal, Mr. Sheehan continued. M_1 had been essentially unchanged over the past several weeks, and the staff was projecting relatively moderate growth in the period ahead. The staff could be wrong, of course, as they had been in the past. However, he did not want to risk an unduly tight policy posture to assure that they would be right. He was very much concerned about the present level of interest rates and the atmosphere in the stock market. The mortgage market was extremely tight. Moreover, banks appeared to be really squeezed; on a recent trip to Atlanta he had been informed by the chief

executive of a leading bank that the bank's lending officers had been instructed to cut the level of their outstanding loans by 10 per cent over the next 3 months. In such circumstances he believed it was time for policy to pause and observe the effects of past tightening actions before going much further. He agreed with Mr. Brimmer that a substantial move toward greater restraint might well have to be reversed relatively soon, and he would be very much concerned about the consequences of such a reversal. He was also concerned about the lags in the effects of monetary policy.

In sum, Mr. Sheehan observed, he favored the specifications of alternative A. He thought the M_1 growth rate for the second half associated with alternative B--3-3/4 per cent--was too restrictive, and he would prefer not to see the Federal funds rate above 10 per cent for any period of time.

Mr. Kimbrel said that he found the recent performance of the aggregates disappointing and he thought their rapid growth was serving to fan the fires of inflationary psychology. He agreed with Mr. Sheehan that the System was not responsible for the current inflation, but nonetheless the System was being given at least part of the blame. Fortunately, the outlook was for a slowdown in the growth of the monetary aggregates in the second half; indeed, the staff at the Atlanta Bank was projecting even more moderation than indicated in the blue book. Such a slowdown would in itself have a

favorable impact on inflationary psychology. On the other hand, reservations were already being expressed about the effectiveness of Phase IV.

Mr. Kimbrel remarked that the System had initiated an almost unprecedented series of restrictive actions in recent weeks, and there had not been sufficient time to gauge their impact. In such circumstances, and contrary to his recent policy views, he felt that this was not an appropriate time for an all-out effort to achieve the Committee's targets for the aggregates. However, Chairman Burns' policy prescription would not be unacceptable to him. He would underscore the point made earlier by Mr. Axilrod that adoption of the 2-month ranges for the aggregates shown under alternative C would expedite the movement toward the longer-run aggregate objectives shown under B. He hoped, however, that such a policy would be implemented with caution, and he would be prepared to reverse course quickly if it became apparent that restriction was being overdone.

Mr. Holland said he thought the economic outlook was unusually clouded at the moment. Nonetheless, he believed the economy was in the early stages of a significant slowdown in its growth rate, and he anticipated only modest growth in 1974. By and large, he believed that that would be a desirable outcome, although he thought the slowdown would be accompanied by relatively large price increases which monetary policy could do little to control.

Mr. Holland remarked that a good deal of restriction had already been built into the financial system as a result of System actions. While monetary policy was sometimes described as exerting its impact with a lag, he wanted to put the matter another way. With the present degree of tension in the nation's monetary machinery, cumulative pressures were building up each week in the financial sector and were being transmitted to the real economy. He found evidence of such a development in the report[1/] prepared at the Dallas Reserve Bank which summarized the latest round of information gathered by the Reserve Banks in their contacts with "aggressive" commercial banks. He was surprised by the extent to which those banks were found to be exercising caution in their lending policies just one month after the first round of contacts. Moreover, the information on bank commitment policies acquired by the System's examiners at the first few banks for which reports were available also supported the notion of a cumulative tightening in the banking system. In addition, growth in M_1 and M_2 had moderated substantially over the past 5 weeks. He agreed that it was hazardous to place too much emphasis on such a short-run development, but at least the recent data tended to support the staff's projection of a slowdown to a much lower rate of expansion in July and August.

1/ A copy of this report, dated July 12, 1973, and entitled "Aggressive Bank Contacts: Follow Up," has been placed in the Committee's files.

Mr. Holland said he favored alternative B. If the aggregates in fact grew in July at their June pace, he would be forced to reexamine his assumptions. Fortunately, however, the procedures the Committee was currently following allowed for that sort of reexamination and for modifying specifications in the interval between scheduled meetings when necessary. He would be highly reluctant today to adopt the specifications suggested by the Chairman, particularly the upper limit of 11 per cent proposed for the Federal funds rate. He would hesitate to see the funds rate rise into the 10 to 11 per cent range except as a result of a deliberate decision taken in light of clear-cut evidence that the monetary aggregates were misbehaving. There should be close consultation between the Chairman and the Manager before the Federal funds rate was permitted to rise above 10 per cent.

Mr. Winn said he was concerned about the loss of confidence in the dollar around the world and he thought it would be unfortunate if the Committee took any action that might suggest the System had given up in its efforts to control inflation. He believed it was important to maintain a restrictive policy even though this country's record to date in curbing inflation was far superior to that in most other parts of the world. He also thought it was very desirable not to give the appearance of easing until fiscal policy was in a somewhat better posture and Phase IV was in place. He expected the announcement

of Phase IV to be followed quickly by a bulge in prices which in turn would give rise to a labor reaction that would add to cost pressures.

Mr. Winn remarked that, while the recent behavior of the monetary aggregates looked good if one ignored the first week of June, the data were not published with such omissions. Some close observers had already concluded that System policy had started to ease because the Federal funds rate had declined a bit from its mid-year highs, and he did not want to give further credence to that view. However, if the more moderate growth in the aggregates of the last few weeks were to continue, he believed the Federal funds rate would pose no problem. For the present he would maintain pressure on the funds rate to make certain the aggregates were under control in the July-August period. He would be happy to achieve the targets associated with any of the blue book alternatives and he would be perfectly comfortable with those of alternative B.

Mr. Willes indicated that he and his associates at the Philadelphia Bank preferred the alternative B specifications. He would be concerned if those targets were exceeded but he also saw risks in pressing too hard on the Federal funds rate to achieve them. As Mr. Brimmer had pointed out, an unduly tight policy posture might well have to be reversed soon with damaging consequences. In sum, he favored alternative B, but in balancing the risks he would do any shading in the direction of A rather than C.

Mr. Clay said he was mainly concerned about inflation, but in light of the prospect for substantial slowing in real economic growth over the next eighteen months, he believed the Committee should maintain about its current policy posture in the period immediately ahead. He saw risks in moving the Federal funds rate substantially in either direction at this time. Alternative B came closest to reflecting his policy choice.

Mr. Bucher noted that he had expressed certain concerns earlier and, incidentally, had been surprised by the number of members who had subsequently voiced similar concerns. He would add at this point that he favored the specifications of alternative A, including the 8-1/2 to 10 per cent range for the Federal funds rate--although he would feel more comfortable if the funds rate did not go above 9-3/4 per cent.

Chairman Burns observed that the Committee had had a full and useful discussion. He believed that the members, with a few exceptions, preferred the longer-run targets for the aggregates associated with alternative B. There was more division of opinion with regard to the specifications for the July-August period, but a clear majority were in favor of those shown under alternative B. As to language for the operational paragraph of the directive, it would be helpful if the members would indicate their preference between alternative B as proposed by the staff and the language Mr. Daane had suggested.

Mr. Daane commented that the language he had proposed was intended to be consistent with the view that the Desk should operate sensitively and guard against a precipitous rise in rates, particularly the Federal funds rate.

In the subsequent poll, a majority of members expressed a preference for the alternative B language.

The Chairman then proposed that the Committee vote on a directive consisting of the staff's drafts of the general paragraphs and alternative B of the operational paragraph, on the understanding that it would be interpreted in accordance with the following specifications. The longer-run targets--that is, the annual rates of growth over the third and fourth quarters combined--would be taken as 3-3/4 per cent for M_1, 4-3/4 per cent for M_2, and 7-1/2 per cent for the credit proxy. The short-run operating ranges--that is, annual rates of growth for the July-August period--would be taken as 11-1/2 to 13-1/2 per cent for RPD's, 3-3/4 to 5-3/4 per cent for M_1, and 4-1/2 to 6-1/2 per cent for M_2. The range of tolerance in the daily-average Federal funds rate for statement weeks in the period until the next meeting would be 9 to 10-1/2 per cent. He indicated that in following developments in the economy, the financial markets, and the aggregates, he might find it desirable to consult with the Committee regarding the possible need to change those specifications prior to the next meeting.

The odds that such consultation might be advisable were higher than usual because of the five-week interval until the next scheduled meeting.

With Mr. Francis dissenting, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions for the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting, including recent developments in industrial production, employment, and retail sales, suggests that growth in economic activity moderated in the second quarter from the exceptionally rapid pace of the two preceding quarters. Increases in employment were relatively substantial, however, and in June the unemployment rate dropped below 5 per cent. Wage rates advanced at a faster pace during the second quarter than earlier in the year. In the months immediately preceding the price freeze imposed in mid-June, the rise in prices of both industrial commodities and farm and food products remained extraordinarily rapid.

The U.S. merchandise trade balance worsened in May as import prices rose sharply further, but the trade deficit remained well below the first-quarter average. In foreign exchange markets, the jointly floating continental European currencies rose sharply further against the dollar in early July. After the first week in July, the dollar recovered somewhat on the basis of market expectations of official intervention. On July 10 the Federal Reserve announced substantial increases in its swap arrangements with other central banks.

Both the narrowly and more broadly defined money stock rose sharply in May and June, although inflows of consumer-type time and savings deposits slackened somewhat in the latter month. Expansion in bank credit continued at a substantial pace. Since mid-June both short- and long-term market interest rates have advanced

considerably further, with the sharpest increases in the short-term sector. On June 29 increases were announced in Federal Reserve discount rates, from 6-1/2 to 7 per cent, and in member bank reserve requirements; on July 5 ceiling interest rates were increased on time and savings deposits at commercial banks and other thrift institutions.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to abatement of inflationary pressures, a more sustainable rate of advance in economic activity, and progress toward equilibrium in the country's balance of payments.

To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with slower growth in monetary aggregates over the months immediately ahead than occurred on average in the first half of the year.

Mr. Francis indicated the he had dissented not because he disagreed with the six-month targets for the aggregates being adopted by the Committee but because he believed that--as had proved to be the case following other recent meetings--the desired growth rates would not be achieved as a consequence of the constraint on the Federal funds rate.

Secretary's note: The specifications agreed upon by the Committee, in the form distributed following the meeting, are appended to this memorandum as Attachment B.

It was agreed that the next meeting of the Committee would be held on August 21, 1973, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

July 16, 1973

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on July 17, 1973

GENERAL PARAGRAPHS

The information reviewed at this meeting, including recent developments in industrial production, employment, and retail sales, suggests that growth in economic activity moderated in the second quarter from the exceptionally rapid pace of the two preceding quarters. Increases in employment were relatively substantial, however, and in June the unemployment rate dropped below 5 per cent. Wage rates advanced at a faster pace during the second quarter than earlier in the year. In the months immediately preceding the price freeze imposed in mid-June, the rise in prices of both industrial commodities and farm and food products remained extraordinarily rapid.

The U.S. merchandise trade balance worsened in May as import prices rose sharply further, but the trade deficit remained well below the first-quarter average. In foreign exchange markets, the jointly floating continental European currencies rose sharply further against the dollar in early July. After the first week in July, the dollar recovered somewhat on the basis of market expectations of official intervention. On July 10 the Federal Reserve announced substantial increases in its swap arrangements with other central banks.

Both the narrowly and more broadly defined money stock rose sharply in May and June, although inflows of consumer-type time and savings deposits slackened somewhat in the latter month. Expansion in bank credit continued at a substantial pace. Since mid-June both short- and long-term market interest rates have advanced considerably further, with the sharpest increases in the short-term sector. On June 29 increases were announced in Federal Reserve discount rates, from 6-1/2 to 7 per cent, and in member bank reserve requirements; on July 5 ceiling interest rates were increased on time and savings deposits at commercial banks and other thrift institutions.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to abatement of inflationary pressures, a more sustainable rate of advance in economic activity, and progress toward equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPHS

Alternative A

To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with somewhat slower growth in monetary aggregates over the months immediately ahead than occurred on average in the first half of the year.

Alternative B

To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with slower growth in monetary aggregates over the months immediately ahead than occurred on average in the first half of the year.

Alternative C

To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with significantly slower growth in monetary aggregates over the months immediately ahead than occurred on average in the first half of the year.

July 17, 1973

Points for FOMC guidance to Manager in implementation of directive		Specifications (As agreed, 7/17/73)
A. Longer-run targets (SAAR): (third and fourth quarters combined)	M_1	3-3/4%
	M_2	4-3/4%
	Proxy	7-1/2%
B. Short-run operating constraints:		
1. Range of tolerance for RPD growth rate (July-Aug. average):		11-1/2 to 13-1/2%
2. Ranges of tolerance for monetary aggregates (July-Aug. average):	M_1	3-3/4 to 5-3/4%
	M_2	4-1/2 to 6-1/2%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		9 to 10-1/2%
4. Federal funds rate to be moved in an orderly way within range of toleration		

5. Other considerations: account to be taken of international and domestic financial market developments and of forthcoming treasury financing.

C. If it appears that the Committee's various operating constraints are proving to be significantly inconsistent in the period between meetings, the Manager is promptly to notify the Chairman, who will then promptly decide whether the situation calls for special Committee action to give supplementary instructions. It was understood that the chances are greater than usual that consultation may be needed in the coming period for various reasons, including the fact that the inter-meeting period is of 5 weeks duration.