MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, October 16, 1973, at 9:30 a.m.

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

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

Messrs. Black and Coldwell, Presidents of the Federal Reserve Banks of Richmond and Dallas, respectively

Mr. Broida, Secretary
Messrs. Altmann and Bernard, Assistant Secretaries
Mr. Guy, Deputy General Counsel
Mr. Nicoll, Assistant General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Andersen, Bryant, Eisenmenger, Reynolds, and Scheld, Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Melnicoff, Deputy Executive Director, Board of Governors
Mr. Feldberg, Secretary to the Board of Governors
Mr. O'Brien, Special Assistant to the Board of Governors
Messrs. Keir, Pierce, Wernick, and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Pizer, Adviser, Division of International Finance, Board of Governors
Mr. Ettin, Assistant Adviser, Division of Research and Statistics, Board of Governors
Mr. Wendel, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Pruitt, Economist, Office of the Secretary, 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

Mr. Strothman, First Vice President, Federal Reserve Bank of Minneapolis
Messrs. Boehne, Doll, and Taylor, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Kansas City, and Atlanta, respectively
Messrs. Hocter, Green, and Sims, Vice Presidents, Federal Reserve Banks of Cleveland, Dallas, and San Francisco, respectively
Messrs. Garvy and Kareken, Economic Advisers, Federal Reserve Banks of New York and Minneapolis, respectively
Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York
Mr. McTeer, Assistant Vice President, Federal Reserve Bank of Richmond

Chairman Burns noted that the staff planned to make a chart presentation on the economic outlook at the November meeting of the Committee. He suggested that, in order to provide adequate time for the presentation and discussion, the Committee plan to meet over a 2-day period, beginning on the afternoon of Monday, November 19.

There was general agreement with the Chairman's suggestion.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee on September 18, 1973, were approved.

The Secretary reported that after distribution of the revised draft of the memorandum of discussion for the September 18 meeting suggestions had been received for three additional corrections of a minor and nonsubstantive nature. He asked whether there would be any objection to incorporating those corrections in the memorandum, and none was heard.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on September 18, 1973, was accepted.

Chairman Burns invited Mr. Daane to report on the recent Annual Meetings of the World Bank and International Monetary Fund in Nairobi, Kenya.

Mr. Daane said he would be quite brief in view of the length of the Committee's agenda today. The Nairobi meetings, which were held during the period September 24-28, had been labeled as "nonmeetings" by some press commentators. In his judgment that was an unfair and inaccurate characterization. As at the many previous Bank-Fund meetings he had attended, the most useful interchanges occurred outside of the formal sessions. In particular, Chairman Burns had held highly constructive conversations with other central bankers, individually and in small groups, and both he and Chairman Burns had participated along with Secretary Shultz in similar discussions with small groups of Finance Ministers. Perhaps the most noteworthy of those discussions occurred at the residence of the Japanese Ambassador to Kenya on the evening of Saturday, September 22, and during the meeting on the following day of the Ministers and Governors of the Committee of Twenty.

Mr. Daane observed that the Ministers' meeting, and also a session of the C-20 Deputies held on Thursday, September 27, were concerned with procedural rather than substantive matters, but they were significant nevertheless. As Secretary Shultz had indicated in a press conference following the Ministers' session, sufficient progress had been made in the work on international monetary reform to adopt a deadline of July 31,

1974, for its completion. That deadline would require an acceleration of the efforts not only of the Deputies but also of the Ministers themselves. In their session on September 27 the Deputies established four technical working groups, to be concerned respectively with the questions of adjustment, settlement and multi-currency intervention, consolidation and global liquidity, and transfer of real resources. Federal Reserve personnel would be participating in those working groups, which had either begun their labors already or would start very soon. The Deputies would be meeting from time to time in the months ahead, and sessions of the Ministers and Governors were tentatively scheduled for January and possibly April. In addition, the Executive Board of the International Monetary Fund was accelerating its work on such topics as the valuation of SDR's, the rules governing their use, a possible new facility in the IMF for developing countries, and questions concerning the quota structure and possible changes in the general account.

In reply to a question by Mr. Morris, Mr. Daane said the July 31 deadline for the work on monetary reform was a serious one which probably would be met. Of course, it was impossible to say at this point what form the agreement might take or how many meetings might be required to reach it.

Chairman Burns expressed the view that the state of the U.S. payments balance would influence the position, the thinking, and the will to agree of the participants in the discussions. He thought the probability of an agreement by the end of July would be quite high if the U.S. balance of payments continued to improve in the interim, but not otherwise.

Mr. Daane said he might add one further comment about the Nairobi meetings, to the effect that much attention was devoted to the question of replenishing the resources of the International Development Association. It was agreed that the donor countries would contribute a total of $4.5 billion. Although the U.S. share was reduced from the 40 per cent figure used at the time of the last replenishment to one-third, the agreement still meant that the United States would be faced with the not-insignificant obligation of $1.5 billion, to be met probably over a 4-year period.

Chairman Burns added that Congressional action on the matter would, of course, be required, and there was some uncertainty about the outcome.

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 September 18 through October 10, 1973, and a supplemental report covering the period October 11 through 15, 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:

> At the time of the September Committee meeting, the exchange markets were being hit by a new speculative wave set off by the revaluation of the Dutch guilder over the previous weekend. Before the week was over, the Common Market central banks had spent nearly $2 billion in defending their respective parities, while the German Federal Bank and the Federal Reserve together had spent nearly $300 million in resisting selling pressure on the dollar. Our share of this total was $156 million, entirely financed by drafts on our swap line with the German Federal Bank, and reflected considerably more forceful intervention than our initial operations undertaken during July. The German authorities also put up much stiffer resistance to pressures on the dollar rate. We think these operations had a dampening influence on market speculation. In any event, selling pressure on the dollar subsided abruptly during the following 2 weeks and we began making small daily purchases of marks against our swap debt whenever market conditions permitted. By Friday, October 5, we had managed to pay down $86 million of such mark debt, leaving a total of $70 million outstanding.
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> Over the following weekend, the outbreak of war in the Middle East resulted in new pressure on the dollar, and by last Wednesday the dollar had declined by slightly more than 1 per cent against the mark. That same day, the resignation of Vice President Agnew threatened still further selling pressure. After consulting with the Chairman, we conducted our heaviest market operation to date, putting 100 million marks (or roughly $41 million) in the market within ten

minutes time. $21 million of our offerings were immediately taken up, thereby increasing our swap debt in marks from $70 to $91 million. The dollar stabilized the rest of that day and recovered the following day, and it has subsequently held firm around the level of 2.4 marks to the dollar. The market probably has a fairly firm expectation that both the System and the German Federal Bank will put in an appearance if the rate slips much below the current level, and this could have some stabilizing effect.

Meanwhile, we have been continuing to buy Belgian francs in the market and have even stepped up the pace somewhat. As of this morning, we have paid down our Belgian franc debt to $285 million, as compared with $390 million outstanding last July and a peak of $635 million at the time the gold window was closed in August 1971. Our recent purchases of Belgian francs have been facilitated by a temporary weakness of the Belgian franc against the Dutch guilder. In this situation, the Belgian central bank probably felt that our market purchases of Belgian francs helped to reduce their own intervention needs against the Dutch guilder. We have been expecting, however, that this situation could change abruptly, and so it has today. The Belgian franc--partly in response to Middle East pressures--has strengthened very sharply, and this morning the Belgian central bank has asked us to suspend our market purchases for the time being. We have agreed to do so, but will take advantage of the earliest opportunity to go back into the market again.

Looking back over the last few months during which we have been intervening or were prepared to intervene, the earlier volatility of exchange rates on the dollar has gradually settled down to a much more stable and orderly pattern of daily fluctuation. As speculation against the dollar gained momentum last June, the daily-average spread between the high and low quotation on the mark, for example, rose to more than 1 per cent during the last week of June. During the first week of July, the spread widened still further to nearly 3 per cent. With that sort of spread, it was understandable that toward the end of that week New York banks

simply stopped offering quotations on the mark. However, following our resumption of exchange operations on July 10, the spread narrowed to 1-1/4 per cent over the rest of the month. In August the spread contracted still further to seven-eighths of a per cent and in September to one-half of a per cent, and so far in October it has been running at about one-quarter of a per cent. I believe the market has stood up very well to the Middle East developments and other events. While long-term confidence has not been restored, the market is at least showing a fair degree of resistance to new shocks.

Mr. Daane asked about the factors that accounted for the resilience of foreign exchange markets during the current period of turmoil. In particular, he wondered whether the market's resilience could be attributed to the improvement in the U.S. balance of payments and expectations of further improvement.

Mr. Coombs replied that, as Mr. Daane had suggested, recent trends and expectations for U.S. trade and payments had been a fundamental force in helping to stabilize the exchange markets; in effect, participants continued to believe that the dollar was undervalued and was more likely to go up than down. In addition, however, the demonstrated readiness of the German Federal Bank and the Federal Reserve to intervene to avoid sharp swings in the mark-dollar exchange rate had been helpful. The view that the dollar was undervalued had been widespread in June and July, but in the absence of central bank intervention then, traders had been concerned about the risk of sharp dips

in the dollar rate. Now they had more confidence that any temporary declines would not be large.

Mr. Daane asked whether the recent shifts in international interest rate relationships posed any threat to exchange market stability.

Mr. Coombs replied that in his judgment the decline in U.S. short-term interest rates that had occurred thus far had done little or no damage to the dollar; indeed, it might have had a beneficial effect by stimulating a rise in U.S. stock prices and thereby attracting foreign investment in the U.S. equity market. On the other hand, it should be noted that European interest rates had shown no tendency to decline; if anything, they had been under upward pressure in recent weeks. It seemed obvious that if U.S. rates continued to fall relative to those in Europe, at some point the growing gap would begin to have disturbing effects on the exchange market. He was thinking not simply of the interest arbitrage opportunities that would emerge but of the more fundamental effects on market confidence. Many Europeans would no doubt interpret continuing declines in U.S. interest rates as an indication that this country was not willing to deal forcefully with inflation, and they would draw inferences about international price relationships in the longer run. It was worth noting that the troublesome consequences of such interpretations would be greatly

magnified if the rate declines were accompanied by a significant easing of current U.S. restraints on short-term capital outflows.

Chairman Burns said he might supplement Mr. Coombs' response with the observation that, while inflation had been proceeding at a disconcerting rate in the United States, the realization was growing both here and abroad that the inflation rate was faster still in other industrial countries.

Mr. Daane referred to Mr. Coombs' comments about the relationship between U.S. interest rates and those in Europe, and asked whether the Special Manager had in mind the relationship with rates in the Euro-dollar market or in domestic markets of individual European countries.

Mr. Coombs replied that he was thinking of the latter. When domestic rates in a European country rose sharply--as had occurred, for example, in Germany during the July credit squeeze--there was a clear-cut tendency for the dollar to weaken in the exchange market, to a degree dependent on the size of the spread that was opened, the speed of the movement, and psychological factors that were more difficult to assess. In contrast, a rise in Euro-dollar rates was likely to strengthen the position of the dollar.

Mr. Brimmer asked about the prospects for reducing the System's outstanding Swiss franc swap debt to the Swiss National Bank and the Bank for International Settlements.

In reply, Mr. Coombs observed that it was the informed opinion of Swiss monetary officials that the exchange rate for the Swiss franc had been abnormally high recently. So long as the rate remained at such levels, System purchases of Swiss francs for debt repayment purposes were more likely to do harm than good--quite apart from involving a waste of money, since the francs were likely to be available at a lower cost later on. It probably would take no more than a few months of good U.S. trade figures to lead to a change in market sentiment and a decline in the Swiss franc rate. At that point, the System might begin to acquire Swiss francs at about the pace it had recently been purchasing Belgian francs.

Mr. Brimmer then said he might report that on the basis of recent inter-agency discussions he thought there might well be some liberalization of the U.S. capital controls program before long, despite resistance by Federal Reserve participants in those discussions. Chairman Burns remarked that he was not sure Mr. Brimmer's pessimism was fully warranted.

By unanimous vote, the System open market transactions in foreign currencies during the period September 18 through October 15, 1973, were approved, ratified, and confirmed.

Mr. Coombs noted that a number of System swap drawings would be maturing for the ninth time in the period from November 2 through November 16. They included six drawings, totaling $230 million, on the National Bank of Belgium; two drawings, totaling $565 million, on the Swiss National Bank; and one Swiss franc drawing of $600 million on the BIS. Although there might be opportunities to pay down some of the drawings, he would recommend renewals of any still outstanding at maturity. Since the swap lines in question had been in continuous use for more than a year, specific authorization by the Committee was required for renewal under the provisions of paragraph 1(D) of the Authorization for foreign currency operations.

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 November 2-16, 1973, was authorized.

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 rather general recent declines in market interest rates, along with the surprisingly sluggish behavior of the monetary aggregates, raise the question of whether the outlook for the economy may be weaker than the staff has been projecting. A careful review of the incoming economic data, however, seems to me to provide very little evidence in support of that possibility. Some of the recent statistics, including those on retail sales and inventory accumulation, are weaker than we had expected. But other information, including first reports on capital spending plans for 1974 and prospective additions to income flows stemming from fiscal actions, point in a strengthening direction. All in all, our view is that moderate economic growth will persist for some time to come and that the prospects, if anything, are for slightly more real expansion than we had been anticipating earlier.

What is apparent from the data is that the economy currently is running at close to a "flat-out" rate. Industrial production rebounded in September, as expected, and the capacity utilization rate in our index of major materials industries is estimated to have averaged slightly above 96 per cent in the third quarter--a new high for this series. The red book 1/ and other sources report long lists of materials and components in short supply, and delivery lead-times for many items are said to be the longest in many years. The unavailability of critical materials and components may well be limiting desired increases in production schedules. It may also be limiting additions to work forces; manufacturing employment showed no further gain from June to September, while the average factory workweek--which can be adjusted more flexibly to changes in supply--rebounded over the quarter to about its earlier high for the year.

The evidence then, suggests that output can be expanded only gradually from this point on, as additional supplies and capacity become available. This is so even though the over-all unemployment rate, at 4.8 per cent, remains a good deal higher than at other business cycle peaks. Fortunately, it appears that

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

the expansion in demand has also moderated. Consumption has been sluggish for some months now, particularly in real terms, and housing starts are moving sharply downward. We expect that both of these tendencies will continue--consumption limited by the squeeze that high food prices are putting on family budgets, by the earlier extraordinarily high levels of buying, and by the marked deterioration in consumer sentiment indicated by recent surveys; housing starts by sharply higher interest rates, reduced credit availability, and the ample supply of new units that has been coming onto the market. Housing starts are now projected to decline to about a 1.6 million annual rate by next spring, and consumer purchases of durable goods are expected to be falling slightly in real terms over the months to come.

Other demands on the economy, on the other hand, are likely to be strengthening still for a considerable period. Initial private surveys of business capital spending plans for 1974 show gains of 12 to 15 per cent, with disproportionate increases in manufacturing where capacity limitations have been most evident. Given these survey results, and with order backlogs for business equipment continuing to grow, we have raised somewhat our projections of business fixed investment through mid-1974. Net export demand seems likely to remain very strong also, assuming continuation of the economic boom abroad and anything like the present exchange rate relationships. The principal limitation on exports appears to be the shortage of supplies--the availability of which should improve with record harvests of crops, gradual additions here to industrial capacity, and slower growth in domestic demand.

In addition, some rebuilding of domestic inventory positions seems highly probable as supply conditions permit. Inventory investment has run consistently below our expectations thus far this year. But with widespread reports of inventory shortages hampering output and sales, and with ratios of stocks to sales and to backlogs generally the lowest in many years, this must reflect mainly the unavailability of supplies rather than lack of demand. Under the circumstances, businessmen are likely to rebuild their

Chairman Burns asked whether the members had any questions of a kind that would help the Committee evaluate the economic outlook and determine monetary policy.

Mr. Kimbrel asked whether the staff had given much weight in its projections to the possible implications for defense spending of shipments of war materiel to Israel in connection with the current Mid-East hostilities.

Mr. Partee replied in the negative. Such shipments could result in higher defense spending, depending on such matters as how they were financed, but on the basis of the information available to him at this point he would not consider them to be of major significance for the U.S. economy. On the other hand, a cut-off of Arab oil exports to the United States would have major implications for the domestic situation in the coming winter.

Chairman Burns said he thought the outbreak of war in the Mid-East had more significance for defense spending than Mr. Partee had suggested. The volume of supplies being shipped to Israel out of U.S. military inventories was substantial. Moreover, there no longer was any likelihood that the Administration's defense budget would be cut by $5 billion--a reduction for which there had been considerable Congressional

stocks as a slower expansion in final demands provides room for them to do so. The increases in inventory investment that we have projected are moderate in relation to the expansion that has taken place in sales. Such a buildup would be largely voluntary in character and could be substantially larger if there should be a cyclical period of involuntary accumulation.

I would regard the economy at this point in time, therefore, as showing considerable underlying strength rather than developing weakness. A slowing in the growth of final domestic demand seems now to be well in progress, but rising exports and inventory investment should take up much of the slack between sales and potential output as and when such slack begins to develop. In this kind of environment, inflationary pressures will surely remain strong. Persisting shortages in the basic materials-producing industries will make possible upward adjustments in prices to reflect increases in costs and to take advantage of any easing in Phase IV price restraints. With labor markets continuing generally strong, moreover, wage demands are likely to intensify and unit labor costs to rise at an accelerating rate.

We will be looking into these relationships more closely before the next meeting of the Committee, at which time we will present an updated chart show projection of economic prospects for 1974. Clearly, though, the situation today is not one in which public policy can afford to relax its guard. There is very little available slack to accommodate any new upsurge in demand, and inflationary pressures (aside from special supply factors) are probably still on the rise. At the same time, it must be recognized that real growth has been at a more moderate--and acceptable--rate for two quarters now, and that the prospects are for continued moderate--and probably somewhat slower--growth in the next several quarters ahead. There is in this prospect some risk that final demands could turn too weak, that business and investor attitudes could sour, and that the economy could inadvertently be pushed into recession. In my view, the time has not yet come for any easing in policy, but we do need to be sure that we are providing enough monetary support to facilitate a continued moderate upward tilt in over-all economic activity.

sentiment before the hostilities began. Indeed, it was reasonable to assume that the Administration would now ask for larger defense appropriations.

Mr. Mitchell said he would be interested in any assessments Chairman Burns or Mr. Partee might care to offer of the business forecasts being made by other analysts. He gathered from news reports that at the recent meeting of the Business Council, which the Chairman had attended, the economic consultants present had indicated that they expected at least a recession in growth. Other projections he had seen recently suggested that the forecasters were now pretty much on the fence, a position which Mr. Partee also seemed to occupy. Was that a fair description of the posture of most econometric and judgmental forecasters?

In reply, Mr. Partee said it appeared that the projections now being developed by econometric techniques were in most cases weaker than those obtained by judgmental methods. That certainly was the case in the projections made at the Board. Of the various reasons for that difference, one was the great difficulty encountered in econometric projections--and in judgmental forecasts also--of taking appropriate account of the recent wild gyrations in prices, which were without precedent in modern economic experience. Another was the

difficulty of taking account of the quantum change in export demand that had resulted from movements in exchange rates of a magnitude unprecedented in the postwar period. Later this week he would be participating in a meeting of the country's main judgmental forecasters; in advance of that meeting, it was his impression that most of them anticipated a continuation of positive but low growth rates in real output through 1974.

Chairman Burns said he shared that impression. In addition, although he had no detailed evidence on the matter, it was his impression that business economists in general were now more sanguine about the economic outlook for 1974 than they had been 2 or 3 months ago.

Mr. Mayo asked whether it had been assumed in the staff's projections that Phase IV would remain in place in the near term, and whether the particular assumption made on that score mattered much; perhaps it mattered so little that the difference would fall within the margin of error of the projections.

In reply, Mr. Partee said it had been assumed that Phase IV would continue through the winter, although its effectiveness was likely to be steadily eroded. If the controls were, in fact, lifted--and they might well be, in view of the very serious administrative problems that were developing--

there would be at least some instances in which price increases would be larger than otherwise, and adjustments would occur more rapidly in tight supply-demand situations. On balance, however, the easiest answer to the second question was that the difference would probably fall within the margin of error.

Mr. Hayes remarked that in his view the economy was still dominated by demand pressures, widespread shortages, and severe inflation. As he had interpreted Mr. Partee's statement, the latter shared that view, and was not--as Mr. Mitchell had suggested--on the fence with respect to the economic outlook.

In response to the Chairman's request for a clarification of his position, Mr. Partee said he felt more comfortable than he had a few months ago with projections suggesting that increases in demand in the period ahead would be no more than moderate. He also was aware, however, that there was not much unused capacity available, so that moderate increases in demand were the most that could be accommodated. Therefore, an unexpected surge in demand--such as might arise out of the situation in the Mid-East--would pose very real dangers for the economy. On the whole, he was more concerned about that possibility than about the risk that the economy might be a little weaker than projected.

Mr. Hayes observed that he agreed with that view. In his judgment it would be premature at this time for the Committee to shift the main focus of its concern from inflation to the possibility of deficient demand. It was necessary, of course, to remain alert to any signs of developing weakness in the economy, but the costs of responding prematurely to fragmentary--and probably false--signals of weakness could be very high. To his mind, the balance at present was rather clearly in the direction of economic strain and inflationary tendencies.

Mr. Coldwell asked whether the staff had taken account of the possibility of international monetary disturbances in its projections.

Mr. Partee replied in the negative. The projections of net exports had been based on the assumptions that near-boom conditions in major industrial countries abroad, would persist through the forecast period, and that there would be no substantial increases or decreases in exchange rates for the dollar.

Mr. Winn said it was his impression that recent wage settlements involved substantial cost increases, particularly after allowance was made for the pension benefit provisions. He asked whether Mr. Partee agreed.

In reply, Mr. Partee observed that it often was highly difficult to get an accurate assessment of the total cost of wage and fringe benefits provided for in a labor contract. In the case of the recent Chrysler-UAW settlement, for example, many observers had expressed the view that the increase in labor costs over the 3-year contract period would prove considerably greater than 7 per cent per year, the figure estimated by the company. There were possibilities of cost underestimates in connection with the so-called "30-and-out" provision which permitted retirement after 30 years of service regardless of age, and also in connection with the cost-of-living escalator provision if inadequate allowance had been made for increases in consumer prices over the contract period. For the private nonfarm economy as a whole, the index of hourly earnings--which was adjusted for interindustry shifts and for overtime in manufacturing--suggested that a pick-up in earnings was under way, particularly in manufacturing. In general, he believed that the coming period would be characterized by larger increases in wages and total compensation of workers, and thus by larger increases in unit labor costs, than had been the case in the past.

Mr. Eastburn said it was his impression that forecasters typically tended to underestimate the extent of downturns in the

economy. Accordingly, the fact that the staff's econometric projection was weaker than its judgmental forecast might be highly significant. He asked Mr. Partee to elaborate on the reasons for the difference.

Mr. Partee replied that the principal difference was that the projection of personal consumption expenditures was lower in the econometric than in the judgmental projection--mainly because the former included a substantial wealth effect on spending, and the net worth of consumers was shown to be declining over the projection period. The econometric projection generated long-term interest rates rising throughout 1974 to a level close to 9 per cent in the latter part of the year, given growth in M_1 at a rate of about 5 per cent. If long-term rates were instead assumed to level off in the neighborhood of 8-1/4 per cent, which the judgmental forecasters thought was likely, the wealth effect would be smaller and the econometric model would yield consumption estimates roughly similar to those of the judgmental projection. The two sets of estimates also would be approximately the same if the rate of growth of M_1 assumed in the econometric projection was raised by about one percentage point, from a little over 5 to a little over 6 per cent. A preliminary review of the judgmental projection suggested that the figures for consumption expenditures on nondurable goods might be a bit high, but in view of the substantial price increases for such goods that was not certain.

Moreover, it was quite possible that the judgmental projection of plant and equipment spending was on the low side.

Mr. Partee added that the staff would be exploring such questions in detail in preparing for the presentation on the outlook planned for the November meeting of the Committee. At the moment it appeared that the differences could be accounted for by the normal range of error in the econometric projection and the manner in which the equations of the model were formulated.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period September 18 through October 10, 1973, and a supplemental report covering the period October 11 through 15, 1973. Copies of both reports have been placed in the files of the Committee.

Mr. Holmes said that in the interest of time he would summarize the statement he had prepared for today's meeting. He then summarized the following statement:

Since the September 18 meeting of the Committee, short-term interest rates have declined sharply as market participants have sensed an easing in Federal Reserve policy. In yesterday's regular Treasury bill auction average rates of 7.19 and 7.24 per cent were established for 3- and 6-month bills, both down about

160 basis points from the rates established just before the September meeting. The movement of short rates has not exactly been smooth, as the market has been trying to outguess Federal Reserve actions and expectations have at times outpaced reality. The 3-month bill, for example, decreased to just under 7 per cent in late September, rebounded to about 7.60 per cent, and then fell again to the current level. Other short rates--including the rate paid by banks on CD's--have also declined, and to many market observers it appears only a matter of time before the prime rate at major banks will also be cut.

Longer-term rates also declined as dealers covered short positions and investor and bank demand pressed against limited supply. In the Treasury market, intermediate-term rates declined by about 1/2 of a percentage point, while long-term rates were down by 1/4 to 3/8 of a percentage point. In this atmosphere, a large volume of new Federal agency financing was absorbed by the market with only a minimum of friction. The corporate and municipal bond market also benefited from the change in interest rate expectations, but to a lesser degree as calendars began to build up.

As you know, the monetary aggregates have been quite weak over the period, falling below the Committee's range of tolerance in late September. As a result Desk operations have been aimed at a more liberal supply of reserves, with an intensification of that effort following both the October 2 and the October 10 telephone conference meetings of the Committee.

Results were hard to achieve early in the period, and the Federal funds rate persisted at about the 10-3/4 per cent level, despite a large supply of reserves from System operations. There were several reasons for this persistence of undesired money market tightness. First of all, banks, anticipating lower rates ahead and anxious to avoid higher marginal reserve requirements, tended to shift away from the CD market and to rely more heavily on Federal funds purchases. Secondly, banks tended to use a substantial portion of the nonborrowed reserves supplied by open market operations to repay borrowings at the discount window. As a result borrowing was generally

below the level that had been assumed appropriate for the general stance of monetary policy. Third, there were a number of unanticipated shortfalls in reserves caused by factors beyond our control. I recall vividly the day when we had pumped $1.5 billion in reserves in the market only to find the next morning that the action had been almost entirely offset by a $1.3 billion drain from an unexpected decline in float and a higher than expected Treasury balance.

Reserve projections have, in fact, been something of a problem throughout the period. A supply of reserves $900 million greater than anticipated over the long Columbus Day weekend contributed to the sharp easing of the money market in the statement week ending last Wednesday. And, on that day, with the Federal funds rate plunging towards zero, we absorbed $1.4 billion through matched sale-purchase transactions only to find the next morning that the action had been more than offset by an unexpected $1.7 billion bulge in float. That, incidentally, is the largest daily miss in the projections that I can recall.

Finally, operations were complicated by the volatile state of the securities market, with market participants eager to pounce on--and overinterpret--any move by the Desk. In this atmosphere, it was helpful to have an availability of bills from foreign accounts, since they could be purchased without any visibility in the market. All in all, in a very active period, outright purchases of Treasury bills totaled about $1.7 billion, of which about half were made in the market. In addition, the Desk made close to $9 billion repurchase agreements and nearly $7 billion matched sale-purchase agreements.

In any event, although results were slow in coming, the Federal funds rate has finally come into line with the Committee's desires, averaging just over 10 per cent so far this week after dipping to 9.87 per cent last week. And the market, while still edgy, has tended to perform a little more consistently than it did earlier in the period.

The Treasury, as you know, will be announcing the terms of its November refunding a week from tomorrow. The System holds $438 million of the $4.3 billion outstanding November 15 maturities and I would

plan to exchange them for the new issues offered by the Treasury in line with expected public subscriptions. The market seems generally receptive to the financing, and the Treasury has a number of options open to it. As far as cash needs are concerned, some additional borrowing seems called for in early November and additional cash could be raised in the November refunding. The debt ceiling--which must be extended in any case by the end of November--could become something of a problem before that date and could be a constraint on the Treasury's ability to raise cash. And I am sure we will all be watching with interest the progress of legislation extending the System's authority to lend directly to the Treasury.

With the Treasury financing near at hand it would probably be desirable to establish whatever reserve approach the Committee decides on today, and the associated money market conditions, as early in the period as possible. While even keel considerations are not likely to preclude subsequent moves, they could be something of an inhibiting factor.

In recent meetings, particularly in the two telephone meetings, the Committee has been paying a great deal of attention to the Federal funds rate. There has also, apparently, been some difference in interpretation by Committee members of the specifications adopted at the regular September meeting. It would be most helpful to the Desk if the Committee would make it clear whether the full range of tolerance that the Committee adopts for the Federal funds rate is to be used depending on where RPD's and the aggregates are falling with respect to their own ranges.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period September 18 through October 15, 1973, were approved, ratified, and confirmed.

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

The alternatives presented for consideration today indicate that the staff expects the Federal funds rate to decline further over the near term if the Committee wishes to move M_1 back either to a 5-1/4 per cent longer-run growth path or even to a somewhat slower 4-1/2 per cent path. The principal reason for such an expectation is that the sharp short-term interest rate increases of earlier this year (until mid-September) are still exerting a cumulative restraining effect on money demand--at least this is what our various econometric models indicate, and experience of the past few months seems consistent. Thus, some moderate backing off from highly restrictive credit market conditions appears likely in the process of working toward moderate growth in the aggregates.

One issue the Committee will probably want to consider is how large a decline, if any, of the whole interest rate structure should be permitted in the weeks ahead. In relation to that question it might be useful first briefly to analyze recent short-term interest rate movements and their relation to both expectations and credit demands.

As you are well aware, a couple of weeks ago short-term interest rates in general, and the 3-month Treasury bill rate in particular, were dropping sharply while the Federal funds rate remained unchanged. In large part, expectations of an easing in monetary policy were the cause of this divergence between the funds rate and other short-term rates. It was reported that many banks appeared to prefer, for a while, overnight borrowing to 2- or 3-month borrowing in the CD market, and the public may have temporarily accelerated the normal movement of cash flows into short-term market instruments so as to be invested ahead of declining rates. But another important factor that exerted downward pressure on short-term rates as a whole was an apparent moderation of short-term credit demands in September, as indicated by slower growth in short-term loans to business at banks and in the open market combined and by a substantial decline in outstanding loans to dealers.

When expectations distort the rate structure, it is clear that no one rate provides sufficient evidence as to the underlying demand-supply situation. Thus, the high funds rate of late September probably overstated the degree of restraint, while the relatively low bill rate probably overstated the degree of ease. But, while expectations were affecting rate relationships, the weakened credit demands of the last few weeks were tending to bring the whole short-term rate structure down.

Given the downward impact on interest rates of more moderate credit demands, the Federal funds rate would not have been able to remain high unless open market operations kept reserve availability tight relative to demand. In view of the reduced demands for credit, the demand for bank reserves was clearly weakening, and by early October conditions of reserve availability eased--as indicated by a drop in member bank borrowings and a decline in the Federal funds rate toward 10 per cent. This very modest easing in conditions of reserve availability and decline in the funds rate forestalled, in my judgment, a sizable reversal in other short-term rates.

Reserves were not, however, supplied in sufficient quantity to prevent the outstanding money stock from declining in the short run. If they had been, interest rates would, of course, have declined more sharply than the Committee wished, and possibly by more than needed to attain longer-run monetary growth targets, given lagged effects.

I believe two conclusions about the desirable extent of interest rate declines are illustrated by the recent experience. First, if demands for credit moderate, the Committee probably should not take any significant countervailing action against tendencies for interest rates to decline. If a pre-determined growth path for money and reserves is adhered to, the decline in rates will happen naturally. On the other hand, if the System is following a particular interest rate policy, this may in practice involve too high a Federal funds rate constraint and prevent adequate expansion in reserves if credit and money demands weaken enough, as was the case--at least to some extent--in the past few weeks.

A second conclusion, however, is that expectational forces can bring short-term rates below levels that are justified in relation to long-run monetary growth targets, always assuming that staff economic projections are reasonably close to the mark. Such expectational interest rate declines perhaps might be at least partly offset if a speculatively low rate level somehow were to persist for a sustained period. In that case, the low rate could possibly be promoting more monetary expansion later than is desired and could risk overexposed positions or commitments by dealers or lending institutions.

It is, of course, most difficult to disentangle expectational and credit demand effects in practice. Perhaps the safest of the many unsatisfactory ways available for handling this problem is to use the behavior of money supply as one important clue for policy response to interest rate changes. For example, given the 10 per cent increase in nominal GNP projected for the fourth quarter, it is reasonable soon to expect a renewed increase in demand for M_1. We have indicated under alternative B in the blue book 1/ that M_1 might grow by about 5 per cent in November accompanied by some further modest easing in the funds rate. If reasonable M_1 growth is not in fact resumed under the circumstances, I would not be quick to interpret any possible accompanying sharp decline in interest rates generally--with the 3-month bill rate, for example, dropping below about 6-1/2 per cent--as an expectational phenomenon. I would be more inclined to assume that fundamental credit demands are continuing weak and therefore that the decline in rates should not be restrained.

If, however, M_1 is in fact growing moderately and the bill rate drops that far, I would be more inclined to assume an expectational distortion of the rate structure and would make an effort to temper or reverse the decline to minimize the risk of promoting undue monetary ease. A strong M_1 growth in the month ahead would probably rule out interest rate declines, and in fact might require some increase in rates to temper demands, unless the Committee wished to move

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

> rather promptly onto a long-run path more like alternative A or even stronger. Assuming only the aggregates of alternative B, we would in any event expect any near-term decline in interest rates to be reversed by year-end if the economy expands as projected.
>
> I believe that this line of argument suggests that the clause in the directive 1/ instructing the Manager to take account of developments in financial markets should become operative in a significant way only if the incoming data indicate resumption of monetary growth at least at a moderate rate, particularly given the recent shortfalls in growth that have occurred.

Mr. Balles referred to the Manager's question as to whether the full range of tolerance the Committee adopted for the Federal funds rate was to be used. He asked why Mr. Holmes had thought that the lower part of the 9-3/4 to 10-3/4 per cent range established for the funds rate at the September 18 meeting had not been available for use in the recent period.

Mr. Holmes replied that the decisions taken at the two recent telephone conference meetings had suggested to him that the Committee was particularly concerned about the level of the funds rate under present circumstances. As the members would recall, at the time of the October 2 conference the projections of monetary aggregate growth rates were below the lower ends of the ranges the Committee had specified. However, the members had decided in that conference that the Desk should aim at conditions consistent with a funds rate of 10-1/2 per cent, which was well above the 9-3/4 per cent lower limit specified

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

earlier. At the October 10 conference, when the aggregates had appeared weaker still, the decision had been to seek conditions consistent with a funds rate of 10-1/4 per cent and, if new data on the aggregates confirmed the indications of weakness, to move down to 10 per cent.

After some further discussion, Chairman Burns suggested that the Committee concern itself with the future rather than dwell on the past.

Mr. Coldwell asked whether Mr. Axilrod thought that disintermediation was a significant factor in the recent weakness of M_1.

Mr. Axilrod replied affirmatively. He noted, however, that in recent weeks M_1 had fallen short of projections in which specific allowance had been made for that factor. Short-term credit demands appeared to be weaker than the staff had anticipated at the time of the September meeting, and that development--together with System operations that had the effect of maintaining prevailing interest rate levels--was probably more significant than disintermediation in explaining the latest shortfalls.

Mr. Coldwell asked whether the recent weakness in business loan demand at banks could be explained in terms of

the high cost of bank credit relative to other sources, such as the commercial paper market, or whether it might also reflect shortages of goods and consequently reduced needs for loans to finance inventories.

Mr. Axilrod replied that some of the weakness of bank loans was clearly attributable to shifts by borrowers to the commercial paper market. It was also clear, however, that growth in aggregate business credit demands had slowed. Thus, the sum of outstanding business loans at banks and of dealer-placed commercial paper had increased at a 10 per cent annual rate in September, after growing at an average rate of about 20 per cent in the preceding 4 months. It might well be that part of the moderation was due to scarcities of goods, as Mr. Coldwell had suggested.

Chairman Burns noted that in his comments on the moderation in loan growth Mr. Axilrod had stressed demand considerations. He wondered whether supply considerations were not also relevant, particularly since he had been hearing from bankers that they were rationing credit more severely than earlier.

Mr. Axilrod replied that credit rationing at banks no doubt accounted for part of the shift of borrowers to the commercial paper market. However, supplies of funds in that

market did not appear to be particularly constrained; in fact, interest rates on commercial paper had been declining recently.

Mr. Daane said it had been his impression at the time of the two telephone conference meetings that the market was extremely sensitive to changes in the Federal funds rate. Indeed, it was on that account that he--and he believed other members also--had not favored moving the funds rate down to the lower end of the range that had been adopted at the September 18 meeting. He suspected that after the rate fluctuations of the recent period the market was less sensitive now than it had been earlier, and he wondered whether the Manager agreed. In particular, he wondered whether the market would be likely to overreact to actions by the System to reduce the funds rate to, say, 8-3/4 per cent, which was the lower limit of the range shown under alternative B in the blue book.

Mr. Holmes replied that a reduction of the funds rate to the neighborhood of 8-3/4 per cent probably would lead to a market reaction. He agreed, however, that the market had become less sensitive, and he thought a smaller reduction would not involve the kind of risks that it would have earlier. As he had noted in his statement, while the market was still edgy it was tending to perform a little more consistently. It was interesting to note in that connection that the major market

reaction shortly after the September 18 meeting of the Committee had been set off by a System purchase of $75 million of Treasury bills. Since then, however, substantially larger operations had been carried out without producing a similar reaction.

Mr. Morris said the Committee might be interested in a recent comment by the investment officer of a large Boston-based insurance company, since it was relevant to the question of likely credit demands. The official indicated that his company had long-term funds available for take-down in 1974 and 1975, but it was finding that users of such funds were reluctant to undertake commitments now for a period that far ahead. He (Mr. Morris) did not know how general that situation was, but he had been surprised to learn that the company in question was not already fully committed at least through 1974.

In reply to a question by Mr. Black, Mr. Morris said he thought the reluctance of the borrowers in question apparently reflected both expectations that long-term rates might decline and uncertainties about the wisdom of proceeding with real investments.

Mr. Hayes said he had been aware of similar sentiment in the New York market for a time. Recently, however, there had been increasing comment to the effect that long-term credit demands were likely to pick up rather materially in 1974.

Chairman Burns remarked that it would be useful to determine whether the experience of New York insurance companies was similar to that Mr. Morris had reported for the Boston firm.

Mr. Brimmer asked whether difficulties had been produced for the Desk in its efforts to achieve the Committee's objectives either by the somewhat more restrictive administration of the discount window or by the continuation of rather high marginal reserve requirements on CD's.

In reply, Mr. Holmes said that the current posture at the discount window had resulted in a lower level of borrowing; as he had noted in his statement, borrowing had been below the level thought consistent with the current stance of monetary policy. While the Desk consequently had to be much more liberal than otherwise in supplying nonborrowed reserves, that had not been an insurmountable problem. The level of marginal reserve requirements was one of the factors causing banks to shift from CD's to the funds market. In his judgment, however, the shift was not a permanent one, and in any case the other factor underlying the shift--expectations of lower interest rates--was probably far more important.

Mr. Mitchell asked why Mr. Axilrod thought that the declines in interest rates anticipated under alternative B were likely to be reversed by year end.

In reply, Mr. Axilrod said he might first note that--according to the econometric models, at least--the degree of tightness that had developed during the summer was inconsistent with the longer-run growth rates in the monetary aggregates sought by the Committee. Accordingly, some easing was now needed if those growth rates were to be attained. However, if GNP expanded at the projected rate, credit demands were likely to pick up in November and December, and that would put some upward pressure on interest rates.

Mr. Mitchell asked whether there might not be some middle course that would permit a gradual transition to the desired growth rates for the aggregates without involving a zig-zag pattern for interest rates.

Mr. Axilrod replied that a more gradual transition would preclude attainment of the alternative A or B level of M_1 by March 1974, if the econometric models were to be believed. There was a high degree of uncertainty about the nature of the relationships involved, and the implications of the models might well be wrong. But if weakness in M_1 did persist through the first quarter of 1974, he would expect some effects on the rate of growth in GNP.

Chairman Burns suggested that before beginning its discussion of policy the Committee dispose of certain other

matters listed for discussion on the agenda for today's meeting, beginning with the semi-annual review of the authority to lend securities from the System Open Market Account. He asked Mr. Holmes to comment.[1/]

Mr. Holmes said he might briefly summarize his memorandum, which was largely self-explanatory. Delivery failures had increased in the last 6 months, reflecting a shortage of securities available from other lenders, light dealer inventories, and some fairly hectic trading days. The 40 per cent increase in dollar volume of System lending had helped keep the situation from deteriorating even more. On the technical side, repayment experience continued to be good and the operation continued to be a profitable one. Other efforts were under way to solve the failure problem and the Desk had been working with the dealers to that end.

On the basis of the experience of the past 6 months, Mr. Holmes continued, System lending of securities continued in his view to be reasonably necessary to the effective functioning of the market and hence to the effective conduct of System open market operations. He recommended that the Committee

1/ Memoranda on this subject from the System Account Manager and the Committee's General Counsel, dated October 11, 1973, had been distributed on October 12. Copies of these memoranda have been placed in the Committee's files.

renew the authority for the lending of securities, which was contained in paragraph 3 of the authorization for domestic open market operations, for at least a further 6-month period.

Mr. Holmes added that some time ago the Association of Primary Dealers in Government Securities had proposed to the Joint Treasury-Federal Reserve Study Group of the Government securities market a liberalization and extension of official lending. The Committee should be receiving two staff memoranda on that subject shortly--one prepared by the Board staff and one at the Trading Desk.

The Chairman asked if there were any objections to renewing the authority in question, and none was heard.

> It was agreed that the authorization for the lending of Government securities from the System Open Market Account should be retained at this time.

The Chairman asked Mr. Broida to comment on the matter of the Committee's 1974 meeting schedule.

Mr. Broida noted that at its September meeting the Committee had briefly considered a tentative meeting schedule for 1974 set forth in a memorandum from the Secretariat dated September 11, 1973.1/ The matter had been deferred, however,

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1/ A copy of the document referred to has been placed in the Committee's files.

after Mr. Daane had raised a question about possible conflicts with the recently adopted schedule of Basle meetings for the period through mid-1974. It was subsequently determined that one of the proposed FOMC meeting dates would conflict with a Basle meeting. However, the Secretariat believed--and Mr. Daane agreed--that the kinds of changes in the proposed FOMC schedule that would be needed to avoid that conflict would involve disadvantages that outweighed the gain.

After discussion, it was agreed that the tentative schedule proposed in the memorandum of September 11 was satisfactory.

The Chairman then noted that a report by the Subcommittee on Policy Records, dated October 11, 1973, had been distributed on October 12.1/ As the members would recall, the Subcommittee--which consisted of Messrs. Brimmer, Daane (Chairman), Mayo, and Morris--had been appointed last June to try to develop for consideration by the Board and the Committee a consensus on the question of how much, if any, quantitative information should be contained in the description in the policy record of the Committee's policy decisions. He had originally hoped that the matter could be discussed at last evening's dinner meeting of Board members and Presidents, but that had been precluded by

1/ A copy of the document referred to has been placed in the Committee's files.

the need to consider more pressing matters then. The subject was one which undoubtedly would require considerable discussion, and he did not believe there would be time for that discussion today since the Committee had yet to consider the question of current policy.

Mr. Hayes noted that some members had not received the Subcommittee's report until yesterday and had not yet had time to review it. That offered another reason for deferring the discussion.

Mr. Daane said he also would favor postponing the discussion. He hoped, however, that the delay would not be very long, since the nature of the decisions reached would have implications for the manner in which the recent telephone meetings of the Committee were reported in the record.

Chairman Burns said that it might be possible to consider the policy record question during the planned Monday afternoon session of the November Committee meeting, or perhaps in a dinner meeting of Board members and Presidents on that day if one were held.

The Chairman then proposed that the Committee turn to its discussion of the economic situation and outlook and of the appropriate direction for monetary policy in the period immediately ahead. As he saw the current situation, the Committee's

position was good. The monetary aggregates had been brought under control, and growth so far in 1973 was now quite moderate. The tightening that had occurred from the standpoint of the aggregates had been accompanied by a slight easing in interest rates. There was danger, however, that the recent shortfall of the monetary aggregates from the longer-run targets would persist. While the Committee should be prepared to move in either direction as warranted by developing conditions, at the moment he believed the shortfall in the aggregates required its attention.

Mr. Francis observed that alternative B might offer the best framework for policy in the interval until the next meeting of the Committee. He would like to see growth in the aggregates returned to the longer-run targets that had been specified at the previous meeting--namely, annual rates of 4.5, 6, and 6.5 per cent for M_1, M_2, and the bank credit proxy, respectively. To accomplish that objective, in his view, ranges of tolerance for the October-November period would have to be raised somewhat from those shown under alternative B in the blue book. In effect, growth in M_1 in the fourth quarter should be stepped up sufficiently to assure that over the fourth and first quarters combined the growth rate would average about 4-1/2 per cent. He continued to believe that emphasis on the Federal funds rate should be reduced. If the Committee specified any range for the

funds rate, it should be a wide one, in order to provide the Manager with sufficient scope to accomplish the Committee's objectives for the aggregates. With respect to language for the operational paragraph of the directive, he preferred alternative C to B because the former was more specific and because it described essentially what he wanted to achieve.

Mr. Eastburn remarked that while the Committee had believed at its September meeting that it was easing policy, it turned out--at least as far as the behavior of the aggregates was concerned--that policy had in fact been tightened. Moreover, if M_1 remained on a growth path of around 4-1/2 per cent through March 1974, instead of returning to a path of 5-1/4 per cent, some real economic growth would be lost and the unemployment rate would be raised. Projections made at the Philadelphia Bank suggested that in 1974 the loss in real growth would amount to 0.6 of a percentage point and the increment in the unemployment rate would be 0.3 of a percentage point.

Mr. Eastburn observed that those considerations led him to favor alternative A. Although he understood the concern some members might feel about the possible impact of such a policy on markets for short-term securities, a review of the past suggested that fairly large declines in the funds rate and in other short-term rates over a period of about a month could be tolerated

without undue effects. However, a decline in the funds rate to 8 per cent--the lower end of the range specified under alternative A--would be too abrupt. He would like to see the Desk permit the rate to move down gradually--perhaps by 25 basis points each week, and more if feasible--to foster a return in M_1 growth to the 5-1/4 per cent path as soon as possible.

Mr. Hayes observed that there were important conflicts in the considerations bearing on monetary policy at this point. The recent slowing in the monetary aggregates, taken alone, suggested that a significant change in policy was called for. On the other hand, conditions in the real economy pointed decisively to the need for maintaining firm restraint, and international financial conditions also provided grounds for concern about easing. He regretted that market observers were now fairly well convinced that a substantial easing was in progress.

Mr. Hayes said that in his judgment it would be better to accept another month or so of very slow growth in the monetary aggregates rather than risk the adverse consequences of a clearly visible movement toward further easing. The growth rates of the aggregates measured over the past 6 and 12 months were quite satisfactory, and the declines that had already occurred in short-term interest rates, including the Federal funds rate, should have a stimulating effect on the future

behavior of the aggregates. While he recognized that the staff projections suggested that growth in the aggregates would fall short of the Committee's targets in the absence of further easing, he was impressed by the fallibility of such projections and would not want them to be the controlling factor. For the time being, at least, easing had gone far enough.

Mr. Hayes remarked that the longer-term targets for growth in the monetary aggregates shown under alternative B were acceptable to him. He would give only secondary consideration to the near-term growth rates. Whether one liked it or not, to a considerable extent the Federal funds rate had come to symbolize monetary policy in the minds of market observers, and he would want the Desk to proceed extremely cautiously in reducing that rate for the purpose of stimulating monetary growth. He favored the range of tolerance for the funds rate of alternative C--9-1/2 to 10-1/2 per cent--except that he would not want the rate to fall appreciably below 10 per cent unless the aggregates showed extraordinary weakness. As for directive language, he could accept either alternative B or C.

Mr. Mayo noted that the anticipated bulge in agricultural credit demands which he had mentioned at recent meetings had not yet developed, at least in the Seventh District, and it was possible that for tax reasons it would not develop until after the end

of the calendar year. A surge in credit demands still lay ahead, however, and it was necessary for the Committee to be watchful on that score.

As to policy, Mr. Mayo said he agreed completely that a posture of monetary restraint should be continued. Within such a posture, however, he thought it would be appropriate for the Desk to gently accommodate declines in the funds rate--perhaps by a quarter of a percentage point per week, as Mr. Eastburn had proposed. He favored the alternative B directive language and specifications, including the 8-3/4 to 10-1/4 per cent range shown for the funds rate under that alternative. He believed that the market was a little less sensitive now than it had been earlier to movements in the funds rate and that it could accommodate slightly lower rates. Finally, he had been highly gratified by the way in which the Desk had performed during the past 2 weeks. He was thinking not of the specific outcome for the funds rate or other variables, but rather of the general philosophical approach to operations. The Manager should be commended for that performance.

Mr. Kimbrel said he continued to be disturbed by the rate of inflation. He had hoped that some restrictive pressure might be applied through fiscal policy, but that was less likely now that events had reduced the chances of a cutback in military

expenditures. As to monetary policy, he would favor moving cautiously to a posture of somewhat less restraint. The language and specifications of alternative B best represented his ideas.

Mr. Coldwell remarked that he could be quite brief because Mr. Hayes had already expressed many of his own views. He favored maintaining bank reserve and money market conditions in the neighborhood of the averages prevailing during the past few weeks, encouraging neither declines nor advances in market rates. In particular, he would like to see the funds rate centered around 9-3/4 per cent, in a range of 9-1/4 to 10-1/4 per cent, and he certainly hoped it would neither go below 9 nor above 10-1/2 per cent. He continued to believe that under current circumstances the figures for M_1 were unstable and unpredictable, and he had strong doubts that the recent negative figures for M_1 growth reflected accurately the existing degree of monetary restraint.

Mr. Morris said he thought it would be wise at this point for the Federal Reserve to use monetary policy flexibly. The immediate goal should be to spur growth in the monetary aggregates. He wanted to pursue that goal not only because he believed it was the correct policy but also because the credibility of the System might turn on its attainment. Market participants

and the public at large had been assured, through statements by the Chairman and in other ways, that the Federal Reserve would not permit the monetary aggregates to contract for a prolonged period, and he was concerned about the possible reactions to a failure to make good on that commitment.

Against that background, Mr. Morris continued, he favored alternative A today. For the short run, he would instruct the Manager to move the Federal funds rate down to 9 per cent as promptly as possible. There would be some risk that that course would have to be modified or reversed within a fairly short period, should the economy prove to be stronger than suggested by current projections. He would be willing to accept that risk because he believed the greater risk lay in proceeding so cautiously toward stimulation of the aggregates that their growth would fall short of desired rates for an extended period.

Finally, Mr. Morris observed, he would like to comment on the clause in recent directives which instructed the Desk to take account of "international and domestic financial market developments." That clause had caused some problems in the weeks since the September meeting because individual Committee members had placed different interpretations on it. Moreover, it appeared that clauses of that kind were given different meanings when interest rates were rising and when they were falling. As

a member of the Subcommittee on the Directive, he planned to propose to his colleagues on that Subcommittee that it give early attention to the problem of establishing some common body of meaning for such clauses.

Chairman Burns said he thought Mr. Morris' comment on the directive clause was well taken. He then suggested that the Committee's Senior Economist be asked for his policy recommendation at this point.

Mr. Partee observed that the Committee faced a difficult decision today. He was inclined to agree with Mr. Morris on the necessity of getting the monetary aggregates growing again. The staff was projecting that over the current quarter and the first two quarters of 1974 nominal GNP would expand at an annual rate of 9 per cent but that real GNP would rise at only a 3 per cent rate. Continuing low growth rates in the monetary aggregates would create great tensions if spending proceeded at a pace consistent with nominal GNP growth at a 9 per cent rate, and those tensions could jeopardize the prospects for real economic growth in both the first and second halves of 1974. The aggregates had been running increasingly below the desired path recently, in contrast to the experience in the spring when they were above path. Just as the Committee had been prepared earlier in the year to have interest rates rise as it resisted excessive

monetary growth, it should now be prepared to let them decline as it resisted tendencies toward inadequate growth. He now felt a greater sense of urgency about the need to achieve moderate--not large--growth in the aggregates than he had 1 or 2 months ago, and in order to attain that end he thought the Committee would have to accept the risk of prolonging what might eventually prove to have been a mistaken rally in securities markets.

Mr. Partee suggested that if the Committee agreed today to move toward a resumption of growth in the monetary aggregates, it might still find it unnecessary to devote a great deal of attention to the question of the appropriate longer-run growth path for money. At the moment, M_1 was rather far below both the 5-1/4 per cent growth path the Committee had been pursuing for most of the year and the 4-1/2 per cent path it had adopted at the September meeting for the period through March 1974. Detailed consideration of the appropriate longer-run monetary growth path might best be postponed until the November meeting, when the staff would be presenting a chart show on the economic outlook.

With respect to the blue book alternatives, Mr. Partee remarked, the specifications shown under alternative B struck him as reasonable at this point. However, he was a little concerned about the low ranges shown under that alternative for

growth in M_1 and M_2 over the October-November period. As Mr. Coldwell had noted, the money stock figures were rather unpredictable, and it was quite possible that the actual growth rates would be higher than indicated. To avoid suggesting that the Desk should aim in that event for tighter conditions, the Committee might want to raise somewhat the upper limits of the ranges it specified for those 2-month growth rates.

Mr. Sheehan said there was some question in his mind as to whether the Committee was holding to the game plan it had decided upon under the experiment with the aggregates it had launched in early 1972. It had certainly permitted the Federal funds rate and other interest rates to rise earlier this year when the aggregates had been growing at excessive rates. In recent months, however, when the aggregates had slowed dramatically, the Committee had been hesitant to let the funds rate move down to the extent necessary to achieve the desired growth. The Committee had begun to focus on the funds rate, perhaps because--as Mr. Hayes had suggested--the market itself focused on that rate as a symbol of System policy.

Chairman Burns observed that while many market participants used the funds rate as such a symbol, many others had begun to watch closely the growth rates of the aggregates in an effort to assess the likely course of interest rates.

Mr. Sheehan commented that that no doubt was the result of System statements about its policy. In any case, until the Committee decided after full consideration to pursue some different approach, he thought it should hold to the approach it had adopted in early 1972. He agreed with Mr. Partee that it would be desirable at this point to concentrate on growth rates in the aggregates in the near term. He would be a bit troubled by the adoption of the longer-run targets shown under alternative A, particularly the 6-1/2 per cent growth rate shown for M_1. However, the alternative A growth rates for October-November seemed quite reasonable to him. He favored the alternative B language for the directive.

Mr. Bucher said he shared the Chairman's concern about the dangers that would be involved in a persistence of shortfalls in the aggregates, and he agreed with Mr. Sheehan's views about the desirability of holding to the approach the Committee had adopted early last year. Also, he would like to second Mr. Morris' comments about the risks that continued shortfalls would pose for the System's credibility and his suggestion that the Subcommittee on the Directive should try to clarify the meaning of instructions to take account of financial market conditions.

Mr. Bucher remarked that he still had sympathy for the longer-run targets for the aggregates the Committee had agreed

upon at other recent meetings, and he would hope that the members would keep those targets in mind as ultimate goals. At the same time, he agreed with Mr. Partee that it would be wise to concentrate on the immediate future at this point. In that regard, his first inclination had been toward the specifications shown under alternative A. Like Mr. Eastburn, however, he was uneasy about the possible disruptive effects of a decline in the funds rate to 8 per cent, the lower limit of the alternative A range, at this time. Accordingly, he would favor the October-November ranges for the aggregates of alternative A but the funds rate range of alternative B. And he would want to make it clear to the Manager that he was free to use the entire range specified for the funds rate--8-3/4 to 10-1/4 per cent--if necessary to achieve the objectives indicated for the aggregates.

Mr. Balles observed that he was in essential agreement with the staff's economic projections. It obviously would be inappropriate to undertake a substantial easing of policy at a time like the present, when prices were soaring and commodity and labor markets were tight. But it also would be inappropriate to move toward substantial further restraint in view of the outlook for a considerable slowing in real economic growth next year. If the Committee permitted the weakness of the monetary

aggregates to persist in the months ahead it would, in fact, be following a policy course that was more restrictive than desirable or intended. Mr. Hayes had called attention to one element of the Committee's dilemma--that market participants used the Federal funds rate as a symbol of the System's policy stance. As the Chairman had observed, however, many participants looked to the monetary aggregates for policy signals. There was evidence for that in the opening sentence of a recent Business Week article, which said that the System was charged by its critics "first with bringing on today's inflation by creating too much money and now with threatening to bring on a recession in 1974 by creating too little."

In sum, Mr. Balles continued, he considered it urgent to get the monetary aggregates back on the growth track the Committee had agreed upon earlier, in order to avoid becoming more restrictive than had been intended. And he hoped that the Desk, in its effort to achieve the Committee's targets for the aggregates, would feel free to use all of whatever range was adopted for the Federal funds rate. His own inclination was toward the specifications of alternative B, with one possible exception: in view of the importance of getting the aggregates to grow again, he would not have any strong objections to the alternative A range of 8 to 10 per cent for the funds rate.

Mr. Holland remarked that, after the policy adjustments it had made at the September meeting and in the two subsequent telephone conferences, the Committee was now well launched on a "mid-course correction" as it adapted to the economic transition in progress. To continue that correction, he would favor the specifications of alternative B with two modifications. First, he would raise the upper end of the October-November range for M_1 by one percentage point--yielding a range of 1 to 4 per cent--to allow a bit more elbow room for a recovery in M_1, should it develop. Secondly, he would raise the lower end of the range for the Federal funds rate by a quarter of a point, yielding a range of 9 to 10-1/4 per cent. While he was not necessarily opposed to a decline in the funds rate below 9 per cent in the coming period, he thought such an event would have a significant effect on market psychology. Accordingly, it would be desirable for the Committee to review the matter if it developed that a funds rate of 9 per cent or above was inconsistent with the targets for the aggregates.

Mr. Holland noted that the Manager had asked for guidance regarding the possible use of the full range the Committee set for the funds rate. His own feeling was that market conditions had now settled down enough to warrant a return to the usual understanding as to how the Desk would operate under the ranges

specified by the Committee. He would describe that understanding as follows: if the growth rates in the aggregates appeared to be close to or at the lower or upper end of their ranges, the Desk should permit the funds rate to move down or up in its range; and if the growth rates in the aggregates appeared to be below the lower end or above the upper end of their ranges, the funds rate should be permitted to decline to the bottom or rise to the top of its range. It was also understood that the Manager would notify the Chairman if he thought serious inconsistencies were developing, and that the Chairman would decide whether the situation warranted consultation with the Committee. Finally, within those guidelines, there was a fairly large area within which the Manager, in consultation with the Chairman, was expected to exercise his own discretion.

Mr. Black observed that some cogent comments had been made at recent Committee meetings about the effect that recent changes in Regulation Q and the imposition of marginal reserve requirements on CD's had had on the meaning of particular growth rates in the monetary aggregates. In addition, Mr. Axilrod today had offered an excellent commentary on the role that expectations were currently playing in influencing market interest rates. Putting those two kinds of considerations together, it obviously was unusually difficult at present to assess the prevailing relationships between interest rates and growth rates in the aggregates.

Mr. Black said he suspected that the economy was stronger than widely believed and, as a result, that interest rates might well be moving up again soon. He would be rather reluctant to press actively for lower interest rates now partly because of the possibility that subsequent increases would result in a whipsaw pattern. In addition, he was concerned about the effects of domestic rate declines on the international position of the dollar. At the same time, he would be disturbed if M_1 were to decline in October for the third successive month; however the meaning of that series might have changed, he thought it was imperative that growth resume. He favored the specifications of alternative B, modified in the two respects proposed by Mr. Holland.

Mr. Mitchell remarked that he would have no difficulty in accepting the specifications of alternative B. He could also accept the modifications Mr. Holland had suggested, although he did not feel as strongly as the latter did about a 9 per cent lower limit for the Federal funds rate. In his judgment, the primary objective should be to get a resumption of growth in M_1, and if results were not being achieved rather fast he would expect the funds rate to be moved down to 9 per cent and not permitted to hover around the midpoint of its range.

Mr. Mitchell said he had given some thought to the language of the operational paragraph of the directive in

connection with the earlier expectation that the Committee would be discussing the report of the Subcommittee on Policy Records today. He noted that alternative B, like the directive the Committee had adopted in September, called for "bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead." In his judgment, that statement was so close to meaningless as to expose the Committee to very serious criticism. It could be argued, of course, that the specifications approved by the Committee were not meaningless. However, that raised the question of whether the specifications or the broad language of the directive described the Committee's policy stance.

Mr. Mitchell went on to say that the language of alternative A was better than that of B because it was a little more forthright. It could be made still more forthright, however, if it were modified to indicate that the Committee's primary objective at this point was to achieve a resumption of growth in M_1.

In a concluding observation, Mr. Mitchell noted that transactions, as measured by debits to demand deposits outside of New York, had increased by 30 per cent over the year ending in August. Demand deposits themselves rose by only about 6 per cent in that period, so that turnover increased by 22 per cent.

Turnover obviously offered the main source of flexibility in the system. Given that flexibility, the particular rate at which the money stock grew was not of overriding importance.

Mr. Winn said he was more concerned with stabilizing economic activity and employment than with interest rates and growth rates in the monetary aggregates, and he was not persuaded that there were fixed relationships between the former and the latter. One cause of instability in the relationships was the "fluff" introduced by borrowing to lend rather than to spend. Such fluff seemed to have been declining recently.

Mr. Winn remarked that he was disturbed about the possibility of an increase in defense spending and the implications that would have for aggregate demands. In view of likely demand pressures, as well as price and cost pressures, he thought the Committee should maintain a stable posture for policy at this time. The specifications of alternative B seemed to be more or less consistent with that objective.

Mr. Daane observed that he agreed with the assessment of the economic outlook Mr. Partee had presented in his statement earlier today, including his characterization of the present situation as "showing considerable underlying strength rather than developing weakness," and his observations that "There is very little available slack to accommodate any new upsurge in

demand" and that "inflationary pressures are probably still on the rise." He also had no quarrel with Mr. Partee's conclusion in that statement that "the time has not yet come for any easing in policy," but that it was necessary to insure that the System was providing sufficient monetary support.

However, Mr. Daane continued, he parted company from Mr. Partee when the latter, in his more specific subsequent comments on policy, interpreted the provision of "sufficient monetary support" solely in terms of stimulating growth in M_1. Personally, he would take as his point of departure the Chairman's observation that the Committee's position was now good, and he subscribed fully to Mr. Winn's view that the best course at the moment was to maintain a stable posture. Market participants had concluded that the Federal Reserve had eased a bit, and he would not want to disabuse them of that view. At the same time, he would work strenuously to avoid any indication now that the System was moving aggressively toward further ease, whatever the behavior of the aggregates. He was sufficiently skeptical of the economic significance of short-run fluctuations in M_1 to remain unpersuaded of the need to go all out to restore growth. It seemed to him that when the Committee placed great stress on short-run fluctations in M_1--and on quarter-point changes in the funds rate--it was putting itself in a straitjacket, and he would be much happier if it did not do so.

Mr. Daane said he would favor the language of alternative B because it was essentially unchanged from the September directive. He could accept the specifications of B also, but only with reluctance. He would be particularly reluctant to authorize the Desk to use the full range indicated for the funds rate; certainly, he would not want to have overt actions undertaken to move the rate down to the 8-3/4 per cent lower limit of the B range. In response to his earlier question about the degree of sensitivity of the market, the Manager had expressed the view that such a course probably would lead to a market reaction. There were two other reasons for the Committee to raise the floor for the funds rate and for the Desk to proceed extremely cautiously in lowering that rate. First, recent international developments and movements in interest rates abroad suggested that the dollar was once again vulnerable in the exchange markets. Secondly, the Treasury would shortly be undertaking a regular quarterly financing, and even keel considerations were of greater significance for such operations than for intervening short-term financings.

Mr. Daane observed that such considerations led him to the view that the System should probe cautiously at this point. He was not indifferent to the movement of the aggregates; he thought they would begin to grow again whether or not the funds rate declined to the lower limit of alternative B. And it was

important to avoid any indication that the System was rushing precipitously down the road to ease at this juncture, when inflationary pressures were still on the rise.

Mr. Brimmer remarked that there was one advantage to speaking this late in the Committee's discussion: much of what he would want to say had already been said by others. While there also had been some comments with which he disagreed strongly, he would take the time to note only one--Mr. Mitchell's suggestion that the Committee state explicitly in its directive that it was seeking a resumption of growth in M_1. He preferred to continue the past practice of describing the objectives for the monetary aggregates in more general terms.

Mr. Brimmer added that he agreed with Mr. Partee and Mr. Winn about the economic outlook and would not offer detailed comments on that subject. He did believe that the key problem facing the Federal Reserve at this juncture remained one of helping to combat inflation, and that the time had not yet arrived at which the System should hasten to shift gears on the assumption that its main task was to avoid a recession. As to the experiment the Committee had under way, it seemed to him that market participants were interpreting its implications too well. He might note, incidentally, that the experiment had never been formulated exclusively in terms of achieving desired rates of

growth in the aggregates. From the beginning it had involved giving consideration as well to interest rates and money market conditions, and he was not prepared at this time to abandon such considerations.

Mr. Brimmer said he concurred in the view that the Committee was now in a good position and should hold to it. He had been pleased with the press reports regarding the reaction to Chairman Burns' comments on monetary policy at the recent meeting of the Business Council; it appeared that the market had gotten the message that caution was needed in interpreting the System's recent policy actions. He would not want to undo that, and therefore he would consider it unfortunate if the Desk were to press for a sharp reduction in the funds rate. On the whole, Mr. Holland's proposal struck him as reasonable. While he did not feel strongly about the difference between 3 and 4 per cent for the 2-month growth rate in M_1, he did favor setting the lower limit for the funds rate at 9 per cent. In short, his preference was for alternative B as modified by Mr. Holland, and he would encourage the Manager to exercise caution in using the range specified for the funds rate.

Mr. Strothman observed that the economic outlook as described in the green book[1/] and by Mr. Partee today certainly could not be characterized as dismal. Moreover, if one credited

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

the expectations about business fixed investment now current in some quarters, the outlook might be more bullish than the staff projections suggested.

On the whole, Mr. Strothman continued, he considered the specifications shown under alternative B--particularly the range for the October-November growth rate in M_1--to be consistent with the economic outlook. Like others, however, he thought the Desk should be cautious in moving the funds rate downward, and he would prefer that it not be reduced below 9-1/4 per cent.

Mr. Clay expressed the view that inflation continued to be the main problem. While there were signs suggesting a weakening in the economy at some point, that did not appear to be imminent, and if the System moved too rapidly toward ease it would magnify the problem of inflation. Accordingly, he would prefer a very gradual approach toward easing money market conditions over the next few weeks. Such a move probably had already been discounted by financial markets, so it should not result in unstable conditions. He favored both the language and specifications of alternative B.

Chairman Burns said he would make a comment or two at this point and then offer some specific suggestions for consideration by the Committee. He had taken the view consistently

in recent months that talk about an impending recession was entirely premature. He continued to hold that view; in fact, his feeling had been strengthened recently because he was now quite sure that Federal expenditures--which had appeared earlier to be under reasonably good control--would rise quite sharply, largely but not entirely for military reasons. He was definitely of the opinion that inflation remained the main economic problem facing the country.

At the same time, the Chairman continued, he was deeply concerned about the risk that the shortfall in the monetary aggregates would continue. Looking back over the recent past, the record was quite good; M_1 had grown at a 5.4 per cent rate over the 12 months ending in September 1973, and at a rate slightly over 4 per cent from December 1972 to September 1973. Looking forward, he considered it imperative for the sake of the System's credibility that growth in the money stock resume, since Federal Reserve officials repeatedly had said publicly that the System would maintain moderate growth in the monetary aggregates and would avoid a credit crunch.

With respect to today's policy decision, Chairman Burns remarked, most of the members had expressed a preference for some variant of alternative B. While there might be some sympathy for Mr. Mitchell's criticism of the alternative B

language for the operational paragraph of the directive, he would suggest that the Committee not shift at this time to the type of language Mr. Mitchell had proposed. As to the longer-run targets for growth in monetary aggregates, he would suggest adopting the rates shown under alternative B in the blue book. With respect to the October-November ranges of tolerance for the aggregates, he thought the members would agree on the desirability of raising somewhat--perhaps by one percentage point--the upper limits of the ranges shown under B. Otherwise, the Desk would be obliged to begin tightening if M_1, for example, appeared to be growing at a rate in the neighborhood of 3 per cent.

Turning to the specifications for the Federal funds rate, the Chairman noted that there had been a number of comments on the question of whether the Desk should feel free to use all of whatever range the Committee specified. Personally, he saw no point in specifying some range unless all of it was to be available for use; if the alternative B range was considered too wide, some narrower range should be adopted. By specifying a range it was prepared to see employed, the Committee would avoid problems of interpretation on that score and would make the task of the Desk easier. At this point, he thought a figure of 9-1/4 per cent would be realistic for the lower limit of the funds rate range, in place of the 8-3/4 per cent figure shown

under alternative B in the blue book. If in the coming inter-meeting period the funds rate declined to that limit and the aggregates were growing too slowly or declining, he would call for a reconsideration.

Mr. Sheehan observed that a 9-1/4 per cent floor for the funds rate struck him as rather high, given the objectives for growth in the aggregates. He asked whether the staff would consider specifications along the lines described by the Chairman to be internally consistent.

Mr. Axilrod replied that the specifications shown in the blue book reflected the staff's best judgment concerning the relationships that were likely to prove consistent. While the precise figures had frequently proved to be off the mark, the general directions of change indicated had usually proved to be correct. Obviously, the staff would believe that a modification of one specification--such as an increase in the lower limit of the funds rate range--would reduce the chances that the set of specifications would prove consistent.

However, Mr. Axilrod continued, the Chairman's proposal involved another change from the blue book ranges--increasing the upper limits for October-November growth rates in the aggregates. If the Committee desired to permit, although not necessarily to seek, growth in the aggregates at rates somewhat above

the upper end of the blue book ranges, it would seem quite reasonable for it to raise the lower end of the range for the funds rate. The latter action would signify an intent to permit somewhat more rapid growth in the aggregates should it develop in response to demand forces, but not to encourage such growth by actively pressing market rates down sharply.

Mr. Sheehan then said he was concerned about a possible repetition of the experience in the period following the September meeting. In that period the Committee had been content to let the funds rate remain well above the lower limit of the range it had set in September even though the growth rates in the aggregates were below the lower ends of their ranges.

Chairman Burns noted that he had suggested adopting a range for the funds rate that was realistic and that was intended to be fully available for use. He might add that he would expect to lose no time in communicating with the Committee if the specifications proved to be seriously inconsistent and the aggregates were behaving in a disappointing manner.

Mr. Brimmer noted that inconsistencies had developed in the specifications adopted in September very soon after the meeting date. Assuming the Committee agreed to the specifications the Chairman had suggested, he wondered whether the Manager would expect a similar development this time, and whether he would anticipate any other problems in operating under such specifications.

Mr. Holmes replied that it was never possible to say with confidence how particular specifications would work out in practice, and it was quite possible that problems would develop in the coming period. At the moment, he saw no reason for anticipating special difficulties or for expecting inconsistencies to emerge as quickly as they had in September.

Mr. Mayo asked whether the Desk would be expected to permit the funds rate to stay at a level of, say, 10 per cent for a week or so while awaiting the information on the aggregates that would become available in that period.

Chairman Burns replied in the negative. He noted that there would be new information on the aggregates later in the current week which the Manager would be expected to take into account.

Mr. Holmes said he assumed the Committee would want him to permit the funds rate to shade down slightly, perhaps to 9-3/4 per cent, even if estimates of the growth rates in the aggregates were at the midpoint of the ranges specified.

Mr. Mayo remarked that such a course would be acceptable to him, but that he could not speak for the rest of the Committee.

The Chairman expressed the view that the Committee, which was a policy-making body, should not attempt to lay out instructions in such fine detail that it was, in effect, performing the Manager's job. While from time to time individual

members may have been unhappy with the way the Manager interpreted particular instructions, he thought all members would agree that, by and large, he had done extremely well in implementing the Committee's decisions.

Mr. Daane said he would certainly agree that the Committee should not try to do the Manager's job. With respect to the proposed specifications, he found 9-1/4 per cent much more to his liking as a floor for the Federal funds rate than either 8-3/4 or 9 per cent. Taking the specifications as a whole, the Committee would, in effect, be saying that it was willing to have the funds rate move down a bit if necessary to achieve growth in the aggregates, but it wanted to proceed cautiously. Looking ahead, however, he would be reluctant as a general rule to specify narrow ranges for the funds rate; the narrower the range, the less discretion the Manager was allowed in carrying out the Committee's intentions. He might add that in the period immediately ahead the Desk would probably have to move early to accomplish the bulk of any contemplated easing of money market conditions, in view of the forthcoming Treasury financing.

Mr. Mayo commented that the Committee had traditionally attached less weight to even keel considerations in periods when interest rates were declining than when they were rising.

Mr. Daane agreed, but added that even keel considerations should not be ignored entirely even if rates were declining.

Mr. Morris said he would be prepared to approve the Chairman's proposal in light of the latter's assurances that he would consult with the Committee if it appeared that the specifications were seriously inconsistent and the aggregates were not behaving in the manner desired. What had concerned him was the possibility that monetary policy would follow a pattern characteristic of the past--namely, that of responding with a lag to evidence of a need to change course. He hoped the System would avoid such a lag this time, but he was not entirely certain that it would.

Chairman Burns remarked that the Committee would remain alert to the risk of a lagged response, although like Mr. Morris, he could not be certain that it would succeed in avoiding it. As he had indicated earlier, he thought monetary policy was now in a good position to move in either direction as circumstances warranted, and he would not want to make a sharp change at the moment. He would stress again the importance of restoring the monetary aggregates to the desired growth path. On the question of further consultation in the period following today's meeting, the decisive point was likely to come in about 10 days. If the figures on the aggregates becoming available during the next

day or two were disappointing, and if the same were true of the following week's figures, it would be proper and timely for the Committee to consult about the possibility of moving the floor for the funds rate down from 9-1/4 per cent. He should add that while he was sharing his thinking fully with the members, he could not make a specific commitment with regard to such consultation.

Mr. Hayes observed that his concern was different from that of Mr. Morris. What worried him was the possibility that a reduction in the funds rate to 9-1/4 per cent would have an undesirable effect on market psychology.

The Chairman observed that he had had such a risk in mind when he had suggested raising the lower limit of the range for the Federal funds rate. He agreed that a decline in the funds rate even to 9-1/4 per cent would be an appreciable move. Nevertheless, the Committee might decide to permit the rate to go a bit lower in the coming period, depending on the behavior of the aggregates. It was also possible that the funds rate would not have to fall that low to achieve the objectives.

Mr. Francis said he would prefer to raise both the lower and upper limits of the range for growth in M_1 in the October-November period. Specifically, he thought a range of 2 to 5 per cent for that period would be consistent with the Committee's

longer-run target for M_1, and that growth in such a range would simplify the task of maintaining moderate growth in early 1974.

Chairman Burns replied that in his judgment the range he had suggested more nearly reflected the Committee's consensus. However, if Mr. Francis so desired, the members could be polled on the matter.

Mr. Francis remarked that he was prepared to accept the Chairman's interpretation of the consensus.

The Chairman then suggested that the Committee vote on the proposal he had described. Specifically, he suggested that the Committee adopt a directive consisting of the staff's draft of the general paragraphs and alternative B for the operational paragraph. It would be understood that that directive would be interpreted in accordance with the following specifications. The longer-run targets would be those shown under alternative B--namely, growth rates for the fourth and first quarters combined for M_1, M_2, and the bank credit proxy of 5, 7, and 5-1/2 per cent, respectively. The associated ranges for the October-November period would be 2 to 5 per cent for RPD's, 1 to 4 per cent for M_1, and 5 to 8 per cent for M_2. The range for the weekly average Federal funds rate in the intermeeting period would be 9-1/4 to 10-1/4 per cent.

Mr. Bucher said he was troubled about the potential inconsistency of the specifications proposed. However, in light of the Chairman's comments on the subject of consultation during the coming period, he was prepared to vote favorably on the proposal.

Mr. Mitchell said he also would vote favorably, although he hoped some means could be developed in the future for avoiding the semantic problems he found in the proposed directive.

Mr. Sheehan concurred in Mr. Mitchell's observation. He added that the difficulties experienced in the period following the September meeting had been caused by semantic problems in the directive issued at that meeting.

By unanimous vote, 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 suggests that growth in real output of goods and services in the fourth quarter is likely to remain at about the moderate rate indicated for the third quarter. In recent months manufacturing employment has leveled off and total nonfarm employment has expanded less rapidly than earlier; the unemployment rate has remained at 4.8 per cent. The advance in wage rates has been somewhat faster than earlier. In September wholesale prices of industrial commodities rose appreciably; farm and food prices declined, but by far less than they had risen in August. The U.S. merchandise trade balance weakened

slightly in August. Net foreign purchases of U.S. stocks continued large, however, and the balance of payments on an official settlements basis was in surplus in both August and September. Exchange rates for the dollar against most foreign currencies have changed little since mid-August.

The narrowly defined money stock, which had risen sharply during the second quarter, declined in September for the second successive month. The more broadly defined money stock expanded slightly in September as a result of net inflows at banks of consumer-type time deposits. The deposit experience at nonbank thrift institutions improved somewhat in September following a period of sizable outflows. Bank credit--which had been expanding rapidly--increased little as business loan growth slowed markedly, and after mid-September the outstanding volume of large-denomination CD's declined substantially. Short-term market interest rates fell sharply from mid-September to early October, partly as a result of a shift in market expectations regarding monetary policy, and rates on long-term market securities declined moderately further.

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 sustainable rate of advance in economic activity, and continued progress toward equilibrium in the country's balance of payments.

To implement this policy, while taking account of the forthcoming Treasury financing and of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead.

> 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 November 19-20, 1973, beginning at 4 p.m. on November 19.

Thereupon, the meeting adjourned.

Secretary

ATTACHMENT A

October 15, 1973

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on October 16, 1973

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that growth in real output of goods and services in the fourth quarter is likely to remain at about the moderate rate indicated for the third quarter. In recent months manufacturing employment has leveled off and total nonfarm employment has expanded less rapidly than earlier; the unemployment rate has remained at 4.8 per cent. The advance in wage rates has been somewhat faster than earlier. In September wholesale prices of industrial commodities rose appreciably; farm and food prices declined, but by far less than they had risen in August. The U.S. merchandise trade balance weakened slightly in August. Net foreign purchases of U.S. stocks continued large, however, and the balance of payments on an official settlements basis was in surplus in both August and September. Exchange rates for the dollar against most foreign currencies have changed little since mid-August.

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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 sustainable rate of advance in economic activity, and continued progress toward equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPHS

Alternative A

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

Alternative B

To implement this policy, while taking account of the forthcoming Treasury financing and of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead.

Alternative C

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

ATTACHMENT B

October 16, 1973

Points for FOMC guidance to Manager in implementation of directive		Specifications (As agreed, 10/16/73)
A. Longer-run targets (SAAR): (fourth and first quarters combined)	M_1	5 %
	M_2	7 %
	Proxy	5-1/2%
B. Short-run operating constraints:		
1. Range of tolerance for RPD growth rate (October-November average):		2 to 5%
2. Ranges of tolerance for monetary aggregates (October-November average):	M_1	1 to 4%
	M_2	5 to 8%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		9-1/4 to 10-1/4%
4. Federal funds rate to be moved in an orderly way within range of toleration.		

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

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