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 Monday and Tuesday, January 20-21, 1975, beginning at 4:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Black
Mr. Bucher
Mr. Clay
Mr. Coldwell
Mr. Holland
Mr. Kimbrel
Mr. Mitchell
Mr. Sheehan[1]
Mr. Wallich
Mr. Winn
Mr. Debs, Alternate for Mr. Hayes

Messrs. Baughman, MacLaury,[2] Mayo,[2] and Morris, Alternate Members of the Federal Open Market Committee

Messrs. Eastburn, Francis, and Balles, Presidents of the Federal Reserve Banks of Philadelphia, St. Louis, and San Francisco, respectively

Mr. Broida, Secretary
Mr. O'Connell, General Counsel

Chairman Burns said he wanted to inform the Reserve Bank Presidents that the Board earlier today had acted to reduce member bank reserve requirements on demand deposits, by one-half of 1 percentage point on deposits up to $400 million and by 1 percentage

1/ Attended Tuesday session only.
2/ Entered meeting at point indicated.

point on deposits of more than $400 million. The action would apply to deposits during the week ending February 5 and would affect required reserves during the week ending February 19. It was expected to release about $1.1 billion of reserves to the banking system.

The Chairman then said he would comment briefly on the outlook for the Federal budget. As noted in one of the staff documents distributed to the Committee, according to the Administration's preliminary budget estimates, the deficit in the 1976 fiscal year would be $46 billion. Developments since those estimates were prepared suggested that the figure should be raised somewhat, to the neighborhood of $50 billion.

However, Chairman Burns continued, the 1976 budget estimates were premised on the assumption that the Congress would accept a number of Presidential recommendations for reductions in expenditures, including a list of budget deferrals and rescissions, new legislation placing a 5 per cent limit in 1975 on increases in Federal employee salaries, civil service and military retirement pay, and social security payments, and certain other reductions for which legislative action was required. Altogether, the recommended spending cuts came to $17-1/2 billion.

To the extent that Congress did not accept those recommendations, the Chairman continued, the estimate of the deficit would have to be raised. While it was impossible to forecast the outcome with assurance, some who professed to understand Congressional attitudes were now guessing that the spending cuts actually approved would total at most $5 billion. Personally, he would conjecture that Congress would concur in only about $2 or $3 billion of the reductions recommended, but would also reduce the military budget by $3 to $5 billion. If that conjecture was reasonably accurate, the total reduction would be roughly $10 billion rather than $17-1/2 billion, and the correct estimate of the deficit in fiscal 1976 would be closer to $60 billion than to $50 billion.

In response to a question by Mr. Winn, Chairman Burns said he thought the estimate of the deficit in fiscal 1975, which was now $34 billion, would almost certainly be raised somewhat, but by much less than that for 1976--perhaps to $35 or $36 billion.

Mr. Eastburn asked whether the Chairman thought it was likely that new spending programs would be enacted this year.

Chairman Burns replied that the President himself was recommending no new spending programs outside the energy sphere. It was quite likely, however, that Congress would enact new programs.

In reply to a question by Mr. Kimbrel, the Chairman said he thought Congressional sentiment for direct controls had abated now that evidence of a definite lessening in the rate of inflation was beginning to accumulate. If the rate of inflation should step up again, however, there undoubtedly would be a strong clamor for controls.

In response to other questions, Chairman Burns said it was his guess that Congress would move speedily on the President's recommendation for a $16.5 billion cut in individual income taxes, and would probably make the cut a little larger. The President's proposal for a one-year increase in the investment tax credit probably would be enacted, although perhaps with some modifications. On the other hand, he doubted that the energy program and associated tax changes would be enacted in a form anywhere near that recommended. And he thought action probably would be taken to rescind the President's existing authority to raise the tariff on crude oil imports.

Mr. Eastburn referred to the Chairman's opening comments about today's reduction in reserve requirements and asked about the reasons for lowering requirements more on demand deposits over $400 million than on deposits below that amount.

In reply, the Chairman noted that reserve requirements for large banks had been stepped up sharply in recent years, and the desirability of a correction--which, of course, could best be made at a time when there was a need to reduce over-all requirements--figured in the Board's thinking. Another consideration that some Board members, at least, had had in mind was the increasing extent to which large banks were currently serving as lenders of last resort; they were now carrying a heavy burden in that regard.

Chairman Burns added that the reserve requirement action was unlikely to be a popular one. Indeed, there was little that the Federal Reserve could do from this point on that would be popular; whatever actions the System took would be considered wrong by a large segment of the public and the Congress. The System simply had to do its duty as it saw it.

After some further discussion of the reserve requirement action, the following staff members entered the meeting:

Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. Partee, Senior Economist
Mr. Solomon, Economist (International Finance)
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Brandt, Bryant, Davis, Doll, Hocter, Parthemos, Pierce, and Reynolds, Associate Economists

Mr. Holmes, Manager, System Open Market Account

Mr. Coyne, Assistant to the Board of Governors
Mr. Keir, Adviser, Division of Research and Statistics, Board of Governors
Mrs. Farar, Economist, Division of Research and Statistics, Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant, Board of Governors

Messrs. Eisenmenger, Scheld,[1/] and Jordan, Senior Vice Presidents, Federal Reserve Banks of Boston, Chicago, and St. Louis, respectively
Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York
Messrs. Pardee, Kaminow, and Green, Vice Presidents, Federal Reserve Banks of New York, Philadelphia, and Dallas, respectively
Mr. Kareken,[1/] Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Keran, Director of Research, Federal Reserve Bank of San Francisco

Chairman Burns observed that the Committee had planned to discuss the first-stage report of the Subcommittee on the Directive this afternoon. He thought it would be best, however, to turn at this point to a discussion of the economic situation and outlook. The Committee could consider the Subcommittee's report at the end of tomorrow's session, if time permitted; otherwise, that subject would be held over until a later meeting.

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

Mr. Partee made the following statement:

> With the economy in the midst of a strong recessionary movement, virtually all of the business indexes are now highly unfavorable. The November and December declines in industrial production are among the sharpest

1/ Entered meeting at point indicated.

of the postwar period, as is the fourth-quarter reduction in real GNP, estimated by the Commerce Department to have been at a 9 per cent annual rate. Nonfarm payroll employment dropped by more than 1 million during the last 2 months of 1974, and the unemployment rate soared to 7.1 per cent, with a further sizable rise highly probable for January. Final sales have fallen off notably in recent months, with retail sales down significantly further, residential construction sharply lower, and even business capital spending showing substantial signs of weakness.

Every indication, moreover, points to a continued downtrend in the economy over the months immediately ahead. All segments of the private economy are likely to be weakening further, as consumer income and spending propensities are affected by widespread unemployment, businesses respond to the marked deterioration in their markets and in internal cash flows, and residential construction remains depressed because of the further decline we have had in housing starts and the still heavy overhang of completed but unsold units. Probably the most important source of weakness, at least arithmetically, will be a sharp drop-off in inventory investment, from substantial accumulation in the fourth quarter to probable liquidation by spring. Virtually all industries are now working hard to reduce their inventory positions--whether of finished goods or materials--and they will be increasingly successful as time goes on.

Even now, however, the basis for economic recovery is being laid. Savings inflows to the thrift institutions have improved considerably, and the tightness in credit markets is easing. Thus, mortgage credit is once again becoming available and the capital markets are successfully absorbing a very large volume of corporate financing. Housing starts and, in time, business receptivity to new expansion plans should respond accordingly. The inventory correction also is, by its nature, likely to be self-limiting. A period of substantial disinvestment is no doubt ahead, but as the inventory liquidation comes to an end and is reversed, this will help to buttress economic activity. Finally, it is evident that price quotations are being trimmed now in response to the weakness in markets. Special promotions in order to move merchandise should help to stimulate spending, even though strong underlying inflationary pressures in the economy persist.

This is the kind of reasoning that has led us for some time to the view that an economic recovery is likely to commence in the second half of 1975. The President's new fiscal proposals, if enacted, serve to increase that probability considerably. Leaving aside the energy conservation program, both the personal tax refund and the increase in the investment tax credit are likely to have a stimulative impact beginning in late spring or summer. Much of the tax refund, because it is a one-time--or perhaps I should say two-part--windfall, is likely to be saved, but with family budgets under great pressure we believe that perhaps one-half will show up in the spending stream. And the tax credit, because it is temporary, should significantly increase near-term capital spending commitments, even in the face of currently slack demands. Increased Federal spending will also be adding to demands over this and the next fiscal year, apparently by a good deal more than we have allowed for in the green book[1/] projection.

We did not incorporate the energy package into the projection, partly because the details were slow to become available and partly because of our uncertainty as to its disposition by the Congress. It is evident, however, that the program would have large effects on prices, income distribution, and sectoral relationships among major industries. A preliminary, and very rough, attempt to analyze the program's impact through the use of our econometric model suggests that it would raise the level of consumer prices on the order of 3 per cent by mid-1976, and would very likely stimulate a round of additional

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

wage rate pressures on the structure of costs and prices. The increased extent to which current expenditures would need to accommodate higher prices, in turn, would tend to depress real economic activity and employment unless offset by increased monetary expansion. Even on the assumption of fiscal neutrality, therefore, the program taken by itself would be expected to worsen the economic outlook.

Because of the incorporation of other aspects of the President's program, our projected upturn in the economy after midyear is stronger than before, albeit from a lower level of activity than we had anticipated a month ago. We would expect consumption to be strengthened materially, though probably temporarily, in the second half of the year, and business capital spending to rise by early 1976 to a level about 5 per cent higher than otherwise would be expected. The result is a projected rate of growth in real GNP averaging nearly 4-1/2 per cent in the three quarters from mid-1975 through early 1976--2 percentage points more than we were anticipating a month ago. Given this real growth, the unemployment rate, which is now expected to reach 8 per cent by midyear, would subsequently level off and perhaps even edge downward. Moreover, as I noted, our projection appears to have underestimated Federal expenditures for the remainder of fiscal 1975 and for fiscal 1976--the latter by as much as $10 billion--which should have the effect of improving demand and reducing the unemployment rate marginally further.

The effect of substantial fiscal stimulus may be to reduce somewhat the progress that can be expected in moderating the rate of inflation. But the impact of the program on prices--aside from the energy package--is unlikely to be appreciable in the current environment of widespread softness in markets and substantial slack in resource utilization. Indeed, we have reduced somewhat the projected rate of inflation over the next several quarters, reflecting mainly the greater weakness in prices now expected in consumer durable and nondurable goods markets as special efforts are made to clear such goods out of inventory. So far, however, there does not seem to be much basis for expecting a parallel softening in wage rate advances, which we were already anticipating would moderate during 1975 and into 1976. Therefore, with unit labor costs projected to be increasing at a fairly rapid rate, we think that the scope for any lasting additional downward adjustment in pricing policies is quite limited.

In our view, moreover, there still remains a serious danger of a premature slowing in the recovery by early 1976 that will leave unemployment and other measures of resource slack at unacceptably high levels. In part this reflects the wearing off of the stimulus provided by the personal tax refund and temporary tax credit, although it is probable that these tax measures would be continued, or other fiscal actions substituted, if the economy remains quite weak.

Even more important, however, is the interaction of continued inflation and renewed economic growth on financial market conditions. In the three quarters from mid-1975 through early 1976, our projected rise in nominal GNP averages 11 per cent at an annual rate. The counterpart financing needs to sustain this rate of increase in nominal expenditures imply that interest rates will be rising and credit conditions tightening, beginning as early as this summer, assuming a continuation of the Committee's present monetary growth targets. Rising interest rates, in turn, are likely to mean a slowing in savings inflows to depository institutions, with unfavorable implications for mortgages and housing, and the adoption of more conservative financing and spending programs by business corporations and State and local governments. Accordingly, there is danger that housing starts will turn down again in 1976, that capital spending plans will be trimmed back, and that the economic recovery will slow well before resource use reaches adequate levels.

To test this possibility, we have reestimated our flow of funds accounts to accord with the revised economic projection as presented in the green book. The new flow of funds projections indicate that total credit demands will remain at a reduced level in the first half of this year, despite the larger Federal deficit, but that the total of funds raised will recover in the second half of 1975 to about the advanced rate of the first half of 1974 and then rise somewhat further in the first half of 1976. This volume of financing would be expected to require substantial direct purchases of securities by households, the stimulation of which in the past has required rising interest rates. Thus, both a comparison of projected nominal GNP expansion with targeted monetary growth and our analysis of likely credit demands and sources of financing suggest that interest rates will be on the rise by late summer, if not earlier.

My attempt today to focus on the probable shape of the economic recovery may be regarded by Committee members as borrowing trouble from the future. As of now, our problem is one of deepening recession, with the economy moving downward faster and farther than almost anyone would have forecast just a few months ago. If the decline persists, or if the inflation rate slackens significantly more than we are projecting, there probably will not be supply difficulties in credit markets later this year. But our view is that the President's fiscal program, by stimulating public spending and increasing credit market demands, raises considerably the prospects for recovery to begin by summer or early fall. If so, the Committee will soon be facing the question of whether it is prepared to see an early and sizable upturn in interest rates, or whether it will instead accept somewhat more rapid monetary expansion and thereby appear to be validating a part of the underlying pressures working for inflation. Since monetary and financial developments generate their economic impacts only after a considerable lag, the strategy that the Committee decides to follow as 1975 progresses will importantly shape the behavior of the expected economic recovery, not only in late 1975 but well on into 1976.

Messrs. Mayo and Scheld entered the meeting during Mr. Partee's remarks.

Mr. Winn observed that bank managers finally had recognized the need to rebuild liquidity and, consequently, he was concerned that they would be reluctant to expand loans even in an environment of greater availability of reserves. Also, delinquencies on auto instalment loans had been increasing, and consumers, burdened with heavy debt repayments, might well use tax refunds much more to improve their financial positions than to increase their expenditures. In those circumstances, the course of economic activity would differ considerably from that portrayed by the staff projection.

Mr. Partee commented that bank managers appeared to be more concerned about the risks confronting them than at any earlier time in the postwar period, and finance companies in general also would be influenced by the dangers inherent in the present economic situation. Moreover, business firms would take steps to improve their liquidity. To overcome the effects of such attitudes, policies would need to be more expansive than otherwise. With respect to the banks, the demand for excess reserves had increased substantially over the past 6 to 8 weeks. As the availability of reserves increased, however, banks were bound to become more active in making loans and investments. And at some point, businesses would have improved their liquidity to an extent that they would become willing to undertake new spending programs.

Mr. Balles, noting that the decline in real GNP in the fourth quarter of 1974 had been much greater than generally expected, said forces might be at work that would continue economic activity on a steep decline throughout the first half of this year. He was particularly concerned about the influence of consumer and business confidence, as well as about the developments that Mr. Winn had mentioned. With respect to the projection, he asked whether the staff rated the risks of error greater in one direction than the other.

In response, Mr. Partee observed that, as he had said before, a serious financial disturbance could occur, and if it did, economic activity in the months ahead would be considerably weaker than projected. That possibility aside, greater weakness in the first two quarters of this year, if it developed, would most likely result from larger-than-projected declines in real expenditures for business fixed investment and more severe liquidation of inventories. On the other hand, housing starts--which had declined further in December, contrary to staff expectations--might now be at or near their low, and consumer confidence, already so weak, seemed to him more likely to recover somewhat than to deteriorate further. In any case, as he had observed in his statement, the prospects for recovery beginning by summer or early fall would improve considerably if the President's fiscal proposals were enacted.

Mr. Coldwell remarked that the projected upturn in activity in the second half of this year appeared to be based primarily on a turnaround in residential construction and a shift in business inventory investment. With respect to the projected behavior of inventories, he asked whether there were precedents in earlier business fluctuations.

Mr. Partee replied that there were such precedents. A significant point to remember about the behavior of inventories was that even a slowing in the rate of liquidation had an expansive effect on total GNP. For example, the annual rate of liquidation was projected to fall from $9 billion in the second quarter of this year to $7 billion in the third quarter, and that contributed $2 billion to the annual rate of increase in total GNP. Moreover, there was a dynamic element to the inventory investment process that was not quite reflected in the figures. In the current quarter, the automobile industry and some others would be reducing inventories, but over all, accumulation at a $1.5 billion rate was projected because of unintended or involuntary increases in other industries. During the second quarter, production adjustments were expected to shift inventory investment to a substantial rate of liquidation. Liquidation was projected to continue at only a slightly lower rate in the third quarter, but by then some part of the liquidation would be unintended; that is, stocks would be drawn down by the upsurge in consumer spending that was expected to be spurred by the tax refund. With inventories in some industries then lower than desired and with sales improving, new orders and production would be on the rise. In an environment of ready availability of labor, materials, and plant capacity, the expansion in production could be rather sharp by late summer or early fall.

Mr. Bucher asked how confident the staff felt about the projected upturn in residential construction, particularly in view of the inventory of unsold houses.

In response, Mr. Partee noted that in November the inventory represented nearly an 11-1/2-months' supply at the current depressed rate of sales. The statistics on the number of unsold houses had not been available for enough years to judge whether the stock was large by historical standards, but it would not appear to be nearly so large once sales began to revive from the very low rate of recent months. In any case, the staff deliberately had restrained the projected recovery in home-building not only because the overhang of unsold houses was substantial but also because house prices had risen so much, builders were so demoralized, and the improvement in the flow of savings to the thrift institutions was not likely to be sustained.

Mr. Morris commented that the Boston Bank staff, using the Data Resources, Inc. model and making exactly the same assumptions as had been made by the Board's staff, projected a rate of growth in real GNP of only 1.3 per cent in the second half of this year, compared with the Board staff's projection of a 4.3 per cent rate. He suggested that the Board staff's projection of a month ago--which indicated a 1.9 per cent rate of growth in the second half--might be better than its latest one.

Mr. Partee responded that the kind of tax relief proposed by the President had no historical precedent, and therefore, projections depended a great deal on the assumptions one made with respect to the proportion of the personal tax refunds that would be spent and with respect to the degree of extra stimulus to business spending that might be provided by the temporary feature of the increase in the investment tax credit. It was possible that in the DRI model, less stimulation was attributed to the tax program.

Mr. Pierce added that none of the models could take into account the effects flowing from an increase in the investment tax credit which was limited in duration. In the judgmental forecast, the rates of expansion in both business fixed investment and personal consumption expenditures had been raised somewhat from those generated by the model, in order to take account of the special features of the increase in the tax credit and the reduction in personal income taxes. Consequently, the staff expected the annual rate of expansion in real GNP during the second half of this year to be about 1-1/2 percentage points higher than it would have been otherwise, and that would account for much of the difference between the Board staff and DRI projections.

Chairman Burns remarked that the tax measures proposed by the President differed from any in the past not only because the increase in the investment tax credit was for one year only, but also because the personal tax reduction came in the form of two lump-sum rebates. Consequently, not much could be learned from history about the effects that those measures would have. However, the objective of those who designed the measures was to get the maximum amount of fiscal stimulation from the specified reduction in tax revenues.

Mr. Eastburn observed that one pleasant surprise in the recent statistics was the degree to which the rate of increase in prices had slowed. Moreover, one heard that for nonferrous metal products and some other commodities, actual transactions prices were declining relative to the list prices reflected in the indexes, with the latter being held up by manufacturers because of their fear that price controls would be reimposed. Against that background, he asked how confident the staff was about its projections for prices and wages.

Mr. Partee replied that there were no periods earlier in the postwar era that could be analyzed for guidance concerning the effect on wage rates of, on the one hand, an 8 per cent unemployment rate and, on the other hand, a 12 per cent annual rate of increase in the consumer price index sustained over a considerable number of months. In the projection, compensation per manhour declined from a peak rate of 10.8 per cent in the third quarter of 1974 to 7.7 per cent in the second quarter of 1976. That seemed to him to be a rather optimistic expectation. Although the high rate of unemployment would have a moderating effect on wage rate increases, the increase of nearly one-fourth in consumer prices over the past 2 years was bound to exert a strong influence even in the non-unionized industries where benevolent employers would want their employees' living standards to be maintained. If wage rate increases continued large, as projected, the resulting rise in unit labor costs would continue to exert substantial upward pressure on the structure of prices.

Mr. Pierce added that in his judgment the chances were better than even that the wage and price projections were close to the mark. For the reasons stated by Mr. Partee, the models were quite unreliable, probably tending to overstate the rate of inflation to be expected. In the projection, the rate of increase in labor costs per unit of output was down to about 5 per cent by the second quarter of 1976, and he regarded that as reasonable.

Chairman Burns remarked that some representatives of the construction industry had told him that wage rates had stabilized in the part of their industry that was not unionized.

Mr. Wallich asked Mr. Partee for his assessment of the share of the contemplated rate of monetary growth that, under current conditions, might be reflected in the rate of increase in prices rather than in expanded output.

Mr. Partee said he would judge that, given the generally low rate of resource utilization, an increase in demands stemming from monetary expansion would have almost no inflationary effect in the short run; the impact would be almost entirely on physical activity. It was possible, however, that faster monetary expansion in the period immediately ahead might be reflected in stronger inflationary pressures later on, if output rose enough in relation to capacity.

Mr. Wallich said he agreed with the judgment that under present conditions the impact of monetary expansion was likely to be largely on production. He also believed that the estimated policy lags suggested that prices might rise at some more distant time in the future.

Chairman Burns remarked that money created now might merely be reflected in a decline in velocity rather than in an increase in expenditures. On the other hand, there were historical experiences of monetary expansion leading to inflationary pressures rather quickly, even when rates of resource utilization were low.

In reply to a question by Mr. Kimbrel, Mr. Partee commented that special price concessions of the sort mentioned by Mr. Eastburn had been taken into account in making the staff projections. The consumer price indexes used to deflate components of personal consumption expenditures comprised the most important part of the GNP deflator, and the increases in projected prices for both durable and nondurable goods over the projection period were well below the rates in recent quarters. The price rises in the period ahead, moreover, were less rapid than the increases in unit labor costs in the same sectors, reflecting special price concessions for apparel, appliances, and furniture as well as for automobiles. Prices of services, however, were projected to continue upward at a fast pace, and prospects still seemed to point toward a substantial rise in food prices during the spring and summer, followed by moderation in the rise later in the year.

Mr. Balles asked whether the staff could provide some general indication of the effects that the President's energy program, should it be enacted, would have on economic developments over the period covered by the staff projection.

Mr. Partee observed that, in the staff's judgment, the program might raise the level of the consumer price index by about 3 per cent by the middle of 1976--the end of the projection period--and perhaps by as much as 4 per cent over a period of 2 to 2-1/2 years from the time of its implementation. Gasoline and heating oil prices, for example, would increase promptly, while average electric utility rates would rise gradually. Increases in prices of energy would have secondary effects on wage rates and on prices of other goods and services over a still longer period of time. The price increases provoked by the program and the expansion in expenditures associated with them would tend to weaken demands for other goods and services, unless the rate of monetary growth was raised in compensation. The econometric model indicated that if such an allowance in the monetary growth rate were not made, the unemployment rate in the second quarter of next year would be increased by roughly one-half of a percentage point--that is, the rate would be a little above 8.5 per cent rather than slightly over 8 per cent. In forming that judgment, the staff had made no allowance for possible structural side-effects of the program, such as the effects of higher energy prices on demands involving the resort industries and condominium developments; that could prove to be the straw that would precipitate business failures.

In response to a question by Mr. Black, Chairman Burns observed that the staff obviously believed that the Administration's forecast of a 2 per cent rise in the consumer price index resulting from the energy program was too low. In the Administration's estimate, which purported to be inclusive, the effects would be exhausted during the course of 1975; in the staff's judgment, the effects would extend throughout 1976.

Mr. Mitchell remarked that over recent months staff projections of the level of activity in the period ahead had been progressively reduced, and his confidence in the ability to see what lay ahead had weakened. Today, however, he had the impression that the staff had greater confidence in its projection for the first and second quarters of the year, and perhaps for the third quarter as well. One reason for that greater confidence appeared to be a notion that the rate of decline in real GNP was on the verge of diminishing, and that once it did so, an upturn would follow. And secondly, one could expect some strengthening in over-all activity to result from a decline in the rate of inventory liquidation and from the stimulation to residential construction that would be provided by the improved inflows of funds to the thrift institutions. He wondered whether the staff agreed that there was justification for viewing prospects for the intermediate term with less uncertainty than in the recent past. If so, the Committee might be able to devise a policy appropriate to that period of time with a greater degree of confidence than had been possible in the past 4 or 5 months.

Mr. Partee agreed that his confidence in the staff projections for the immediate future had improved. He believed that economic activity would not slide into a deeper and deeper recession--in effect, into a major depression--but would decline at a diminishing rate in the first half and then turn up. Most importantly, the fiscal stabilizers were working; the Administration had proposed a program of fiscal stimulus; and the Committee was endeavoring to achieve monetary expansion. In addition, he believed that younger Americans basically were more optimistic than the Depression generation had been, and consequently, that their propensity to spend was more likely to recover as their situation improved or, at least, stopped deteriorating.

Mr. Partee added that, in view of population growth and the need to maintain the stock of automobiles, it was difficult to imagine auto sales declining much further from the very low rates of recent months. Similarly, given the underlying rate of household formation, it seemed unlikely that housing starts would have much further a decline in them from the December annual rate of 870,000 units. The one major fear he had was that the expected upturn could be thwarted by the spreading of business bankruptcies, abroad as well as at home, to an extent that would disrupt financial markets and impair public confidence.

Messrs. MacLaury and Karaken entered the meeting at this point.

Mr. Holland asked whether it was correct to infer from Mr. Partee's remarks that the rates of monetary growth implicit in present policy would be adequate to bring about an upturn in economic activity--and that, in fact, some shortfall in monetary growth could occur without aborting the recovery--but that continuance of policy on the same course indefinitely would start to dampen the recovery at some time and limit its duration.

In response, Mr. Partee noted that the staff had assumed a 6 per cent rate of growth of M_1 over the projection period. On the assumption that the President's energy proposals were not put into effect, he agreed that Mr. Holland's interpretation was correct. With respect to the effects of a shortfall in monetary growth in the period immediately ahead, he agreed that it was not likely to abort the recovery provided that it occurred in an environment of declining interest rates and easing credit conditions. Unless the shortfall were made up later on this year, however, the dimensions of the over-all recovery in activity would be smaller than projected by the staff.

With reference to Mr. Partee's remarks concerning possible financial shocks, Mr. Debs asked whether it was correct, as it appeared to him, that the risks of such disturbances were less now than they had been a few months earlier.

Mr. Partee replied that, apart from the REIT's, the financial sector might be in less difficulty now than earlier. For nonfinancial corporations, however, the worst might still lie ahead. In coming months corporate profits and cash flow would decline sharply, and many nonfinancial corporations were likely to be subjected to severe tests.

Chairman Burns remarked that as a result of the difficulties that nonfinancial corporations might experience, banks might suffer large losses, provoking serious consequences for the financial system.

In response to a further question by Mr. Debs, Mr. Partee remarked that business efforts to improve their liquidity were likely to continue for some time. Many corporate treasurers appeared to have the conviction that they needed to restructure their liabilities, and in consequence, they continued to demand funds in the long-term market even though rate spreads now favored short-term borrowing.

Responding to a question by Mr. Mayo, Mr. Partee observed that there was little in past experience either in the United States or in other countries that was helpful in judging the possible effects of the sort of income injections represented by the personal income tax rebates proposed by the President. Quarterly GNP data for the mid-1930's were not sufficiently reliable to permit judgments about the effects of the veterans' bonus disbursed at that time. In early 1950, a large National Service Life Insurance dividend was paid, but its effects could not be disentangled from those of the Korean war which broke out only a few months later. Other estimates of the proportion of the tax rebates likely to be spent generally ranged down from the 50 per cent estimated by the staff.

Mr. Baughman remarked that if confidence did not improve and economic activity did not turn up, involuntary transfers of ownership of existing assets were likely to occur and debts were likely to be converted involuntarily into equity positions--in some cases, through bankruptcy proceedings. He asked whether data were available that would permit such developments to be watched closely.

Chairman Burns said, in response, that systematic data were not available to follow such developments closely. However, the Reserve Bank Presidents often were in a position to learn, through their informal contacts with bankers, how particular situations of financial distress were being worked out by the commercial banks and their customers, and it would be useful if every 2 weeks or so the Presidents gave the Board reports on those situations.

Mr. Holland remarked that the percentage of loans on which a bank was no longer accruing interest often was a useful indicator of the spreading of such work-out situations. It might be that bank examiners, as they moved from bank to bank, could be alert to changes in that particular ratio and report back to their Reserve Banks.

Chairman Burns agreed that such information could be useful, along with reports on doubtful loans.

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 December 17, 1974 through January 15, 1975, and a supplemental report covering the period January 16 through 20, 1975. Copies of these reports have been placed in the files of the Committee.

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

> We were hopeful that dollar rates would recover some of the ground lost in December once the year-end pressures had passed. But two developments quickly dispelled that hope. First, just into the new year, German government spokesmen again said that they would not mind seeing a higher rate for the mark. This echoed the earlier statement by Chancellor Schmidt, as well as the subsequent qualifications that the government would not actually take

measures to push the rate up. Nevertheless, it had the same psychological effect on the market. Traders began talking about higher rates for the mark than they had previously considered possible and the reflux into dollars quickly dried up.

Second, the mounting evidence of an economic downturn in the United States has troubled the exchanges. Although the pattern is mixed, on balance the slowdown elsewhere has not been so severe. This has given some benefit to our trade balance and it should bolster the dollar. Nevertheless, the markets have watched closely the decline in interest rates here and in the Eurodollar market. Several foreign central banks have cut their discount rates in recent weeks, but the easing of interest rates abroad has been piecemeal and generally slower than ours. Moreover, the relative weakness of the U.S. economy has reinforced expectations in the market that interest rates will decline here all the more, and these expectations have weighed heavily on the dollar in the exchanges.

In recent days, the Swiss franc has been bid up sharply, reportedly in connection with the covering of some huge short positions of Sindona-related banks which are now in various stages of liquidation. Since early fall, the unruly run-up of the franc had been an unsettling factor in the markets, and early in January the Swiss National Bank resumed intervention in the spot market, operating rather forcefully to turn the market around. The Swiss National Bank has bought nearly $300 million so far and we have provided some follow-up in New York.

This completes the circle of central banks willing to intervene on a day-to-day basis to maintain orderly markets, and during the period the central banks of Germany, Switzerland, France, and the Netherlands bought dollars at times when the dollar weakened. In cushioning operations we intervened on 11 days during the period, selling a total of $92 million equivalent of German marks, of which $69 million were financed by swap drawings and the rest from balances; and $26 million equivalent of Swiss francs, $10 million equivalent of Dutch guilders, and $3 million equivalent of Belgian francs, all drawn under the swap lines with the respective central banks.

> On a few occasions when the dollar was buoyant, we recouped some of the Swiss francs and guilders and all of the Belgian francs, but we have not had an opportunity to make a further dent in the mark debt, which currently stands at $254 million. On balance, the dollar declined by 1 to 2 per cent against the major European currencies during the period.
>
> Looking ahead, there are several elements of strength for the dollar, particularly the underlying improvement in our trade account which should continue. Moreover, despite the exhortations of German government officials, the German trade surplus is clearly narrowing. But market psychology remains in the grip of bearish factors. In addition to interest rate considerations and more generalized concerns over the U.S. economy, there remain fears of another war in the Middle East. Some good news would surely help.

Chairman Burns asked Mr. Bryant for his views on prospects for the U.S. trade balance.

Mr. Bryant noted that the staff's best guess about the outlook for trade was incorporated in the green book; there it was projected that net exports of goods and services would decline somewhat, although not markedly, in coming quarters. The projections for imports had been raised a bit since the previous green book as one consequence of the new assumptions about fiscal policy. Nevertheless, imports in real terms were still expected to be quite weak. Real exports also were projected to be weak, because of the weakness anticipated in economic activity abroad. He suspected that the staff's expectations for foreign economic aetivity were, if anything, a little too optimistic; accordingly, he would be inclined to shade the export projection downward.

The Chairman noted that Messrs. Pardee and Bryant evidently differed in their views on the trade outlook.

Mr. Pardee remarked that foreign trade was a particularly hazardous area for forecasting. He did feel, however, that the outlook was stronger than Mr. Bryant had suggested.

Mr. Bryant then observed that Mr. Pardee had mentioned some of the uncertainties affecting prospects for dollar exchange rates. He might add another to the list: the uncertainty about the extent to which OPEC investments would flow into dollar assets as opposed to, say, Swiss franc and German mark assets. It was unclear at present whether much of the recent strength of the Swiss franc and the mark was attributable to efforts by the OPEC countries to invest in those currencies.

Chairman Burns noted that the flows of funds would be affected to some extent by expected legislation in Germany to restrict OPEC investments.

Mr. Bryant agreed. He added that the contemplated legislation would affect direct investments and large purchases of equity securities. He understood, however, that it would not limit acquisitions of fixed-income assets in Germany or Euro-mark deposits in banks outside Germany.

In response to the Chairman's request for comment, Mr. Solomon said there was still another variable to be considered, namely the magnitude of capital outflows from the United States. The Board's staff was projecting a small surplus on U.S. trade in goods and services in 1975, and from Mr. Pardee's comments he gathered that the staff at the New York Bank expected a somewhat larger surplus. For the United States to be a net importer of capital at a time when it was running such a surplus would not make much sense. Perhaps the relationships that would emerge between financial conditions in this country and in other countries would act to prevent the United States from importing capital on balance; in particular, any inflows of OPEC funds to the United States might be matched by capital outflows, through U.S. banks or otherwise. In any case, it was important to consider U.S. capital outflows if one was interested in prospects for the dollar and in the viability of the international payments system.

Mr. Holland noted that the staff's projections implied further declines in U.S. interest rates. He asked whether it was reasonable to expect rates in other industrialized countries to follow U.S. rates down or whether further declines here would simply widen existing differentials.

Mr. Bryant replied that developments in recent months suggested that some countries--including Italy, and perhaps also Britain and France--were willing to follow the lead of others, such as the United States and Germany, in permitting interest rates to decline. It was his personal view that the recent declines in U.S. rates were due primarily to the weakening of economic activity. It was true that rates on dollar assets had fallen faster than those on assets denominated in, say, German marks or French or Swiss francs--a fact that had been widely noted in the exchange markets, and that represented one important reason for the recent fall in dollar exchange rates. Thus, even if U.S. rates were now to stabilize, rates in Europe--and in Japan, where the declines thus far had been limited--would have some catching up to do. Any further declines in U.S. interest rates would provide an opportunity for additional reductions in rates in those countries with precarious balance of payments positions.

Mr. Pardee concurred in Mr. Bryant's observations. He added that market participants expected U.S. rates to continue to fall more sharply than those abroad. In their view, the foreign central banks that had reduced their discount rates thus far had tended to follow declines in market rates, whereas U.S. discount rate cuts had led the market down and would continue to do so.

Chairman Burns noted that highly restrictive monetary policies were still being pursued in a number of countries, including Japan, Britain, France, and Switzerland.

Mr. Wallich asked whether Mr. Pardee had heard reports of any new developments with respect to the proposal being considered by the Common Market countries to limit the range of day-to-day fluctuations in the exchange rates against the dollar.

Mr. Pardee replied in the negative. While he had not yet seen the document containing the proposal, he understood that it would not involve a marked departure from current practice.

In response to a question, Mr. Wallich said the proposal was to limit daily fluctuations in the exchange rate against the dollar for each Common Market currency to either 1.0 or 0.75 per cent. Thus, it was directed more at maintaining orderly markets than at any longer-range intervention objective. It did, however, imply some tightening of the bands for the "snake" currencies, and it perhaps would draw France into a somewhat closer relation with the countries participating in the "snake" arrangement. As the discussions proceeded it was likely that the Common Market countries would inquire of the Federal Reserve about the extent to which it was willing to help.

Mr. Black noted that at a number of recent Committee meetings Mr. Coombs had expressed the view that the dollar was undervalued. Accordingly, he (Mr. Black) was rather disturbed about the recent intervention operations in dollars undertaken in support of their own currencies by the Japanese, Italians, and British, since those operations tended to put downward pressure on the dollar. He asked whether there was any possibility that such countries might use other currencies, such as the German mark or Swiss franc, in their support operations.

In reply, Mr. Pardee said he might first note that it was hard to assess the impact that such support operations had had on the general level of dollar exchange rates, given the huge pool of dollars in the world today. Nevertheless, the procedure Mr. Black had suggested no doubt would be helpful. He suspected that the possibility of conducting intervention operations in currencies other than the dollar had been discussed, perhaps with the Germans, by some of the countries mentioned. The issue might also have been raised in connection with the general discussions now under way of intervention strategy and tactics.

By unanimous vote, the System open market transactions in foreign currencies during the period December 17, 1974, through January 20, 1975, were approved, ratified, and confirmed.

Mr. Pardee reported that six System drawings on the German Federal Bank, totaling $130.4 million, would mature for the first time in the period from February 11 through February 27, 1975. He recommended that those drawings be renewed for further periods of 3 months, if necessary, when they matured.

> Renewal for further periods of 3 months of System drawings on the German Federal Bank maturing in the period February 11-27, 1975, was noted without objection.

Mr. Pardee said he would also recommend the renewal, if necessary, of drawings in Swiss and Belgian francs that would mature for the fourteenth time in February. Specifically, a drawing of $371.2 million on the Swiss National Bank, and a Swiss franc drawing of $600 million on the Bank for International Settlements, would mature on February 14; and six drawings, totaling $230 million, on the National Bank of Belgium, would mature in the period from February 4 through February 14. Since those drawings had been outstanding for more than a year, specific Committee authorization for their renewal was required under the provisions of paragraph 1D of the Authorization for Foreign Currency Operations.

With respect to the Belgian franc drawings, Mr. Pardee continued, the Treasury's negotiations with the Belgians concerning the applicability of the revaluation clause in the swap contract had about run their course. Last June the Committee had delegated to the Subcommittee, consisting of Chairman Burns, Vice Chairman Hayes, and Mr. Mitchell, the authority to act on the Committee's behalf with respect to repayment terms on the Belgian franc, as well as the Swiss franc, drawings. Accordingly, he would shortly submit to the Subcommittee his recommendations on that complicated matter.

After discussion, it was agreed that the renewal of the drawings in question should be authorized.

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 February 4-14, 1975, was authorized.

Secretary's note: A report by Mr. Wallich on certain recent international monetary meetings, which was distributed during this meeting, is appended to this memorandum as Attachment A.

Thereupon the meeting recessed until 9:30 a.m. the following morning, Tuesday, January 21, 1975. The attendance was the same as on Monday afternoon except that Mr. Sheehan and Mr. Coyne also were present.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on December 16-17, 1974, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on December 16-17, 1974, was accepted.

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 December 17, 1974, through January 15, 1975, and a supplemental report covering the period January 16 through 20, 1975. Copies of both reports have been placed in the files of the Committee.

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

> Over the period since the Committee last met, open market operations became increasingly accommodative in providing nonborrowed reserves as the monetary aggregates consistently showed slower rates of growth than the Committee had desired. After a period of rather frantic money market churning around the year-end, interest rates began to decline, influenced in part by the 1/2 percentage point cut in the discount rate in early January. Over the period, rates on short-term private market instruments fell by 1-1/2 to 2 percentage points. Long-term rates responded only moderately, but the corporate market was able to handle a record volume of financing much more readily than had been anticipated before the year-end. In yesterday's regular Treasury bill auction, an average rate of 6.37 per cent was established for 3- and 6-month bills, down 69 and 49 basis points, respectively, from rates established in the auction just prior to the last Committee meeting. I understand that, in response to the reserve requirement action, bill rates are sharply lower this morning, with the 3-month bill trading as low as 6.17 per cent.
>
> Year-end pressures were even more intense than usual as commercial banks sought aggressively to build up their positions by the statement date. Competition in the CD market drove the 30-day rate as high as

9-3/4 per cent late in December. Under the weight of this pressure, the Federal funds rate was slow to respond to the more plentiful supply of reserves, and banks tended to carry unusually high excess reserves. For much of this period, in fact, there seemed to be little relationship between the quantity of reserves actually in the banking system and the Federal funds rate. On Monday, December 30, for example, the 46 money market banks had accumulated almost $11 billion in excess reserves, but the oversupply did not show through in the money market until the final day of the year when funds traded as low as 1/2 per cent.

A measure of sanity returned to the financial markets as the new year got under way. Generally speaking, the market is anticipating further easing by the Federal Reserve as long as the economy continues to be weak and the aggregates exhibit sluggish growth. The President's program to fight the threefold problem of recession, inflation, and energy is a matter of lively debate and the progress of legislation through Congress will be closely watched.

While interest rates have declined, a certain air of caution remains in financial markets and in the banking system. Dealers have displayed a willingness to cut back their inventories in response to retail demand, rather than to exact the last ounce of profit from investors. With prices generally on the rise, profit performance has, of course, been good and the sharp decline in short-term rates has reduced the cost of carry.

The size of Treasury financing needs does cast a cloud over the market. Whether or not private credit demands will weaken enough to make room for Treasury financing will be a key factor in the interest rate picture in the months ahead. Bank attitudes toward their investment policies will also be important. So far, because of concern about capital adequacy and liquidity, banks have not been as active participants in securities markets as would normally be expected at this stage of the business cycle. Whether this will change with time remains to be seen.

As far as open market operations are concerned, the Desk has been quite active on both sides of the market, injecting or absorbing reserves to counteract the erratic movement of market factors and swings in the way commercial banks manage their reserves. Over the period through last Friday, outright purchases and sales of Treasury bills--many directly with foreign accounts--were about matching at about $1 billion each way. The Desk also purchased $685 million of Treasury and Federal agency coupon securities. Reflecting the erratic movement of reserve numbers, repurchase agreements amounted to over $13 billion and matched sale-purchase transactions in the market came to $6 billion. The System also arranged matched transactions of about $3 billion with foreign accounts directly.

As far as the Treasury is concerned, it will announce tomorrow the terms of its February refunding of $3.6 billion publicly held maturing securities. The market also expects that the Treasury will take the opportunity to raise additional cash. I would plan to exchange the System holdings of $1.2 billion maturing securities into whatever issues the Treasury offers, in proportion to the amounts offered to the public.

Finally, I would like to report on the status of the System's guaranteed acceptances held by foreigners. As of mid-January, outstandings were reduced to $592 million from the peak of over $2 billion on November 6, 1974. The last $2 million of such acceptances will mature in May. A few foreign accounts have been buying unguaranteed acceptances, and the amount held for those accounts is now at $176 million. In general, the market has performed reasonably well, as should be expected in a period of declining interest rates.

In response to a question by Chairman Burns, Mr. Holmes said that, on the whole, the market had adjusted quite smoothly to the elimination of the System's guarantee on acceptances held by foreign accounts. Initially, regional banks had encountered some minor difficulties in selling acceptances, but as he had indicated, over all the market had performed reasonably well.

In reply to a question from Mr. Black, Mr. Holmes said that although rates on acceptances differed according to the credit standing of the accepting bank, it appeared that banks had not faced serious problems in moving acceptances.

Mr. Black then said he was concerned about the cautious attitudes of banks because he felt such attitudes had contributed to the recent sluggishness in the growth of the money supply. He asked whether Mr. Holmes thought the reserve requirement cut announced yesterday would affect bank attitudes.

In reply, Mr. Holmes said he thought yesterday's action would probably have some effect on attitudes. On the whole, however, he would expect banks to remain more cautious than normally.

In response to a question by Chairman Burns, Mr. Black said he would not like to see any significant expansion of bank loans at this time. He noted, however, that banks seemed reluctant even to buy investments, and they were tending to hold excess reserves for unusually long periods. He hoped that banks would begin to increase their investments and thus stimulate growth in the monetary aggregates.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period December 17, 1974, through January 20, 1975, were approved, ratified, and confirmed.

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

Of the alternatives presented in the blue book,[1] alternative A is based on the 6 per cent rate of growth in M_1 over the 7-month period from November 1974 to June 1975 that was adopted by the Committee at its previous meeting. As indicated in the blue book, attainment of such a growth rate--given the shortfall in December--would require a 6-3/4 per cent rate of growth in M_1 over the first half of this year. Since January expansion in M_1 also appears to be falling well short of long-run desires, an even more rapid rate of growth in M_1 would be implied for the months ahead.

Of the other alternatives shown, alternative B in effect forgives the December shortfall and is based on a 6 per cent rate of growth over the first half of this year. Alternative C includes a rate of growth in M_1 over the first half of this year of around 5-1/4 per cent. Growth rates for M_2 under all three alternatives work out to be on the order of 2 to 3 percentage points more than for M_1.

The Committee is well aware that there has been a steady shortfall in M_1 growth in recent months at given Federal funds rates. A principal reason for this has been the continued weakening of the economy relative to projections. That does not, however, in my view fully account for the weakness in M_1 growth.

So far as we can tell from our models, the demand deposit component of M_1 has been weaker relative to both actual GNP and interest rates than would have been predicted. An obvious question is: has demand for money more or less permanently shifted downward in relation to GNP, or have we simply been confronted with a temporary aberration? We do not yet have sufficient experience, or reason, to assume a permanent downward shift in money demand. In January, growth in broader measures of money appears larger than usual relative to M_1, possibly indicating an increased preference for interest-bearing deposits relative to demand deposits. But month-to-month variations in the mix of deposits have been volatile enough to preclude

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

conclusions at this point that the public has, on a permanent basis, shifted its preference more toward time deposits or other instruments relative to demand deposits. Thus, we have assumed a sharp rebound in growth of demand deposits and of M_1 in February and March as past relationships between demand deposits and other variables are restored.

But it also needs to be recognized that developments with respect to the supply of money, rather than to money demand, may be retarding money growth. Banks have been very cautious in their approach to lending and investing in recent months. The lag in the decline of the prime loan rate is one bit of evidence. Another piece of evidence is the apparent rise in banks' demand for free reserves above what would have been predicted given current market interest rate levels. As a result, we have experienced a sharp drop in member bank borrowings over the past several weeks that has offset a good part of the reserves supplied through open market operations. In other words, increased liquidity preference on the part of banks may have been retarding money growth. Given the available reserve supply, our projections of M_1 assume that banks will become more willing lenders and investors over the weeks ahead; to be explicit, they assume that, once borrowings are reduced to relatively low levels, banks will not wish to add large amounts to their excess reserves.

Obviously, we cannot be sure at what point, or to what extent, either the demand and/or supply sides of the money function will once again exhibit more normal behavior. Thus, a larger than usual measure of uncertainty adheres to staff projections of relationships between interest rates and the money supply.

In response to a question from Mr. Bucher, Mr. Axilrod said he had no plausible explanation for the slow rate of growth during December in consumer-type time and savings deposits, and therefore in M_2. After considering and rejecting various hypotheses, the staff had concluded that the slow December growth was simply a random aberration.

Mr. Bucher noted that data on currency in circulation showed a marked increase in the rate of growth of large denominations. For example, currency in denominations of $50 through $10,000 had increased at an annual rate of more than 16 per cent in 1974, compared with about 12 per cent in 1973 and 8 per cent in 1969. If the increase in large denominations outstanding was primarily for purposes of hoarding, then a growing proportion of the money supply would be inactive. That, of course, would have implications for the significance of particular changes in M_1.

In reply, Mr. Axilrod remarked that both the rapid growth of currency and the particularly sharp rise in large denominations outstanding in 1974 appeared to be primarily explainable in terms of transactions needs in a year of rapid inflation. In his judgment, the 1974 increases did not deviate sufficiently from recent trends to suggest that there had been a substantial increase in hoarding.

Mr. Morris commented that his staff's findings supported Mr. Axilrod's conclusion that the growth in currency holdings in 1974 was not much out of line with recent experience.

Mr. Mitchell agreed that the currency increase likely was due to transactions demands and not hoarding. He noted, for example, that the indifferent reaction of Americans to the opportunity to purchase gold cast doubt on the hypothesis that hoarding had become prevalent.

Mr. Wallich noted that large CD's outstanding had increased sharply during 1974. In his judgment, changes in CD's--as well as the month-to-month fluctuations in Government deposits--created greater difficulties in interpreting money supply statistics than did movements in currency.

Mr. Eastburn asked about the rate at which M_1 was likely to grow in 1975 if the Federal funds rate were held steadily in the neighborhood of, say, 6 per cent.

In response, Mr. Axilrod said his best judgment--which could, of course, be off the mark--was that with a 6 per cent funds rate M_1 would grow at a rate of about 6-3/4 per cent during the first half of 1975 and considerably faster--probably at more than an 8 per cent rate--in the second half, assuming that the staff's GNP projections were correct.

Mr. Coldwell asked how confident the staff felt about the probability of attaining the M_1 growth rates for the January-February period shown under the various alternatives in the blue book, such as the 4 to 6 per cent rate of alternative A, given the shortfalls of recent months.

Mr. Axilrod replied that his confidence was not high. On the basis of past experience, it seemed reasonable to expect a rebound in the money supply, and under all three alternatives M_1 was projected to grow at a rate of 8 to 9 per cent in February. Such a February growth rate was likely, however, only if there was a pick up in demand deposit growth in the last half of January. He was not at all certain that that would occur in the present environment.

Mr. Coldwell then asked whether another shortfall might not result if loan demands remained weak or if banks continued to exercise caution in making loans.

In reply, Mr. Axilrod noted that the staff projections assumed that banks would buy investments--in particular, that they would participate heavily in the upcoming Treasury financing--especially when faced with the alternative of holding large excess reserves. There now were substantially more safe investment outlets than, for example, in the 1930's when banker caution had led to a sharp run-up in excess reserves. In the current environment banks certainly should be willing buyers of U.S. Government securities, if nothing else.

Mr. Morris said he was disturbed by Mr. Axilrod's comments on demand deposits today, just as he had been last night on reading in one of the documents distributed that the staff had found "no fully convincing rationale for the slow rate of growth of the demand deposit component of the money stock." In his view, the staff was neglecting the fundamental proposition that deposit growth depends on the expansion of bank loans and investments. In that regard, he noted that total bank loans and investments were lower in December of 1974 than in July. Moreover, total reserves had declined over that period, according to a blue book chart, and excess reserves had not risen markedly. In his judgment, the lack of demand deposit growth stemmed simply from the fact that banks had not had an adequate reserve base to permit deposit expansion.

Mr. Axilrod said he might note in defense of the staff that the analysis Mr. Morris had quoted had not addressed the question of how to increase money growth; had it done so, the answer would have been to supply more reserves. Instead, the purpose had been to examine a demand relationship--that between the amount of money the public wanted to hold and interest rates, at given levels of GNP. The staff had concluded that the money supply would have grown faster recently than it in fact had if the historical relationship had been holding. Since none of the explanations for the shortfall that were explored had proved satisfactory, and since, in the past, the demand curve had exhibited long-run stability, it had not seemed unreasonable to conclude that the level of demand deposits would move back into a more normal relationship with interest rates.

Continuing, Mr. Axilrod remarked that because of an apparent increase in recent months in their demands for free reserves, member banks had sharply reduced their borrowings from the System, so that the behavior of total reserves had been much weaker than that of nonborrowed reserves. Open market operations directed at achieving a still faster growth in non-borrowed reserves would have resulted in a sharp drop in the Federal funds rate, and the Committee had chosen to constrain declines in the funds rate.

Mr. Morris said he agreed that the Committee's constraint on declines in the funds rate was responsible for the recent lack of growth in reserves, which in turn explained the weakness in deposits.

Chairman Burns observed that there evidently was some confusion in the various kinds of information on reserves shown in the blue book. For example, a text table indicated that total reserves had grown at annual rates of about 8-1/2 per cent in the past 12 months, 6-1/2 per cent in the past 6 months, and 4-1/2 per cent in the past 3 months. Those data were inconsistent with the indication in the chart to which Mr. Morris had referred that total reserves had declined on balance in recent months. He might note in passing that the growth rates shown for nonborrowed reserves were far higher--10-1/2, 20-1/2, and nearly 35 per cent for the past 12, 6, and 3 months, respectively.

Mr. Axilrod observed that the apparent inconsistency was a result of a difference in the way in which changes in reserve requirements were treated in the blue book in connection with data on reserve levels and on growth rates in reserves. All figures on growth rates were adjusted to compensate for changes in reserve requirements. On the other hand, the charts and tables relating to reserve levels reflected the actual levels, without such adjustments. The usual procedure was to indicate in the charts of reserve levels the points at which requirements had been changed by breaks in the line and explanatory footnotes. It appeared, however, that in the chart Mr. Morris had cited such indications had been inadvertently omitted in connection with the reserve requirement changes of September and December 1974. That omission had contributed to the confusion mentioned by the Chairman.

Mr. Axilrod added that the marked difference between the fourth-quarter growth rates of total reserves and nonborrowed reserves--4-1/2 per cent for the former and nearly 35 per cent for the latter--reflected the sharp drop in member bank borrowings he had mentioned. The 4-1/2 per cent increase in total reserves might best be viewed in relation to the 4.1 per cent increase in the bank credit proxy, which includes all bank deposits subject to reserves.

In response to a question by Mr. Mitchell, Mr. Axilrod said banks had reduced their borrowing partly because the System had been supplying a substantial amount of nonborrowed reserves. It was true that their repayments were larger than might have been expected on the basis of past relationships between the discount rate and market rates. In his judgment, that reflected a strong desire for liquidity stemming from the aftermath of the Franklin National Bank failure and other developments affecting confidence.

Mr. Mitchell said the Federal Reserve apparently had accommodated that desire for liquidity. However, he wondered how banks might respond in the future, now that their borrowings had been reduced to low levels.

Mr. Coldwell remarked that the reduction in borrowing did not necessarily indicate that banks had fully satisfied their desire for liquidity.

Mr. Mitchell then asked whether the volume of activity in the inter-bank market had changed significantly.

Mr. Axilrod replied that inter-bank borrowing appeared to have dropped more than seasonally in the latter part of December--probably in conjunction with particularly intensive year-end window dressing efforts--but it had picked up since then.

Chairman Burns observed that he had had a table prepared showing growth rates by years for eight different concepts of the money supply. He had asked for those data because, in a changing world, liquidity requirements were increasingly being met in novel ways, and in his judgment the Committee tended to focus unduly on the narrowly defined measure of money. Without citing all of the figures, he might note that using the broadest definition --which included CD's, savings bonds, short-term U.S. Government paper, and commercial paper--money had grown at a rate of 10 per cent in 1974, as compared with 4.5 per cent for M_1, 7.3 per cent for M_2, and 6.7 per cent for M_3. In addition, since 1966 the broadest concept of money had grown far more rapidly than either M_1 or M_2, and the gap between that comprehensive measure and the narrowly defined money supply had widened. He intended to have more extensive analyses made of such data and would have the results distributed to the Committee.

Mr. Wallich remarked that the staff's current projections for the first half of 1975 would tend to support the Chairman's findings, since they allowed for considerably more rapid growth in M_2 and M_3 than in M_1. On the other hand, he recalled that prior to the 1960 recession, when he was a member of the Council of Economic Advisers, the Council had responded to criticisms of the slow growth in M_1 by referring to the ample growth in total liquid assets. The fact that a recession subsequently did occur suggested that M_1 would have been a more appropriate measure to focus on than total liquid assets, at least at that time.

In response to a question by the Chairman, Mr. Wallich observed that the direction of causality was unclear; M_1 might have declined then because of the recession.

Mr. Balles said he agreed with the view expressed by Mr. Morris that inadequate reserve growth, stemming from the Committee's constraint on declines in the Federal funds rate, had resulted in monetary growth substantially below the Committee's targets. He recalled that on an earlier occasion, when growth in the monetary aggregates was exceeding the Committee's targets, the Chairman had observed that the explanation was simple--the System was providing too many reserves. The same reasoning would seem to apply, in an opposite direction, to the current situation.

Chairman Burns remarked that Mr. Balles' point was valid. He might note, however, that interest rates had declined considerably in recent months. For example, the Federal funds rate had dropped from a peak of 13-1/2 per cent in early July to 7-1/4 per cent currently, and the commercial paper rate had declined from 12-1/4 to 7-3/8 per cent. To be sure, the Committee could have tolerated an even faster decline in the funds rate, but doing so would have increased the risk that rates would rise again at a time when the economy was still weak.

Mr. Balles said he thought it was important to pursue the question of the harm that might have resulted if the Committee had permitted a more rapid decline in the funds rate--say, to a level of 4 or 5 per cent. Except for the risk the Chairman had mentioned, he personally was unable to think of many ways in which damage might have been done.

Chairman Burns replied that two factors came to mind immediately. First, a large number of people, who had given up hope as far as the Congress and the Administration were concerned, still looked upon the Federal Reserve as the guardian of the integrity of the nation's money and the guardian of monetary stability. Secondly, the weakness in foreign exchange markets in recent months had been due in part to the decline in interest rates in the United States relative to interest rates abroad. It was a fair judgment that if short-term rates had fallen more rapidly than they actually had, the dollar would have depreciated more--possibly much more. That not only would have reduced confidence but also would have had a direct effect on the domestic price level.

Mr. MacLaury remarked that he also was impressed by the magnitude of the recent decline in the Federal funds rate. It was noteworthy, however, that despite the large decline, the growth rates of the monetary aggregates had been below the Committee's targets. With respect to the various concepts of money the Chairman had mentioned earlier, he was not sure what significance should be attached to the fact that the broader measures had tended to grow more rapidly than the narrower ones. It was quite possible that because of structural changes the Committee should begin to emphasize different measures of money than in the past. As far as the measures themselves were concerned, however, he thought the essential question was not how fast they were growing but how stable the relationship was between their changes and changes in GNP over time.

The Chairman observed that growth rates for the various concepts of money, when used in conjunction with turnover rates, could provide some insight into the nature of institutional changes under way. Turnover rates of such money substitutes as deposits at thrift institutions were rising, suggesting that they were being used increasingly to serve the functions served by money narrowly defined. He might note that he had held some preliminary discussions with the staff about the potential usefulness of aggregating data for the various money-like assets, with the series for each asset weighted by its turnover rate. He was not yet sure that such a weighted aggregate would be meaningful, but the approach seemed likely enough to be fruitful to warrant further investigation. Work along that line would be going forward at the Board, and the Reserve Bank Presidents might also be interested in having similar analyses carried out at their Banks.

Mr. Holland referred to Mr. Axilrod's earlier comment that in recent months the relationship among interest rates, GNP, and M_1 had gone awry. He asked whether M_2 and M_3 had exhibited more stable relationships with interest rates and GNP.

In reply, Mr. Axilrod said that particular question had not been investigated in detail. It was true, however, that the behavior of consumer-type time and savings deposits had not been as inconsistent with expectations as that of M_1, so that the weakness in demand deposits had accounted for most of the weakness in M_2 and M_3. Accordingly, he suspected that the relationships involving those aggregates had been more stable than that for M_1.

Mr. Black remarked that he had been interested in the concept of a weighted-average monetary aggregate for a long time and thought the Chairman's suggestion that the subject be investigated had a good deal of merit. With respect to the outlook for money demands, he agreed with most of the points Mr. Axilrod had made in his excellent presentation; with respect to considerations bearing on the supply of money, he concurred in the views Mr. Morris had expressed earlier. On the question of banker conservatism, he wondered about the extent to which bankers' attitudes stemmed from concern about capital inadequacy, as opposed to a desire for liquidity.

Mr. Axilrod replied that it was difficult for him to gauge the factors that might influence the decisions of bank directors. He believed, however, that capital adequacy was an important factor. He assumed that some role also was played by concern about potential losses on loans and by awareness of the dangerously over-extended positions banks had faced in the summer, when they had had some difficulty in rolling over CD's. Such considerations were, of course, related to the question of capital adequacy.

Mr. Black then remarked that he saw no reason why such cautiousness would prevent banks from investing rather heavily in U.S. Government securities.

Mr. Axilrod observed that, as he had noted earlier, the assumption that banks would acquire Government securities was critical to the staff's projection of stepped-up money supply growth. Banks were expected to participate heavily in the forthcoming large-scale Treasury financings and also to be net purchasers of short-term, although not long-term, municipal securities.

Mr. Holland observed that because bank purchases of even the shortest-term Government securities would result in a reduced capital asset ratio--as measured by total capital over total assets --banks might be less willing than usual to invest in such issues.

Chairman Burns remarked that, to some modest degree, banks might follow the alternative course of building up excess reserves. He considered it extremely unlikely, however, that they would accumulate excess reserves to the extent they had in the 1930's, barring a complete collapse of confidence.

Mr. Mitchell said he thought that Federal Reserve jawboning had had a great deal to do with bringing about the present cautious investment policy of banks. Some action might be needed now if banks were to be encouraged to buy Government securities. He was not sure, however, just what form that action might take.

Mr. Black commented that yesterday's reduction in reserve requirements might have an important effect in that connection.

Mr. Kimbrel remarked that recent conversations with business people in his District had tended to confirm some of the Chairman's earlier comments. In those conversations he found despair over Congressional inaction and disappointment with the Administration's shift in attitude regarding the need to fight inflation. In his opinion, interest rates already had declined so far as to raise questions about the sustainability of present levels, particularly in light of the large volume of Treasury financing that would be associated with budget deficits of the magnitudes under discussion. Against that background, he expected bankers in his District to be reluctant to commit funds except for relatively short periods. At least two large banks in the Sixth District already had planned advertising campaigns, to begin in June, which focused on consumer instalment loans. While he did not know whether that represented the beginning of a trend, he would prefer that rates not decline too sharply. He certainly would not want rates to be driven down to levels that would be unsustainable and would result in a premature back up.

Mr. Eastburn noted that in the discussion thus far a number of references had been made to the liquidity problems of banks. While he agreed that the situation at banks was important, he thought it was also important to bear in mind that the problem was not confined to banks; rather, it extended to corporations, individuals, and State and local governments. Thus, even if banks were now to respond in the manner desired, the efforts of other types of economic units to restructure their balance sheets might limit the effects on expenditures for goods and services.

Chairman Burns said he would interpret the situation as one in which a corrective process was needed to deal with the serious mistakes that had been made within both the banking system and the business community. Banks were now recognizing their mistakes and taking the necessary corrective measures. As had been mentioned, there was a danger that they might go too far in that direction, but that was still a concern for the future; at the moment the System should not discourage their efforts to put their houses in order.

Mr. Eastburn observed that he had not meant to advocate such a course, and Chairman Burns remarked that he recognized that fact. He (the Chairman) went on to say that the needed corrective process might well slow the economic recovery. However, if a more rapid recovery were built on the unsound financial conditions now prevailing, the troubles that would be encountered later--a year and a half or two years from now--might be far more serious than the present ones.

Mr. Wallich observed that he had made some rough calculations which started from the premise that at the present 7 per cent unemployment rate real GNP was about 6 per cent below its full employment potential. If 4 per cent were taken as the rate of growth in real GNP at which the unemployment rate would remain unchanged, and if it were decided that the shortfall in real GNP should be made up within a 3-year period, the growth rate in real GNP over that period would be expected to average 6 per cent, ignoring the effects of compounding. The rate of growth in nominal GNP would, of course, depend on the anticipated rate of inflation; if prices were expected to advance at a 4 per cent rate, nominal GNP would rise by 10 per cent per year, and on the less optimistic assumption of a 6 per cent inflation rate, the annual increase in nominal GNP would be 12 per cent.

Such figures for nominal GNP growth, Mr. Wallich continued, might be contrasted with figures derived by assuming specific rates of increase in the income velocity of money and in the supply of money. One might, perhaps optimistically, take 2 per cent per year as the rate at which velocity would increase, given constant interest rates. If, then, the Committee held firmly over the 3 years to its present longer-run target for growth in M_1 of 6 per cent, nominal GNP would expand at a rate of only 8 per cent per year. It would thus appear that maintenance of that target for M_1 growth would result in too small a money stock to permit the present shortfall in real GNP to be eliminated within 3 years. He did not mean to imply that a higher rate of monetary growth was obviously needed; indeed, he was not prepared to draw any policy conclusions from that kind of analysis at this time. Nevertheless, he thought the magnitudes he had mentioned were useful to keep in mind.

Mr. Morris said he was concerned about the range of the policy alternatives presented by the staff in the blue book. The most aggressive option shown--alternative A--implied a 4-3/4 per cent rate of growth in M_1 over the year ending in June 1975--a rate below any longer-run target agreed upon by the Committee over the past year. For the November to June period, the M_1 growth rate shown under that alternative was 6 per cent, as compared with the rate of 7-1/4 per cent shown under the most aggressive alternative in the December blue book. He thought he understood the staff's reasoning; no doubt they felt that, given the latest shortfall, the growth rate now needed to achieve the June level implied by December's alternative A would be considered unacceptably high by the Committee. Nevertheless, he found the situation disturbing.

Chairman Burns noted that the Committee's choices were not limited to the alternatives presented by the staff; the members were free to propose any additional alternatives they desired.

Mr. Morris said he understood that the Committee had a wider range of options than set forth in the blue book. Nevertheless, he thought that the nature of the alternatives presented by the staff had some effect on the outcome of the Committee's discussion. He would hope that when shortfalls occurred in the future the longer-run targets would not be scaled down as a consequence.

Mr. Mitchell remarked that he viewed the significance of the options presented in the current blue book in rather different terms. As he understood it, under alternative A short-term rates would fall sharply, and then rise as spring progressed; under B rates would fall less, and the reversal would be delayed until perhaps early summer; and under C rates would remain about level.

Mr. Partee said it might be helpful if he explained how the staff proceeded in formulating the blue book alternatives. One of the alternatives always shown involved the maintenance of prevailing money market conditions; in the present case, that was alternative C, the tightest of the three. Another alternative always shown involved the longer-run growth rate for M_1 adopted by the Committee at its previous meeting. Since on this occasion that alternative called for a rather sizable near-term decline in the Federal funds rate followed by an upturn before the end of the 6-month projection period, the staff thought it probably would be as liberal a policy as the Committee was likely to consider within the range of reasonableness. Consequently, that alternative was labeled "A," and the third was formulated to fall between the other two.

While he agreed that significant shortfalls from the targets for the aggregates should not be ignored, Mr. Partee continued, he might note that the Committee had a choice regarding the length of the period over which it would seek to compensate for them. The Committee had lengthened that period at times in the past, in connection with both shortfalls and overshoots. Such a lengthening might be appropriate now because, in light of the most recent shortfall, a high rate of growth would be needed in the time remaining until June to achieve a longer-run growth rate on the order of that previously contemplated.

Mr. MacLaury remarked that he found highly relevant Mr. Partee's comments about the possibility of lengthening the period over which misses were to be made up. In that connection, he noted that at times in the past the blue book had contained a chart illustrating options with respect to such periods. He had found those charts to be highly useful, and he hoped they would be included in future blue books whenever the staff wanted to suggest an option of that kind. Such charts, together with textual discussion of the interest rate implications of each of the options, would facilitate decision-making by the Committee.

Mr. Mitchell said he thought the Committee should recognize the special nature of the policy alternatives presented at this meeting. Some members might feel that the end of the downturn in the real economy probably was now in sight, and others might not. However, they all would no doubt agree that the outlook was still highly uncertain. Of the three alternatives presented by the staff, he would interpret the middle one as involving a posture that, in effect, would temporize in the face of uncertainty by permitting interest rates to drift a little lower but not drastically lower.

Chairman Burns expressed the view that the present blue book presented a fuller and more precise analysis of the implications of the policy alternatives described than any of its predecessors.

In reply to a question by Mr. Coldwell, Mr. Holmes said he thought Government securities dealers generally expected that short-term interest rates would decline and that that probably would tend to put downward pressure on long-term rates. They were, however, concerned about the magnitude of forthcoming Treasury financings, and they expected that the Treasury would find it necessary to offer securities in every maturity area. Presently, dealers were not as anxious to hold on to inventories in anticipation of price advances as they typically had been at corresponding stages of earlier cycles.

Chairman Burns then called for the discussion of monetary policy and the Committee's directive. To begin, he wanted to make some general observations of his own. He thought the Committee had had a good discussion of the economic situation. All were aware of the deterioration that had taken place in the real economy and of the recent performance of prices which indicated a lower rate of inflation. The consumer price index for December being released this morning would show an annual rate of increase of 8.4 per cent. The Committee was also aware of the outlook for Governmental finances. He thought the members should bear in mind that strong actions bearing on the economic situation had already been taken by the Government and others were in the making. The Government had acted on housing programs; legislation had been passed that would lead to material expansion in public service employment and in the coverage and duration of unemployment insurance; and a sizable tax cut was undoubtedly in the making. He also wanted to underscore the comments that had been made earlier regarding the widespread opinion in the business and financial community that the Federal Reserve was almost the only institution still dedicated to the integrity of the dollar and to a return to an approximation of price stability.

Mr. Coldwell said he thought that further easing through open market operations and the discount rate could be held back somewhat in light of the Board's announcement of a reduction in reserve requirements. He was disturbed today, as he had been over the last few months, by the emphasis in the operational paragraphs of the draft directives[1/] on monetary aggregate targets that had not been performing very well. He recommended again that the Committee consider adopting an operational paragraph indicating that it "seeks to achieve somewhat easier bank reserve and money market conditions, expecting a faster growth in monetary aggregates over the months ahead." His basic reason for favoring that sort of approach in the past--and it was reinforced by recent experience--was that an M_1 target did not provide very good guidance for the Manager. Adoption of such a target now could lead to excessive movements in the Federal funds rate during the inter-meeting period in either the upward or the downward direction. It seemed to him that a steady but slow decline in the funds rate from 7-1/8 per cent to perhaps 6-1/2 per cent could provide the stimulus needed at this time. He believed that any hesitation in fostering a further decline in the Federal funds rate might cause an undesirable back-up in

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

market interest rates; on the other hand, he was not ready for another reduction of 150 basis points in the funds rate during the inter-meeting period.

With that objective in mind, Mr. Coldwell continued, he would propose specifications that would encompass wider January-February ranges for the aggregates than shown in the blue book, including a range of 4 to 7 per cent for M_1, 7-1/2 to 9-1/2 per cent for M_2, and 7 to 10 per cent for RPD's. For the funds rate, he would suggest an inter-meeting range of 6-1/8 to 7-1/2 per cent. He would not mind if the funds rate range were somewhat narrower than that; his general objective was to achieve a slow downdrift in the rate, without significant back-ups.

Turning to the staff's draft of the general paragraphs of the directive, Mr. Coldwell observed that the reference to the President's energy proposals appeared to be misleading in that there was no mention of proposed tax increases other than excise taxes on oil products.

Following discussion of that point, Chairman Burns suggested that the language be amended to read in part: "...the program includes new taxes in the energy area along with measures of tax relief that, on balance, are designed to have a neutral effect on the size of the Federal deficit."

Mr. Coldwell indicated that such a revision would meet his point.

Mr. Morris said he wanted to compliment the Board of Governors on its decision to reduce reserve requirements. He thought the action was highly constructive not only for its effect as a signal but also from the standpoint of alleviating the System's membership problem.

Mr. Morris observed that, as he had intimated in his earlier remarks, he continued to be seriously concerned about the course of monetary policy over the past 6 months. The country was clearly moving into the most severe recession of the postwar period at a time when both the nation's corporations and its banks were in the least liquid position of the postwar years. To him, that combination implied a strong possibility that the economy would turn out to be substantially weaker than the staff projections suggested. He thought monetary policy should guard against such a contingency by moving more aggressively now.

In particular, Mr. Morris continued, he believed that it was essential to keep short-term rates moving down aggressively, for two reasons. First, the primary imperative of monetary policy at present was to create a set of financial conditions that would permit a strong revival of the mortgage market. In the absence of such a revival, it was likely that real GNP in the second half of the year would be much weaker than the staff had projected. Second, with corporations under substantial pressure to restructure their balance sheets and with State and local governments certain to be large borrowers, the bond market was going to be under a heavy burden this year. He was worried about the ability of the bond market to handle the load that would be imposed upon it by those two sectors, even apart from the financing requirements of the Federal Government. He was not concerned so much about long-term rates, which he did not expect to decline very much, as he was about the depth of the market--its ability to handle a large volume of securities.

In his judgment, Mr. Morris remarked, the key to assuring the necessary absorptive capacity was a steeply upward-sloping yield curve. Such a curve would give portfolio managers a strong incentive to lengthen the maturities they held. Greater willingness on the part of investors to stretch out maturities and make long-term commitments was a key to economic revival.

Mr. Morris added that he did not find any of the alternative sets of specifications offered by the staff to be fully adequate, but if he had to choose one it would be alternative A. He could foresee political problems for the Committee later this year if it followed the policy he had suggested. Clearly, the more short-term rates were reduced now, the larger would be the increase needed later to maintain control over the monetary aggregates in an expanding economy. On the other hand, a reluctant approach in reducing short-term rates now would represent a sub-optimal policy as far as the economy was concerned. It seemed urgent to him that steps be taken now to produce an upturn in economic activity during the second half of the year that was at least strong enough to permit the unemployment rate to level off at around 8 per cent.

Like others, Mr. Morris observed, he was greatly concerned about the prospective size of the Federal deficit. It seemed to him, however, that the most important thing the Committee could do to moderate the size of the deficit would be to take steps to assure that the recession did not become too deep or too prolonged. The main source of the deficit, in his judgment, was the recession.

Chairman Burns said he would agree that the recession was a significant factor in explaining the Federal deficit. He believed, however, that the main sources of the deficit were the built-in expenditure increases in the Federal budget and the prospective tax cuts.

The Chairman added that political considerations were of virtually no importance in his own thinking. The Federal Reserve would be subjected to severe criticism no matter what it did. When he had commented earlier about a possible back-up in interest rates, he had had in mind the economic, and not the political, consequences. And while he had not spelled it out at the time, he also had had in mind the effects that rapid growth in the monetary aggregates would have on the prospects for inflation and, therefore, on the behavior of long-term interest rates.

Mr. Black said he continued to be quite concerned about the slow growth of M_1 over the last 7 months and, like Mr. Morris, he applauded the Board's decision to reduce reserve requirements. He thought it should be kept in mind that over the same 7-month period the Committee had permitted the Federal funds rate to decline by more than 650 basis points from its peak, and that key short-term rates had fallen from about 300 to nearly 500 basis points. Unfortunately, the sharp drop in money market rates and the related changes in money market conditions had not resulted in growth in the monetary aggregates at the rates desired.

However, Mr. Black continued, for a number of reasons he anticipated an acceleration in monetary growth over the months immediately ahead, perhaps even if interest rates were not reduced further. It was important to remember that the monetary aggregates responded with a lag to market developments. Also, as Mr. Axilrod had noted, banks had been following unusually conservative policies in recent months. Banks were likely to be large buyers of Government securities in the period ahead in light of the low level to which their borrowings from the System had fallen and of the reduction in reserve requirements announced yesterday. Finally, the prospective tax refund and tax rebate checks would probably lead to at least a temporary bulge in the money supply.

In his judgment, Mr. Black remarked, the Committee should now temper somewhat its efforts to push down the Federal funds rate, given the outlook for faster growth in the money supply and the prospects for an expansive fiscal policy. In addition, he was not indifferent to the relatively rapid growth in the broader measures of money over the past year. As Mr. Holland had suggested on a number of occasions, M_2 and M_3 might provide a better index than M_1 of the potential impact on the economy of recent easing actions.

Mr. Black added that an important objective for monetary policy was to help restore confidence. Too much easing at this point would lead many observers to conclude that the Federal

Reserve had given up in its fight against inflation. Accordingly, he came out in favor of alternative B. He would retain a 6-month target of 6 per cent for M_1, although he would not want to actively resist any tendency for growth in M_1 to exceed that rate over the next several months. The longer-run target of 8-3/4 per cent shown for M_2 under alternative B struck him as amply generous. For the January-February period, the targets for M_1 and M_2 associated with alternative B seemed about right. For the Federal funds rate, however, an upper limit of 7-1/2 per cent seemed too high; he would set the ceiling at 7-1/4 or perhaps even 7 per cent. He would hold the Federal funds rate within a relatively narrow range unless market rates fell significantly in response to the reduction in reserve requirements. In that event he would allow a further reduction in the Federal funds rate and perhaps also give consideration to a lower discount rate.

Mr. Mayo observed that he shared Mr. Coldwell's preference for paying a little more attention to money market conditions than to M_1 at this time. He would not want to ignore M_1, which was widely read as a gauge of monetary policy, but he was impressed by the uncertainties involved in the linkages relating to that aggregate. He had been persuaded by the argument that growth in demand deposits would be stimulated as banks, which were now in a more liquid position, became sizable buyers of Government securities. Indeed, he expected the effect to be stronger than that the staff had allowed for in its projections. Accordingly, he believed it would be possible to achieve the longer-run targets of alternative A, including the 6 per cent growth rate in M_1 shown for the November-June period, if the Committee adopted the short-run ranges of tolerance for the aggregates shown under alternative B and a range for the Federal funds rate of, say, 6 to 7-1/2 per cent, which was close to that of B.

Mr. Mayo said his preference for a funds rate range more like that of alternative B than A was reinforced by his concern about the problems that would be created later if interest rates were reduced too sharply now. Those problems, which he viewed as being more economic than political, related to the real danger that the economic recovery would be inhibited if public psychology were to be adversely affected by a large rebound in interest rates. However, whether the Committee adopted the specifications of alternative A or B, for the operational paragraph of the directive he would prefer the language of alternative A, which called for "more rapid" growth in monetary aggregates, to that of alternative B, which called for "somewhat more rapid" growth.

Mr. MacLaury noted that a number of those around the table were wary of relying too heavily on the monetary aggregates as guides to policy under current circumstances. While he appreciated the reasons for that attitude, he was still impressed by Mr. Morris' earlier observation that, even if alternative A were adopted today, M_1 would be expected to rise by only 4-3/4 per cent over the year ending in June 1975. That was a smaller rise than he would want to see over the 12-month period. For those who preferred to focus on M_2, he might note that under alternative A the expansion over the year would be 7-3/4 per cent; that too, would be on the low side under present circumstances.

Mr. MacLaury observed that he applauded the tax cut under consideration for fiscal 1975 and he shared the misgivings about anticipated expenditure increases in fiscal 1976. Nevertheless, he thought current monetary policy should be designed to exert a stimulative impact on economic activity. Even with the expansionary fiscal policy in prospect for fiscal 1976, he did not anticipate that unemployment would fall below a 7 per cent rate by mid-1976--some 18 months away.

Apparently, Mr. MacLaury continued, the main reason some Committee members were not ready to adopt a policy that would assure moderate growth in the aggregates--indexed by a 6 per cent growth rate in M_1--was the fear that the Committee would not be able--or would not be prepared--to let interest rates turn back up once expansion in economic activity began. He believed that reasons could be found for that fear, even in the Committee's own past history. Nevertheless, it would be unfortunate if the Committee was not prepared today to permit much decline in interest rates, if that was needed to get the monetary aggregates growing at moderate rates. He thought that Chairman Burns' point was well taken that an unduly easy policy could lead to high long-term rates by fostering inflationary expectations, and he believed the Committee had not taken adequate account of that consideration at times in the past. But if the Federal Reserve wanted to maintain its reputation as the last bastion against inflation, the time to demonstrate its resolve was not now but later, when it became necessary to permit interest rates to rise again.

Accordingly, Mr. MacLaury remarked, he favored alternative A. However, he thought it would be appropriate to raise both limits of the funds rate constraint by a quarter of a point. The range then would be 5-1/2 to 7 per cent, and the midpoint 6-1/4 per cent.

Mr. Balles said he agreed that the Federal Reserve would be subjected to criticism at this point regardless of the policies it pursued. Nevertheless, he thought the System could not be completely immune to recent criticisms, from Congressmen and others, that it was making the recession deeper and longer than necessary. In an era of management by objectives, the System's performance would be judged by the observable results. Unfortunately, growth rates in the monetary aggregates had been low for a rather extended period--since about mid-1974--and market observers were assuming that that outcome had been intended. Certainly, it was not very easy to explain away persistent low growth rates as misses from intended rates.

Mr. Balles went on to note that the staff's projection of an economic recovery in the second half of 1975 was based on an assumption that M_1 would grow at a 6 per cent rate. Even on that basis, he suspected that any errors in the projection would be in the direction of optimism. In his judgment, it was now imperative to get the aggregates back on the path which the Committee had been trying to achieve for some time. He did not think the alternative A scenario for the longer-run targets--implying growth of only 4-3/4 and 7-3/4 per cent for M_1 and M_2 in the 12 months ending in June--would be viewed as an inflationary monetary policy under present conditions. In short, he did not see any inconsistency between a long-term commitment to fight inflation and a short-term commitment to revive growth in the monetary aggregates.

Mr. Balles added that the failure of the monetary aggregates to meet the target paths desired by the Committee over any period of 6 months or longer had to be explained mainly by either excessive or deficient growth of bank reserves. In retrospect, it was clear that growth in bank reserves since mid-year had been inadequate to meet the Committee's objectives for the aggregates. The policy issue was now rather clearly joined between those who wanted to place primary emphasis on interest rates and money market conditions, and those, including himself, who were concerned about returning the aggregates to the Committee's target path. As he looked back over the past 24 to 30 months, he concluded that the flexibility of monetary policy had been rather seriously limited by the Federal funds rate constraints which the Committee had imposed.

Therefore, Mr. Balles continued, he favored alternative A, which would provide the monetary stimulus in the short run that was needed to achieve the sort of economic recovery envisioned in the staff's projection. The Committee might be facing some severe problems later in holding down the growth of the monetary aggregates as the Treasury undertook to meet its large financing needs in the market. But for the near term he thought it was highly important to get the aggregates moving up again, in line with the Committee's targets.

Mr. Debs said his prescription for policy was very close to that of Mr. Mayo. It could be argued that the present longer-run targets of 6 per cent for M_1 and 9 per cent for M_2 should be raised, because the economic outlook had weakened considerably since the last meeting and because there now were more definite signs that inflation was beginning to come under control. He thought, however, that there were very strong reasons for retaining the present targets. First, as had been noted earlier, fiscal stimulus was clearly in prospect, and it was also clear that the stimulus would probably be much greater than the President was seeking. Second, the possible size of the Federal deficits could make it much more difficult to avoid an unwanted monetary acceleration later in the year, just when the economy might be starting to recover. Such a development would be most unfortunate, since the inflation problem was still far from being resolved. Finally, if the Committee were to try to make up for the shortfalls in the long-term aggregates, it would be necessary to continue or even to accelerate the sharp decline in interest rates that had occurred in the past several months. He would not want to continue a rapid rate of decline without having a much better idea of its probable impact on the aggregates and on the economy in general. It was clear that much more study needed to be done on the linkages associated with the various measures of money. And finally, monetary policy could not ignore the foreign exchange markets, which had been extremely sensitive to the decline in interest rates in this country over the past few months. That was another strong reason for moving rather cautiously.

Accordingly, Mr. Debs said, he would prefer to stay with the long-term targets adopted at the last meeting, which were associated with alternative A. However, he would not want to see a range for the Federal funds rate as low as the 5-1/4 to 6-3/4 per cent range shown under that alternative. Like Mr. Mayo, he was not convinced that such a low Federal funds rate was needed to achieve the longer-term aggregates targets of A. His preference for the funds rate would be a range of about 6-1/2 to 7-1/4 per cent--a narrow range that would be suitable at this time--but he could also accept the broader range of 6-1/4 to 7-1/2 per cent shown under alternative B. In any case, he thought it would be desirable to have the Manager probe below the present funds rate level rather cautiously, moving more decisively if the aggregates continued on the weak side.

As for the short-term tolerance ranges for the aggregates, Mr. Debs continued, given the figures now coming in for January, he believed the Committee would have to accept relatively low growth in the January-February averages. He could go along with the alternative B range of 3-1/2 to 5-1/2 per cent for M_1--implying a sharp pickup in the growth rate for February--but like Mr. Coldwell he would prefer a wider range--perhaps 4 to 7 per cent. As for M_2, the alternative B range of 7 to 9 per cent was acceptable, but again, he would prefer a higher upper limit--something like 10 per cent. As for the wording of the directive, he shared Mr. Mayo's preference for the language of alternative A.

Chairman Burns observed that in recent weeks he had been involved in some very sensitive discussions relating to the international political position of the United States. On the basis of that experience he could say with some confidence that the exchange rate of the dollar was being watched very closely at this critical time by heads of governments, finance ministers, and foreign ministers around the world. Every weakening of the dollar in the foreign exchange markets did something to reduce the strength of the country's international political position. He believed that the Committee, in reaching a decision on policy today, should keep in mind to at least a minor degree the performance of the dollar in foreign exchange markets.

Mr. Francis said he thought that the current slowdown in economic activity, which appeared to have started at the end of the first quarter of 1973, differed considerably from previous recessions. As he had indicated at the previous meeting, it seemed to him that the slowdown was initially brought on by capacity limitations, since he was not aware of any prior economic stabilization moves that would have exerted a retarding effect on demand. Supply factors seemed to have had an adverse impact on economic activity in subsequent quarters, including supply constraints related to the oil situation, new environmental and safety regulations, shifting demands due to changing exchange rates, and wage and price controls. By the fourth quarter of 1974, slower growth of demand probably added to capacity and supply constraints in worsening the recession. His view of the role of stabilization policy was based on the fact that the money stock had expanded at a rate of about 8 per cent for a considerable period prior to mid-1973. Monetary expansion then moderated somewhat to a range centering around 6 to 7 per cent until mid-1974. In the second half of last year, however, the expansion in M_1 fell to a rate of about 3-1/2 per cent on a quarterly average basis.

In his judgment, Mr. Francis continued, the decline in real GNP was now probably at or close to the bottom. The rate of inflation in 1974 was about double that indicated by past stabilization policy as a result of special factors that had to work their way through the economy. That process seemed to be near completion; there already was evidence that the reported rate of inflation was declining, and he hoped shortly to see the rate of price advance slow to about 6 or 7 per cent. It was important that that decline not be interpreted as indicating that the inflation had been whipped and that it was therefore safe for policy makers to pour fuel on the coals; an underlying inflation problem would still remain.

Mr. Francis added that since the fiscal policy outlook suggested very large deficits over the next 18 to 24 months, he could envisage two possible scenarios for policy. First, the Committee could monetize a large portion of those deficits, as had happened on occasion in the past. Such a policy might help to delay the rise in interest rates that was likely to occur, but he thought the eventual outcome would be much higher interest rates than otherwise, and more severe pressures than he would like to see on financial institutions. The other course would be to start now to provide the reserves that the economy needed over time to move it along. He did not agree with the view that it would be desirable to make a heavy injection of reserves in the short run in the expectation of backing off somewhere down the road. He would prefer to move immediately to a rate of growth in M_1 of about 5 or 5-1/4 per cent, as contemplated under alternative C. Such a policy might not have as rapid an impact on real product as a more aggressive policy, but he was confident that over the longer term a recovery would be achieved with less disturbance to the financial sector and with a lower rate of inflation than had been experienced for some time. The alternative C specifications seemed to fit his policy views very well.

Mr. Eastburn said that, after considering the three kinds of trade-offs the Committee now appeared to be facing, he had concluded that it should move vigorously toward getting the aggregates back on track. The first trade-off was the chronic one of inflation versus unemployment. Of the two, it seemed to him that unemployment had become the more important problem. He did not mean to imply that the fight against inflation could be abandoned, but he believed the rate of inflation over the next few months might well be surprisingly favorable.

The second trade-off had to do with fiscal and monetary policy, Mr. Eastburn continued. It was clear that a stimulative fiscal policy was in prospect, but the staff analysis made at the Philadelphia Bank--and at the Board also, as he understood it--suggested that the impact of the fiscal package proposed by the President would be relatively small and relatively short-lived. There was the possibility, of course, that more--perhaps substantially more--fiscal stimulus would be provided, and the situation would have to be watched carefully. As matters now stood, however, he thought it would be unwise to proceed on the assumption that fiscal policy should fight recession and that monetary policy should fight inflation; the two should be working together.

The third trade-off related to the issue of supplying funds now against supplying funds later, Mr. Eastburn observed. At recent meetings he had been concerned about the possibility that unduly marked easing might create problems later in the form of overshoots in the monetary aggregates and related increases in interest rates. However, the aggregates had been lagging so far behind the Committee's targets that vigorous action was needed if they were to catch up. He did not see any real risk of fostering inflationary pressures through such a policy. While he did see a problem associated with rising interest rates later, rates were likely to rise almost regardless of what the Committee did and so that problem would have to be confronted in some degree in any event. He was impressed by Chairman Burns' observations about the attention being paid to the dollar in the foreign exchange markets and he agreed that the international implications of the System's actions could not be ignored. However, he believed that failure to bring the economy out of recession could have even greater implications internationally than the performance of the dollar in the exchange markets.

Mr. Eastburn observed that such considerations led him to favor alternative A. He would permit the Federal funds rate to drop substantially in order to get the expansion needed in the monetary aggregates. He would also raise the upper limits of the January-February ranges for the aggregates shown under alternative A to permit more rapid growth in M_1 and M_2, should that develop. He had in mind a range of something like 4 to 8 per cent for M_1 and a parallel increase for M_2. If the Committee adopted that course, he thought the policy record prepared for this meeting should reflect the Committee's conscious recognition that it might be necessary for interest rates to rise later.

In response to Chairman Burns' request for his policy recommendation, Mr. Partee noted that he had been a strong advocate of faster growth in the monetary aggregates for several months, and he had believed that the Committee should be prepared to reduce interest rates in order to keep the aggregates expanding at the desired pace. He continued to hold that view.

For a number of reasons, Mr. Partee continued, he would not exclude M_1 from among the aggregates that should concern the Committee. First, it was the principal vehicle for transactions. Second, it served as a proxy for a whole range of money market conditions that were important to the performance of the economy. And third, he was not convinced that as yet its relative position had deteriorated as badly as some had suggested.

Mr. Partee added that he agreed with Mr. Morris' view that lower short-term interest rates would improve conditions in both the mortgage market--and thus in the housing industry--and the bond market. Portfolio managers were well aware that when short-term rates were low relative to longer-term rates, investment in short-term assets involved a sacrifice of current income. Thus, the more the yield curve sloped upward, the greater their incentive to lengthen maturities.

Both in that connection and with respect to the aggregates, Mr. Partee continued, he thought the main question facing the Committee was one of degree--how fast and how far to move. In the case of aggregates, he felt it would be unreasonable to attempt to make up for a large and sustained shortfall in a relatively short period of time. He would find it reasonable to achieve the Committee's longer-run 6 per cent growth target for M_1 by tolerating some shortfall from that rate over the next few months and compensating with some overshoot later on in the year. With regard to interest rates, too, he believed that moderation and continuity in movement were important. Accordingly, he would not want to see the Federal funds rate and the associated family of short-term rates drop sharply now, after a period of several months in which the Committee had carefully fostered declines at a moderate pace. He would recommend, therefore, that for the time being the Committee accept targets in the vicinity of those associated with alternative B. He would continue to seek lower interest rates, and because he regarded the performance of the aggregates in December and January largely as an aberration, he would not give up hope of a rebound before too long.

Mr. Kimbrel indicated that his own views were quite similar to Mr. Partee's. He viewed the reduction in reserve requirements announced yesterday as desirable and in keeping with a policy of gradual easing designed to contribute to the growth of the aggregates and to economic recovery. In his opinion, the fiscal policy actions already taken or being contemplated by the Administration and by the Congress could be characterized as abundantly stimulative; in fact, if they continued to be implemented over an extended period, he would be concerned that they might contribute to even greater inflation. He remained disturbed about inflation as a longer-run problem.

Mr. Kimbrel added that he did not think monetary policy actions could provide any major stimulus to the economy in the immediate future, given the lagged effects of such actions. He would prefer to continue the recent pattern of moving slowly but steadily to a more accommodative posture. He hoped that the Committee would not be found guilty in retrospect of having over-reacted to events of the moment and of having diverted its attention from the long-term goal of stability.

In keeping with those views, Mr. Kimbrel observed, he favored the specifications associated with alternative B, including longer-run targets for the aggregates characterized by growth in M_1 at a rate in the 6 per cent area. A substantial decline in interest rates at this time would not be consistent with his desire to move gradually, and he hoped that the Federal funds rate could be maintained within a range of 6-1/4 to 7-1/4 per cent.

Mr. Wallich remarked that, as he had suggested earlier, a long period of time--indeed, several years--might be required before the economy returned to full employment if the Committee were to maintain a 6 per cent rate of growth in M_1 or some corresponding rate of expansion in M_2. While such a course would have the highly desirable result of wringing most of the inflation out of the economy, he doubted that the Committee could adhere to such a policy for that long. One might conclude in the abstract that the Committee should try to move quickly to a higher growth path for the money supply and then stabilize growth at the higher level. The Committee had resisted that course because a sharp acceleration in the expansion in money might be taken as a signal that it had given up the fight against inflation. He had been among those who were concerned about that risk and he would still hesitate to give such a signal. Moreover, he would not want to avoid the issue by shifting from a monetary growth target to an interest rate target. The relatively low growth of the money supply was evidence that the System had persisted in its anti-inflationary efforts, and a shift to interest rate targets under present circumstances might be viewed as an effort to gloss over the failure to achieve the moderate growth rates desired.

Mr. Wallich remarked that his desire to avoid a dramatic move was reinforced by the expansionary posture of fiscal policy and by the programs that had been adopted to assist housing and the unemployed. There was also the fact that the dollar had declined quite a bit in the foreign exchange markets; while he had not considered that a major tragedy, he did share Chairman Burns' view that at some point further weakness in the dollar would have an adverse impact on the nation's international position.

In sum, Mr. Wallich observed, while he was inclined toward specifications along the lines of those shown under alternative A, he would not want at this point to lower the Federal funds rate aggressively in order to stimulate growth in the aggregates. Thus, some shading of the alternative A specifications toward those of B would be satisfactory to him.

Mr. Bucher said he agreed with most of the statements made thus far, although not necessarily with all of the conclusions drawn. In contrast to the past, when he had often been certain about his own policy preferences, he felt quite uncertain today. Indeed, he found the policy decision today to be one of the most difficult he had encountered in his term of service.

On balance, Mr. Bucher remarked, he favored continuing the policy of gradual movement the Committee had been following in recent months. One of the primary considerations leading him to that conclusion related to the observations by Chairman Burns and others on the subject of public confidence and the role of the Federal Reserve in that connection. There were numerous indications of serious erosion of confidence in the nation's institutions, governmental and private, and in the nation's currency, both domestically and internationally. He placed a great deal of importance on the way in which people perceived things and on the consequences that flowed from those perceptions. Consequently, he thought the Committee had to remain aware of the confidence factor and of its potential implications for what it was trying to accomplish.

His specific preference, Mr. Bucher continued, was a posture somewhere between alternatives A and B. He would like to see the Federal funds rate decline gradually over the next 4 weeks from its present level to around 6-1/2 per cent, and he would continue to be patient about a return of M_1 to a 6 per cent growth path. He believed that all of the benefits that some Committee members wanted to obtain through a sharp drop in interest rates would eventually be achieved under a more gradual approach. The results would come more slowly, but with less danger of adversely affecting longer-term objectives. There had already been improvement in flows of funds to thrift institutions, and he foresaw continuing improvement in the bond markets. Patience now would reduce the chances that policy would have to be reversed sooner than would otherwise be desirable. In particular, he did not want to see a turnaround in interest rates next fall when he hoped housing would be recovering, nor a reversal of the recent gratifying price developments.

Mr. Holland said Mr. Partee's views were closer to his own than any others he had heard today. The present interval was a highly troublesome one for policy-making, partly because it was particularly important at this juncture to keep both short-run and long-run objectives in mind, and some of those objectives were in conflict. While the Committee had to deal with a recession, it could not go all out in providing monetary stimulus because of the risks of fostering further inflation. Although the episode of double-digit inflation appeared to have passed, at least for a time, the Committee still had to seek a gradual cooling of inflation over the longer run while it sought a decent recovery in economic activity.

Given the unfolding shape of fiscal policy, Mr. Holland continued, he thought the generation of an upturn in economic activity would rapidly decline in importance as an objective of monetary policy. Indeed, he believed an upturn no longer depended much on monetary policy, so long as that policy was not unreasonable. Rather, the Committee's decisions would increasingly affect the strength and duration of the recovery, and its health in terms of the real and price dimensions of increases in nominal GNP.

In his judgment, Mr. Holland observed, that pointed to the desirability of assuring reasonable rates of growth in the monetary aggregates from now until mid-year. Views would differ, of course, on what growth rates were "reasonable" and a not unimportant consideration was the nature of public perceptions of particular growth rates. However, the most important considerations related to the economic effects of the growth rates achieved, especially in M_2 and M_3. He thought the growth rates in those aggregates between now and mid-year should be in the area just below the two-digit level. The performance of M_2 and M_3 was crucial because it would reflect the stock adjustment in the positions of depository institutions that was needed to encourage what might be called more stabilizing lending policies--that is, lending policies more liberal than at present but not so aggressive as to create problems later during the recovery.

Mr. Holland said he agreed that a change in the attitudes of bankers was needed. Also, as Mr. Morris had emphasized, an upward sloping yield curve was required; indeed, the curve already had a substantial positive slope. However, it had to be borne in mind that in the short run, lending and investing activity in general and the deposit-creating activities of banks in particular were a product of attitudes that were conditioned by many forces, among which the supply of reserves was only one. In terms of the System's near-term tactics, therefore, it would be desirable to try to influence attitudes through a range of monetary policy devices rather than by simply flooding the economy with money and liquid assets. The latter approach might well produce the yield curve and the turnaround in bankers' attitudes that were needed, but there would be a price to pay later in the form of increased difficulty in implementing the policy of restraint that might be required when reasonably full resource employment was achieved. In sum, he believed that such actions as the reduction in reserve requirements announced yesterday and perhaps some further adjustments in the discount rate had the potential for achieving some of the attitudinal changes he had in mind with less need to supply reserves than if the open market approach were followed in isolation.

In terms of a particular policy prescription, Mr. Holland said he favored moving slowly on the open market side for a few weeks to see if attitudes were in fact changing as a result of the reserve requirement and discount rate actions. He would not want to wait long, perhaps not even until the next meeting of the Committee, before evaluating the progress being made. The aggregate growth rates shown under alternative B were acceptable to him. For the Federal funds rate he would set a floor of 6-1/4 per cent, or even 6-1/2 per cent, and an upper limit of 7-1/4 per cent. He did not want any backup in the Federal funds rate; that would be counter-productive by any standard. If after some experience that range for the Federal funds rate did not prove to be consistent with the desired growth in the aggregates, he would be prepared to adopt a more aggressive policy.

Turning to the language of the directive, Mr. Holland said he found acceptable the amendments suggested by the staff this morning to take account of yesterday's action on reserve requirements.[1/] In the paragraph which set forth the Committee's general policy objectives, he would suggest changing the order of the clauses to refer first to the System's anti-recessionary

1/ A copy of the staff note on these changes is appended as Attachment C.

objective and then to its continuing objectives of resisting inflation and achieving equilibrium in the balance of payments. He thought that order would be more in keeping with the Committee's current policy emphasis. With regard to the operational paragraph, he would prefer to call for "more vigorous growth" in the aggregates rather than for either "more rapid" or "somewhat more rapid" growth.

Mr. Sheehan observed that, according to a news story published today, a number of monetarist economists were applauding the Federal Reserve for its recent conduct of monetary policy. However, the monetarists evidently had widely varying views regarding the proper growth rate for M_1, ranging from 3 to 8 per cent.

More generally, Mr. Sheehan continued, he was struck by the wide differences among eminent economists regarding the appropriate course for monetary policy under present circumstances. While that no doubt reflected the difficulty of the times, it seemed to him that the facts and their implications were relatively straightforward. If one examined the data assembled in the blue book, it was clear that over the last 6 months the monetary aggregates had grown at rates far short of the Committee's targets. For example, in the last half of 1974 M_1 grew at a rate of 2.8 per cent, compared with the Committee's target of 5-1/4 per cent. While it was true that the shortfall followed an overshoot in the first half of the year, it was still hard to understand, especially in light of the sharp decline in the Federal funds rate since July.

Mr. Sheehan noted that the Committee was on record as favoring an eclectic approach, in which it did not focus exclusively either on the monetary aggregates or on interest rates and money market conditions, but rather gave some weight to both. The performance of credit markets in recent months had been relatively sound, but the behavior of the aggregates viewed in isolation had been rather dismal. He believed that the System was highly vulnerable to criticism on that score. Since System spokesmen had indicated in Congressional testimony that it was possible to control the growth rates of the monetary aggregates over periods of 6 to 9 months, it would be particularly difficult to explain the shortfall over the second half of 1974. The problem would be compounded by the discouragingly weak behavior of the aggregates unfolding for January, and perhaps also by shortfalls for subsequent months in line with the tendency to undershoot monetary targets in periods of economic weakness.

In his judgment, Mr. Sheehan remarked, the Committee should continue to be eclectic and give weight to all relevant factors. To him, that would call for strong efforts now to stimulate growth in the aggregates, including larger injections of reserves and a rather significant further reduction in short-term interest rates, if those were the requirements for faster growth. He did not believe it would be necessary to flood the banking system with reserves in order to accomplish the objective. He favored the specifications of alternative A, and he would be prepared to accept specifications involving even greater easing if needed.

Mr. Winn said he had wondered while listening to the discussion today whether the Committee's perspective might not be distorted somewhat by the fact that it met at monthly intervals. In particular, he wondered what ranges of tolerance the Committee might adopt now if it did not plan to meet again for 6 months.

In the present environment, Mr. Winn continued, it might be unrealistic to expect M_1 to move onto a 6 per cent growth path by the time of the February meeting even if the Federal funds rate were to be lowered to 5-1/4 per cent, the bottom of the range associated with alternative A. Perhaps more attention should be given to the leads and lags that were involved and to the possibility that the recent shortfall was due in part to temporary factors. In the latter connection, the reserves supplied during November and December might have been offset in part by the rise of currency in circulation, by "as of" adjustments, and by other technical factors. Those factors could well be self-correcting in ways the Committee did not now foresee because of its focus on the short-run relationship between the Federal funds rate and the monetary aggregates.

Mr. Winn added that it might be helpful to make public an analysis of monetary prospects for the longer run, along the lines of the discussion in the blue book. Wider circulation of such material could contribute to the sort of change in attitudes that Mr. Holland had described, by encouraging people to act sooner in making financial commitments and in restructuring their balance sheets. That would eliminate the need for such actions at a time when interest rates were rising and would thus reduce the problems the Committee would face when actions were needed to restrain excessive growth in the aggregates.

In sum, Mr. Winn observed, he would urge that the Committee employ a somewhat longer perspective, not only for specifying objectives but also for evaluating performance. It might well be that not enough time had passed to assess the results of the considerable easing in money market conditions that had occurred over the course of recent months; indeed, what was now happening to the aggregates might well be reflecting in part the Federal funds rates of several months ago. He was in sympathy with the opinion of Messrs. Coldwell and Mayo that the Committee should continue on its easing course but not act precipitously.

Mr. Clay said he had listened with great interest this morning to the discussion concerning the recently abnormal behavior of the monetary aggregates. He was a little surprised at the apparent surprise of others about the recent difficulties in controlling the aggregates and in understanding their behavior. Because the times themselves were abnormal, one should expect people to behave abnormally and statistics to follow abnormal paths.

Recently, Mr. Clay continued, public psychology had shifted rapidly through three phases, from an inflationary psychology to one characteristic of an inflationary recession and then to a recession psychology. He thought the economy needed more stimulus than it had been getting, and accordingly he had been delighted by the reduction in reserve requirements announced yesterday. The shortfall of the monetary aggregates from the Committee's targets was unfortunate. In an effort to bring the aggregates back on track, he would favor seeking the growth rates shown under alternative B, with a funds rate constraint of 5-3/4 to 7-1/4 per cent.

Mr. Clay added that he thought it might be a good idea under present circumstances for the Chairman, or perhaps some other System official, to announce publicly that the Committee was aiming for a growth rate in the money supply of 6 per cent--or whatever rate the Committee decided upon--over the first half of the year. Normally, he would not advocate that procedure. At the moment, however, he believed such an announcement would have beneficial effects on the psychology of businessmen and others, and would increase the chances that the objectives of policy would be achieved.

Mr. Baughman remarked that, like others, he regretted that the growth rate of the money stock had not been closer to the rate the Committee had sought. Generally speaking, however, he thought it would not be desirable for the Committee to attempt to compensate for past shortfalls; rather, it should start from whatever level of the money stock was prevailing and aim at achieving the appropriate rate of growth from that point on. He also thought experience had demonstrated that the monetary aggregates were better guides to policy than interest rates, and he saw no particular reason for deviating from such targets at present. A number of speakers today had referred to the problems that would arise in the future at the time when interest rates began to increase. In his judgment, criticisms of the Federal Reserve and pressures on it were inevitable at such times. The best course would be to accept that as a fact of life and consider how best to cope with the problem when it arose, rather than to search for means of avoiding it.

With respect to current policy, Mr. Baughman said that both the language and the specifications of alternative B appeared appropriate to him. He was interested in Mr. Holland's suggestion that the System seek to accomplish its near-term objectives by using a range of tools, including reserve requirements and discount rates, rather than by relying mainly on open market operations. He wondered whether it might not be possible to work through some other avenues also, such as discount window administration and the classification of assets in bank examinations.

Mr. Mitchell observed that, unlike Mr. Bucher, he disagreed with a large proportion of the statements that had been made today. As was usually the case, however, he did agree with some of the things he had heard. In particular, he thought Messrs. Coldwell and Holland had described their policy preferences in about the same terms as he would. In his judgment, the policy actions taken since the last meeting of the Committee, including the reductions in both the discount rate and reserve requirements as well as open market operations, added up to a fairly substantial dose. He did not think the System should rest on its oars at this point; rather, like Mr. Coldwell, he would like to see a continued gradual decline in the Federal funds rate over the period until the next meeting.

With reference to the comments by Messrs. Morris and Partee about the need to give portfolio managers an incentive to lengthen their maturities, Mr. Mitchell continued, he personally was not sure just how much of an incentive was required. Before pushing hard on them, however, he would be inclined to give them a little time to absorb the implications of the present upward slope of the yield curve. He suspected that the savings and loan associations would be stimulated into action by the size of the inflows they were currently experiencing.

Finally, Mr. Mitchell observed, he was worried that the Committee would let the behavior of M_1 trigger a sharp reduction in the Federal funds rate. He shared Mr. Coldwell's lack of confidence in M_1 at this juncture; indeed, he had no confidence at all in M_1 as a short-term indicator at present. If he were to focus on any aggregate, it would be the bank credit proxy. In that connection, he was disturbed to see that the highest growth rate for the proxy the staff anticipated for the first half of 1975 under any of the blue book alternatives was only 7 per cent. Following the 4 per cent growth rate of the fourth quarter, that did not strike him as high enough. He thought the banking system should play a more active role than it had in the past 3 or 4 months; otherwise, much of its function might well be taken over by the commercial paper market. He expected the credit proxy to grow faster than the staff had indicated, primarily through expansion of time deposits. Since reserves were used more efficiently in supporting time deposit than demand deposit growth, he thought there were ample reserves for the purpose.

In sum, Mr. Mitchell said, he hoped the Committee would cling closely to a Federal funds rate target in the coming period and not be diverted from the pursuit of a slow decline in that rate by the behavior of M_1.

Chairman Burns remarked that he had already conveyed his general views on policy and would make only a brief comment at this point on the subject of portfolio management. In his judgment, the analysis of that complex subject made around the table today was far from complete. It was true, of course, that if short-term rates dropped sharply, portfolio managers would begin thinking about moving into intermediate-term and long-term maturities, and forces would be released tending to make for lower longer-term rates. It was necessary, however, to consider additional questions--namely, the implications of a sharp decline in short-term rates for the pace of monetary growth, and the implications of a combination of sharply lower short-term rates and rapid growth in the money supply for the attitudes of both investors and borrowers. It was his judgment--and one which he thought was confirmed by econometric calculations--that under those circumstances renewed fear of inflation would be kindled and forces would be released that would nullify the normal response of long-term rates to a decline in short-term rates. He would expect long-term rates to move sharply higher and thereby frustrate the prospects of recovery sketched out by the staff and by other analysts. Even assuming a much smaller degree of fiscal stimulus than now seemed clearly in the making, the Board's econometric model indicated that the responses in the long-term markets would be sharp. That very real possibility had not been adequately considered in today's discussion.

The Chairman then said it appeared from the discussion that a majority of the Committee members favored specifications in the neighborhood of those shown under alternative B. Before considering the specifications in detail it might be useful to dispose of a number of questions relating to the directive. He asked first whether there were any objections to the revisions in its earlier draft that the staff had suggested today to take account of the reserve requirement action, or to the revision in the statement in the draft concerning the President's energy program that he had proposed following Mr. Coldwell's statement.

No objections to the revisions in question were expressed.

The Chairman then referred to Mr. Coldwell's suggestion that the operational paragraph focus primarily on money market conditions rather than, as in the staff's drafts, on the monetary aggregates, and he asked for the members' reactions.

Six of the members noted that they would find a money market emphasis acceptable, but a substantial majority indicated that they preferred language along the lines of the staff's drafts.

Chairman Burns remarked that the choice among the staff's alternatives for the operational paragraph seemed to lie between A and B, which differed only in the addition of the word "somewhat" in B to qualify the phrase "more rapid growth in monetary aggregates." With respect to the same phrase, Mr. Holland had suggested replacing "rapid" with "vigorous." He asked about the members' preferences.

A majority indicated that they preferred to omit the word "somewhat," and to use "rapid" rather than "vigorous."

Mr. Holland observed that he had also suggested reversing the order of the clauses in the statement of the Committee's general policy stance. He thought it would be consistent with the discussion today to refer to the objective of cushioning recessionary tendencies and stimulating recovery before mentioning that of resisting inflationary pressures.

In response to the Chairman's request for views, a majority of the members indicated that they preferred the order in the staff's draft.

Turning to the specifications, Chairman Burns said he would suggest for Committee consideration the longer-run growth rates for the monetary aggregates shown under alternative B, and the 2-month ranges of tolerance of B, except that the upper limit of the range for each aggregate would be increased by 1 percentage point.

After discussion, the Committee agreed that those growth rates were acceptable.

With respect to the inter-meeting range for the Federal funds rate, the Chairman said it should be recognized that, in view of the behavior of the financial markets, whatever lower limit was set by the Committee was likely to be reached during the inter-meeting period. Since the average rate in the last statement week was about 7-1/4 per cent, to set a lower limit of, say, 6 per cent would in effect be to say that a decline of 1-1/4 points over the next 4 weeks was acceptable. He would much prefer to adopt a range today of 6-1/2 to 7-1/2 per cent, on the usual understanding that, depending on developments, some adjustment might be made during the inter-meeting period.

In response to a question by the Chairman, a majority of the members indicated that they would prefer a lower limit of 6-1/2 per cent for the funds rate constraint to one of 6-1/4 per cent.

Mr. Holland remarked that he was disturbed by the proposal to set the upper limit for the funds rate at 7-1/2 per cent, since he would not want to see the rate rise during the coming 4 weeks.

Chairman Burns said it was his personal view that 7-1/4 per cent should be considered the effective ceiling in the absence of further consultation. He had suggested setting the upper limit at 7-1/2 per cent with the thought that special circumstances might arise under which the Committee would decide that a higher rate was justified. If the Committee preferred to set the upper limit at 7-1/4 per cent today, it could, of course, raise that limit in the event the need arose during the inter-meeting period.

A majority of the members indicated that they would prefer a 7-1/4 per cent upper limit for the funds rate.

Mr. Sheehan observed that in the earlier discussion of policy, those Committee members who had not favored the alternative B specifications had tended to lean toward those of A; there had been little sentiment expressed in favor of the C specifications. Accordingly, he was rather surprised to find that a majority was willing to accept a funds rate range with a lower limit of 6-1/2 per cent, which was half-way between the lower limits of the B and C ranges shown in the blue book.

Chairman Burns noted that the mid-point of the range the majority appeared to favor was 6-3/4 per cent, the same as the midpoint of the 6-1/4 to 7-1/2 per cent range shown under alternative B in the blue book. If, as he thought likely, the funds rate should decline to the lower limit during the next 4 weeks, it would have fallen by 3/4 of 1 per cent. And, of course, the Committee might find it desirable to reduce the lower limit during the inter-meeting period.

The Chairman then proposed that the Committee vote on a directive consisting of the staff's draft of the general paragraphs and alternative A for the operational paragraph, with the changes agreed upon earlier to clarify the statement regarding the President's energy program and to take account of yesterday's reserve requirement action. It would be understood that the directive would be interpreted in accordance with the following specifications. The longer-run targets--namely, the annual rates of growth for the period from December 1974 to June 1975--would be 6, 8-3/4, and 6-3/4 per cent for M_1, M_2, and the bank credit proxy, respectively. The associated ranges of tolerance for growth rates in the January-February period would be 6-1/4 to 9-1/4 per cent for RPD's, 3-1/2 to 6-1/2 per cent for M_1, and 7 to 10 per cent for M_2. The range of tolerance for the weekly average Federal funds rate in the inter-meeting period would be 6-1/2 to 7-1/4 per cent.

Mr. Sheehan said that, while he planned to vote for the proposed directive, he would do so reluctantly.

> 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 real output of goods and services fell sharply in the fourth quarter of 1974 and that further declines are in prospect for the months immediately ahead. In December declines in industrial production and employment again were sharp and widespread, and the unemployment rate increased from 6.5 to 7.1 per cent. Average wholesale prices of industrial commodities were unchanged, after having risen much less rapidly from August to November than earlier in the year, and prices of farm and food products declined. In recent months increases in average wage rates have been large, but not so large as in the spring and summer.

In his State of the Union message, the President set forth a program of fiscal stimulus, including tax rebates for individuals and a temporary increase in the investment tax credit for business. The President also proposed a new program to reduce the consumption of energy; the program includes new taxes in the energy area along with measures of tax relief that, on balance, are designed to have a neutral effect on the size of the Federal deficit.

The dollar in December and early January continued the gradual decline against leading foreign currencies that began in September. In November, as in October, the U.S. foreign trade deficit was moderate; sizable inflows of official funds from oil-exporting countries continued, while other capital inflows and outflows reported by banks were roughly offsetting.

The narrowly defined money stock grew at an annual rate of 4 per cent over the fourth quarter of 1974, while the more broadly defined measure of the stock grew at a rate of nearly 7 per cent. In December and early January, however, the narrowly defined money stock changed little. Net inflows of consumer-type time and savings deposits at banks slowed sharply in December, although they continued to improve at nonbank thrift institutions; in early January deposit inflows at banks picked up. Business demands for short-term credit, both at banks and in the commercial paper market, moderated further in December, while demands in the long-term market remained strong. Over recent weeks short-term market interest rates have declined substantially, but yields on long-term securities have changed little, on balance. Federal Reserve discount rates were reduced from 7-3/4 to 7-1/4 per cent in early January, and on January 20 the Board announced a reduction in reserve requirements on demand deposits estimated to release $1.1 billion in required reserves.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee, while resisting inflationary pressures and working toward equilibrium in the country's balance of payments, to foster financial conditions conducive to cushioning recessionary tendencies and stimulating economic recovery.

To implement this policy, while taking account of the forthcoming Treasury financing, developments in domestic and international financial markets, and the Board's action on reserve requirements, the Committee seeks to achieve bank reserve and money market conditions consistent with more rapid growth in monetary aggregates over the months ahead than has occurred in recent months.

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

Chairman Burns noted that a memorandum from the Committee's General Counsel, entitled "Proposed revision of Committee's Rules Regarding Availability of Information in light of 1974 amendments to Freedom of Information Act"[1] had been distributed on January 16, 1975. He asked Mr. O'Connell to comment.

Mr. O'Connell observed that revisions in the Rules were necessitated by recent legislation amending that part of the Administrative Procedures Act known as the "Freedom of Information Act" which would become effective February 19, 1975. In his opinion, the new legislation required modifications in the procedures employed for making information of the Committee available to the public but not in the substance of what was made available. The broad objective of the amendments to the Act was to insure more responsible, meaningful, and rapid handling of requests. Among other things, they provided for specific time limits for making a determination as to the availability of requested information and for acting on appeals of denials of information; they required that there be clear identification of the official responsible for denials; and they required promulgation of a uniform schedule of fees to be charged for search and duplication of agency records.

Mr. O'Connell noted that the specific changes he recommended in the Committee's Rules, shown in Attachment B to his

1/ A copy of this memorandum has been placed in the Committee's files.

memorandum, affected parts of Sections 271.4 and 271.6. No changes were proposed in Sections 271.1, 271.2, 271.3, 271.5, and 271.7, or in subsections (a) and (b) of 271.4.

Within Section 271.4, Mr. O'Connell continued, the changes involved revisions in subsection (c) and the addition of new subsections (d), (e), and (f). With respect to subsection (c), one of the recommended revisions would substitute the Secretary of the Committee for the presently designated Secretary of the Board as the person to whom requests for access to Committee records should be addressed. A second would delete the present language relating to fees for locating and copying requested records, in view of the proposal that a fee schedule be set forth separately in the new subsection (f). Finally, language would be added indicating, in accordance with new requirements of the law, that the Secretary would determine within 10 working days after a request was received whether or not to comply, and that he would immediately notify the requesting party of his decision and the reasons therefor and of the latter's right to appeal any denials of records to the Committee.

Mr. O'Connell observed that the addition to Section 271.4 of subsections (d) and (e), which related, respectively, to appeals of denials of access to records and to extensions of time requirements in unusual circumstances, also was proposed in order to conform with new statutory requirements. Subsection (d) provided that appeals of denials could be filed with the Secretary within 10 days, and that the Committee--or such member or members as the Committee might designate--would make a determination regarding the appeal within 20 working days of the receipt of the appeal notice and would immediately notify the appealing party of the nature of the decision and of the party's right to seek a court review of any decision that upheld the denial by the Secretary.

Mr. O'Connell emphasized that the limit of 10 working days for responding to initial requests and the limit of 20 working days for acting on appeals both related to the determinations as to whether the records requested would be made available, not to the physical production of any records requested. In cases where the response was favorable, a reasonable additional amount of time would be available for actually locating and supplying the records.

Before turning to the fee schedule in the proposed new subsection (f) of Section 271.4, Mr. O'Connell commented briefly on the two revisions proposed in Section 271.6. The first involved a modification of the wording of item (a) in the list contained in that section of the types of information that would not be disclosed except as might be authorized by the Committee. Item (a) concerned information exempted from disclosure by statute or executive order, and the modification was recommended to conform to a change in the corresponding provision of the statute. The second revision involved the deletion of the concluding sentence of 271. 6, which provided that any person denied access to Committee records could file a written request within 5 days for Committee review of such action. That deletion would, of course, be desirable if the Rules included the provisions for appeals contained in the proposed new subsection (d) of 271.4.

Mr. O'Connell noted that the Committee could act finally today with respect to all of the proposed revisions in the Rules except the adoption of subsection (f) of 271.4, setting forth the fee schedule. Final action with respect to the latter had to be deferred because of a statutory requirement that proposed uniform schedules of fees be published for comment. The Board of Governors was, of course, subject to the same requirement in connection with its own Rules Regarding the Availability of Information, and the schedule contained in the proposed 271.4(f) of the Committee's Rules was identical with one the Board yesterday had authorized for publication in the Federal Register, except that reference was made to the Secretary of the Committee rather than to the Secretary of the Board. The proposed language called for a charge of $10 per hour for time spent in searching and 10 cents per standard page for copying. For information obtainable only by computer processing, it provided for a fee "not to exceed the direct and reasonable cost of retrieval and production of the information requested," and indicated that detailed schedules of such charges were available on request.

Mr. O'Connell said he recommended that the Committee adopt the revisions in Sections 271.4 and 271.6 of its Rules Regarding the Availability of Information set forth in Attachment B to his memorandum, effective February 19, 1975, except for the fee schedule shown in the proposed new subsection (f) of 271.4; and that it authorize publication for comment in the Federal Register of that fee schedule, in the expectation that final action would be taken on the matter, in light of comments received, on or before February 19.

After discussion, the Committee agreed that Mr. O'Connell's recommendations should be approved.

By unanimous vote, Sections 271.4 and 271.6 of the Committee's Rules Regarding the Availability of Information were amended to read as follows, effective February 19, 1975:

Section 271.4--Records Available to the Public on Request

(a) Records available.--Records of the Committee are made available to any person, upon request, for inspection or copying in accordance with the provisions of this section and subject to the limitations stated in §§ 271.5 and 271.6. Records falling within the exemptions from disclosure set forth in section 522(b) of Title 5 of the United States Code and in § 271.6 may nevertheless be made available in accordance with this section to the fullest extent consistent, in the Committee's judgment, with the effective performance of the Committee's statutory responsibilities and with the avoidance of injury to a public or private interest intended to be protected by such exemptions.

(b) Place and time.--In general, the records of the Committee are held in the custody of the Board, but certain of such records, or copies thereof, are held in the custody of one or more of the Federal Reserve Banks. Any such records subject to this section will be made available for inspection or copying during regular business hours at the offices of the Board in the Federal Reserve Building, 20th and Constitution Avenue, Washington, D.C., 20551, or, in certain instances as provided in paragraph (c) of this section, at the offices of one or more designated Federal Reserve Banks.

(c) Obtaining access to records.--Any person requesting access to records of the Committee shall submit such request in writing to the Secretary of the Committee. In any case in which the records requested, or copies thereof, are available at a Federal Reserve Bank, the Secretary of the Committee may so advise the person requesting access to the records. Every request for access to records of the Committee shall state the full name and address of the person requesting them and shall describe such records in a manner reasonably sufficient to permit their identification without undue difficulty. The Secretary of the Committee shall determine within ten working days after receipt of a request for access to records of the Committee whether to comply with such request; and he shall immediately notify the requesting party of his decision, of the reasons therefor, and of the right of the requesting party to appeal to the Committee any refusal to make available the requested records of the Committee.

(d) Appeal of denial of access to records of the Committee.--Any person who is denied access to records of the Committee, properly requested in accordance with paragraph (c) of this section, may file, with the Secretary of the Committee, within ten days of notification of such denial, a written request for review of such denial. The Committee, or such member or members as the Committee may designate (pursuant to section 272.4(c) of its Rules of Procedure), shall make a determination with respect to any such appeal within 20 working days of its receipt, and shall immediately notify the appealing party of the decision on the appeal and of the right to seek court review of any decision which upholds, in whole or in part, the refusal of the Secretary of the Committee to make available the requested records.

(e) Extension of time requirements in unusual circumstances.--In unusual circumstances as provided in 5 U.S.C. § 552(a)(6)(b), the time limitations imposed upon the Secretary of the Committee or the Committee or its designated representative(s) in paragraphs (c) and (d) of this section may be extended by written notice to the requesting party for a period of time not to exceed a total of ten working days.

* * *

Section 271.6--Information Not Disclosed

Except as may be authorized by the Committee, information of the Committee that is not available to the public through other sources will not be published or made available for inspection, examination, or copying by any person if such information

(a) is exempted from disclosure by statute or is specifically authorized under criteria established by an executive order to be kept secret in the interest of national defense or foreign policy and is in fact properly classified pursuant to such executive order;

(b) relates solely to internal personnel rules or practices or other internal practices of the Committee;

(c) relates to trade secrets or commercial or financial information obtained from any person and privileged or confidential;

(d) is contained in inter-agency or intra-agency memoranda or letters, including records of deliberations and discussions at meetings of the Committee and reports and documents filed by members or staff of the Committee that would not be routinely available to a private party in litigation with the Committee;

(e) is contained in personnel, medical, or similar files (including financial files) the disclosure of which would constitute a clearly unwarranted invasion of personal privacy; or

(f) is contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of any agency responsible for the regulation or supervision of financial institutions.

Except as provided by or pursuant to this Part, no person shall disclose, or permit the disclosure of, any information of the Committee to any person, whether by giving out or furnishing such information or copy thereof, by allowing any person to inspect, examine, or reproduce such information or copy thereof, or by any other means, whether the information is located at the offices of the Board, any Federal Reserve Bank, or elsewhere, unless such disclosure is required in the performance of duties for, or pursuant to the direction of, the Committee.

By unanimous vote, publication for comment in the Federal Register of the following proposed uniform schedule of fees, intended for incorporation in the Committee's Rules Regarding the Availability of Information, was authorized:

Fee Schedule.--A person requesting access to or copies of particular records shall pay the costs of searching and copying such records at the rate of $10 per hour for searching and 10 cents per standard page for copying. With respect to information obtainable only by processing through a computer or other information systems program, a person requesting such information shall pay a fee not to exceed the direct and reasonable cost of retrieval and production of the information requested. Detailed schedules of such charges are available upon request from the Secretary of the Committee. Documents may be furnished without charge or at a reduced charge where the Secretary of the Committee or such person as he may designate determines that waiver or reduction of the fee is in the public interest because furnishing the information can be considered as primarily benefiting the general public.

Mr. O'Connell referred to his earlier observation that the new subsection (d) of 271.4 of the Rules provided that either the Committee "or such member or members as the Committee may designate" would act on appeals of denials of access to records. In view of the time requirements for responding to appeals and of the Committee's practice of meeting at monthly intervals, he would suggest that that responsibility be delegated to one member--preferably one located in Washington, where requests for records would be received and where the bulk of the records were kept.

After discussion, Chairman Burns suggested that the responsibility for acting on appeals be delegated to Mr. Holland, and in his absence, to Mr. Coldwell.

There was general agreement with the Chairman's suggestion.

By unanimous vote, responsibility for making determinations with respect to appeals of denial of access to Committee records, under the provisions of 271.4(d) of the Committee's Rules Regarding Availability of Information, was delegated to Mr. Holland, and in his absence, to Mr. Coldwell.

The Chairman then noted that two memoranda from the Secretariat, regarding the release of the Committee's memoranda of discussion for the year 1969, had been distributed on January 13, 1975.[1/] He asked whether there were any objections to the recommendations contained therein, and none was heard.

By unanimous vote, transfer to the National Archives of the FOMC memoranda of discussion for 1969, on the basis described in memoranda from the Secretariat dated January 13, 1975, was authorized.

1/ The first of the two memoranda recommended that the Committee authorize the release of its memoranda of discussion for the calendar year 1969 in the same manner as had been employed for earlier years--namely, by transmitting the original signed copies to the National Archives and placing bound volumes containing reproductions in the libraries at all Federal Reserve offices. The second memorandum recommended that when the 1969 memoranda of discussion were initially released, one passage, in the memorandum for November 25, 1969, be withheld, in accordance with a request by a foreign central bank. It was noted that such a procedure would be consistent with that followed in the corresponding documents for the years 1962 through 1968, where a number of sensitive passages had been withheld. A prefatory note included in the volumes for each of those years explained that deletions were made only for certain specified reasons, that the point at which each deletion occurred was noted, and that the general nature of the omitted material was indicated by footnote.

It was agreed that the next meeting of the Committee would be held on Wednesday, February 19, 1975.

Thereupon the meeting adjourned.

Arthur L. Broida

Secretary

ATTACHMENT A

Henry C. Wallich
January 21, 1975

Report to the Federal Open Market Committee on
International Monetary Meetings (January 1975)

The international monetary meetings held in Washington from January 9 to January 17 focused on two broad areas: arrangements for the multilateral financing of oil deficits and provisions governing the future evolution of the international monetary system. Some progress toward final agreement was noticeable in both areas.

With respect to arrangements for the multilateral financing of oil deficits, the Group of Ten Ministers and Central Bank Governors agreed that the Kissinger/Simon/OECD solidarity fund should be established at the earliest possible date. Several aspects of this new financial support arrangement, which will be open to all members of the OECD, have yet to be worked out. In particular, the form of financing for the solidarity fund and the distribution of quotas within the proposed total of $25 billion remain undecided and await political decisions. Although by the end of the meetings all countries supported the concept of the solidarity fund, it was necessary to make concessions to the viewpoints of other countries, particularly Germany, in order to reach agreement; it now appears that access to the fund will be only as a last resort, stiff policy conditions will be applied to borrowers, and tough majorities will be required to approve any loans made under the facility. Some countries have expressed concern that when final agreement on the solidarity fund is reached -- approval by the OECD

Council at the end of February is expected -- countries in need may be reluctant to apply to it.

A complementary proposal for a 1975 Oil Facility in the IMF was also approved in principle by the IMF Interim Committee. The United States initially opposed renewal of the 1974 Oil Facility, which was designed to borrow primarily from the oil-exporting countries and lend to countries in a quasi-automatic form on the basis of the increase in their oil import costs, without much regard to their overall position. The United States finally agreed to a 1975 Oil Facility with a limit of SDR 5 billion, roughly $6 billion, on total IMF borrowing for this purpose -- the Europeans and developing countries wanted a limit of SDR 10-12 billion. Many countries will press for the continuation of the oil facility concept in 1976 and hope that the 1975 Oil Facility will be expanded at a later date. The United States will continue to argue for the phasing out of the oil facility and for increased reliance on the IMF's regular resources in the General Account which provide for more efficient use of financial resources. In this connection, the United States received some support for the proposition that members of the IMF should be required to relax their constraints on the IMF's use of their currency subscriptions. Currently many currencies cannot be used because of countries' effective veto power.

On a third related topic, the Managing Director of the IMF mad a proposal that a Special Account be established that would be administe by the IMF and would receive contributions (from oil-exporting, industri and, possibly, other countries) that would be used to subsidize the interest burden on drawings from the 1975 Oil Facility by the most seriously affected developing countries. The Managing Director's proposal leaves open the question of how these contributions might be financed. The United States had proposed contributions to a Trust Fund administered by the IMF, which would be used to make actual loans at concessionary rates and should be financed in part from the "profits" on the IMF's gold holdings. This proposal was not well received, although it was referred by the IMF/IBRD Development Committee to the Executive Directors for further study. Although the Managing Director's proposal received general endorsement, it is known that several major countries do not support the idea, or will be unwilling, or unable, to contribute. Thus, the prospects for quick financial assistance for the most seriously affected developing countries remain uncertain.

Turning to other proposals concerning the evolution of the international monetary system that were before the IMF Interim Committee, a tentative agreement was reached on the question of increasing IMF quotas. It was tentatively agreed that (1) IMF quotas should be increased by 32.5 per cent, rounded up to a total size of the Fund of SDR 39 billion; (2) the collective quota share of the major oil-exporting countries should be doubled; (3) the collective quota share of the other developing countries should be unchanged; and (4) the next review of quotas should be in three years, instead of the normal five. It was also understood, but not made explicit, that the U.S. voting quota would be maintained at a level giving the U.S. certain veto rights. This tentative agreement on IMF quotas will require considerable negotiation within the IMF.

The major amendments tentatively scheduled for inclusion in the package are: (1) an amendment increasing the usability by the IMF of countries' currency subscriptions, (2) an amendment legalizing floating, (3) a comprehensive set of amendments on gold, and (4) an amendment establishing a permanent Council in the IMF to replace the advisory Interim Committee. It is clear that there will not be an amendment on the SDR/aid link, but the developing countries may insist on other concessions.

On the legalization of floating under the IMF Articles, few countries now support the U.S. view that countries should have the unrestricted right to permit their currencies to float indefinitely. France, some other industrial countries, and the developing countries continue to hold the view that any floating should be a temporary exception to a regime of stable but adjustable par values and should be subject to IMF approval and conditions. Nevertheless, it is hard to predict how firm an endorsement of legalized floating might ultimately prove acceptable to other countries as part of a package of amendments.

On gold, France presented its position favoring: (1) the abolition of the official gold price, (2) freedom for countries to engage in transactions in gold with the IMF, each other, and the market subject possibly to temporary restraining arrangements among governments -- but outside of the IMF -- governing such transactions, and (3) the return of the IMF's gold to its members. France does not favor a limited amendment dealing only with the payment of the gold portion of countries' quota increases. The Managing Director observed that (1) removing gold from the IMF Articles did not ensure its removal from the center of the international monetary system; (2) it was desirable to adopt arrangements to ensure that countries' gold stocks would decline; (3) the time period specified in any agreement on conditions governing gold transactions between governments and with the market should not be too short; and (4) the return of the IMF's gold to its members, at par, would hurt the Fund. Several representatives of other countries expressed support for his views. Nevertheless, it appears that the Interim Committee has gone some way toward the eventual adoption of the French position, although this depends on the working out of the details.

On the Council, it was generally agreed that an amendment on this subject was not urgent, but, if a package of amendments is put together, an amendment on the Council is likely to be included.

The Interim Committee will meet again in Paris in early June; at that time it will consider the package of amendments to the IMF Articles and will reconsider the agreement on IMF quota increases. It is clear that the legalization of floating and broad resolution of the gold question have been, for the moment, linked together in the consideration of any package of amendments. It is also clear that many countries oppose the U.S. position on the legalization of floating and many countries oppose the French position on gold.

Attachments

16th January, 1975.

COMMUNIQUE
OF THE MINISTERIAL MEETINGS OF THE GROUP
OF TEN
in Washington on 14th and 16th January, 1975.

1. The Ministers and Central Bank Governors of the ten countries participating in the General Arrangements to Borrow met in Washington on the 14th and 16th of January, 1975, under the Chairmanship of Mr. Masayoshi Ohira, Minister of Finance of Japan.

The Managing Director of the International Monetary Fund, Mr. H. J. Witteveen, took part in the meetings, which were also attended by the President of the Swiss National Bank, Mr. F. Leutwiler, the Secretary-General of the OECD, Mr. E. van Lenn the General Manager of the Bank for International Settlements, Mr. R. Larre, and the Vice-President of the Commission of the E.E.C. Mr. W. Haferkamp.

2. After hearing a report from the Chairman of their Deputies Mr. Rinaldo Ossola, the Ministers and Governors agreed that a solidarity fund, a new financial support arrangement, open to all members of the OECD, should be established at the earliest possible date, to be available for a period of two years. Each participant will have a quota which will serve to determine its obligations and borrowing rights and its relative weight for voting purposes. The distribution of quotas will be based mainly on GNP and foreign trade The total of all participants' quotas will be approximately $25 bill

3. The aim of this arrangement is to support the determination of participating countries to pursue appropriate domestic and international economic policies, including cooperative policies to encourage the increased production and conservation of energy. It was agreed that this arrangement will be a safety net, to be used as a last resort. Participants requesting loans under the new arrangement will be required to show that they are encountering serious balance-of-payments difficulties and are making the fullest appropriate use of their own reserves and of resources available to them through other channels. All loans made through this arrangement will be subject to appropriate economic policy conditions. It was also agreed that all participants will jointly share the default risks on loans under the arrangement in proportion to, and up to the limits of, their quotas.

4. In response to a request by a participant for a loan, the other participants will take a decision, by a two-thirds majority, on the granting of the loan and its terms and conditions, in the case of loans up to the quota, and as to whether, for balance-of-payments reasons, any country should not be required to make a direct contribution in the case of any loan. The granting of a loan in excess of the quota and up to 200 per cent of the quota will require a very strong majority and beyond that will require a unanimous decision. If one or more participants are not required to contribute to the financing of a loan, the requirements for approval of the loan must also be met with respect to the contributing participants.

5. Further work is needed to determine financing methods. These might include direct contributions and/or joint borrowing in capital markets. Until the full establishment of the new arrangement, there might also be temporary financing through credit arrangements between central banks.

6. Ministers and Governors agreed to recommend the immediate establishment of an ad hoc OECD Working Group, with representatives from all interested OECD countries, to prepare a draft agreement in line with the above principles. In their view this work should be concluded in time to permit approval by the OECD Council by the end of February, 1975.

INTERNATIONAL MONETARY FUND
19th and H Streets N. W., Washington, D.C. 20431

PRESS RELEASE NO. 75/2

FOR IMMEDIATE RELEASE
January 16, 1975

Press Communiqué of the Interim Committee of the Board of Governors on the International Monetary System

1. The Interim Committee of the International Monetary Fund held its second meeting in Washington, D.C. on January 15 and 16, 1975. Mr. John N. Turner, Minister of Finance of Canada, was in the chair. Mr. H. Johannes Witteveen, Managing Director of the International Monetary Fund, participated in the meeting. The following observers attended during the Committee's discussions of the matters referred to in paragraphs 2, 3, and 4 below: Mr. Henri Konan Bedié, Chairman, Bank-Fund Development Committee; Mr. Gamani Corea, Secretary General, UNCTAD; Mr. Wilhelm Haferkamp, Vice President, EC Commission; Mr. Mahjoob A. Hassanain, Chief, Economics Department, OPEC; Mr. René Larre, General Manager, BIS; Mr. Emile van Lennep, Secretary General, OECD; Mr. Olivier Long, Director General, GATT; Mr. Robert S. McNamara, President, IBRD.

2. The Committee discussed the world economic outlook and against this background the international adjustment process. Great concern was expressed about the depth and duration of the present recessionary conditions. It was urged that anti-recessionary policies should be pursued while continuing to combat inflation, particularly by countries in a relatively strong balance of payments position. It was observed that very large disequilibria persist not only between major oil exporting countries as a group and all other countries, but also among countries in the latter group, particularly between industrial and primary producing countries. Anxiety was also voiced that adequate financing might not become available to cover the very large aggregate current account deficits, of the order of US$30 billion, in prospect for the developing countries other than major oil exporters in 1975.

3. The Committee agreed that the Oil Facility should be continued for 1975 on an enlarged basis. They urged the Managing Director to undertake as soon as possible discussions with major oil exporting members of the Fund, and with other members in strong reserve and payments positions on loans by them for the purpose of financing the Facility. The Committee agreed on a figure of SDR 5 billion as the total of loans to be sought for this purpose. It was also agreed that any unused portion of the loans negotiated in 1974 should be available in 1975. The Committee agreed that

in view of the uncertainties inherent in present world economic conditions, it was necessary to keep the operation of the Oil Facility under constant review so as to be able to take whatever further action might be necessary in the best interests of the international community. It was also understood that during the coming months it would be useful to review the policies, practices, and resources of the Fund since it would be appropriate to make increased use of the Fund's ordinary holdings of currency to meet the needs of members that were encountering difficulties.

4. The Committee emphasized the need for decisive action to help the most seriously affected developing countries. In connection with the Oil Facility, the Committee fully endorsed the recommendation of the Managing Director that a special account should be established with appropriate contributions by oil exporting and industrial countries, and possibly by other members capable of contributing, and that the Fund should administer this account in order to reduce for the most seriously affected members the burden of interest payable by them under the Oil Facility.

5. The Committee considered questions relating to the sixth general review of the quotas of members, which is now under way, and agreed, subject to satisfactory amendment of the Articles, that the total of present quotas should be increased by 32.5 per cent and rounded up to SDR 39 billion. It was understood that the period for the next general review of quotas would be reduced from five years to three years. The Committee also agreed that the quotas of the major oil exporters should be substantially increased by doubling their share as a group in the enlarged Fund, and that the collective share of all other developing countries should not be allowed to fall below its present level. There was a consensus that because an important purpose of increases in quotas was strengthening the Fund's liquidity, arrangements should be made under which all the Fund's holdings of currency would be usable in accordance with its policies. The Committee invited the Executive Directors to examine quotas on the basis of the foregoing understandings, and to make specific recommendations as promptly as possible on increases in the quotas of individual member countries.

6. I. The Committee considered the question of amendment of the Articles of Agreement of the Fund. It was agreed that the Executive Directors should be asked to continue their work on this subject and, as soon as possible, submit for consideration by the Committee draft amendments on the following subjects:

(a) The transformation of the Interim Committee into a permanent Council at an appropriate time, in which each member would be able to cast the votes of the countries in his constituency separately. The Council would have decision-making authority under powers delegated to it by the Board of Governors.

(b) Improvements in the General Account, which would include (i) elimination of the obligation of member countries to use gold to make such payments to the Fund as quota subscriptions and repurchases and the determination of the media of payment, which the Executive Directors would study, and (ii) arrangements to ensure that the Fund's holdings of all currencies would be usable in its operations under satisfactory safeguards for all members.

(c) Improvements in the characteristics of the SDR designed to promote the objective of making it the principal reserve asset of the international monetary system.

(d) Provision for stable but adjustable par values and the floating of currencies in particular situations, subject to appropriate rules and surveillance of the Fund, in accordance with the Outline of Reform.

II. The Committee also discussed a possible amendment that would establish a link between allocations of SDRs and development finance, but there continues to be a diversity of views on this matter. It was agreed to keep the matter under active study, but at the same time to consider other ways for increasing the transfer of real resources to developing countries.

7. The Committee also agreed that the Executive Directors should be asked to consider possible improvements in the Fund's facilities on the compensatory financing of export fluctuations and the stabilization of prices of primary products and to study the possibility of an amendment of the Articles of Agreement that would permit the Fund to provide assistance directly to international buffer stocks of primary products.

8. There was an intensive discussion of future arrangements for gold. The Committee reaffirmed that steps should be taken as soon as possible to give the special drawing right the central place in the international monetary system. It was generally agreed that the official price for gold should be abolished and obligatory payments of gold by member countries to the Fund should be eliminated. Much progress was made in moving toward a complete set of agreed amendments on gold, including the abolition of the official price and freedom for national monetary authorities to enter into gold transactions under certain specific arrangements, outside the Articles of the Fund, entered into between national monetary authorities in order to ensure that the role of gold in the international monetary system would be gradually reduced. It is expected that after further study by the Executive Directors, in which the interests of all member countries would be taken into account, full agreement can be reached in the near future so that it would be possible to combine these amendments with the package of amendments as described in paragraphs 6 and 7 above.

9. The Committee agreed to meet again in the early part of June, 1975 in Paris, France.

ATTACHMENT B

January 20, 1975

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on January 20-21, 1975

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that real output of goods and services fell sharply in the fourth quarter of 1974 and that further declines are in prospect for the months immediately ahead. In December declines in industrial production and employment again were sharp and widespread, and the unemployment rate increased from 6.5 to 7.1 per cent. Average wholesale prices of industrial commodities were unchanged, after having risen much less rapidly from August to November than earlier in the year, and prices of farm and food products declined. In recent months increases in average wage rates have been large, but not so large as in the spring and summer.

In his State of the Union message, the President set forth a program of fiscal stimulus, including tax rebates for individuals and a temporary increase in the investment tax credit for business. The President also proposed a new program to reduce the consumption of energy; the program includes import fees and excise taxes on petroleum products and measures of tax relief that, altogether, are designed to have a neutral effect on the size of the Federal deficit.

The dollar in December and early January continued the gradual decline against leading foreign currencies that began in September. In November, as in October, the U.S. foreign trade deficit was moderate; sizable inflows of official funds from oil-exporting countries continued, while other capital inflows and outflows reported by banks were roughly offsetting.

The narrowly defined money stock grew at an annual rate of 4 per cent over the fourth quarter of 1974, while the more broadly defined measure of the stock grew at a rate of nearly 7 per cent. In December and early January, however, the narrowly defined money stock changed little. Net inflows of consumer-type time and savings deposits at banks slowed sharply in December, although they continued to improve at nonbank thrift institutions; in early January deposit inflows at banks picked up. Business demands for short-term credit, both at banks and in the commercial paper market, moderated further in December, while demands in the long-term market remained strong. Over recent weeks short-term market interest rates have declined substantially, but yields on long-term securities have changed little, on balance. Effective January 6, Federal Reserve discount rates were reduced from 7-3/4 to 7-1/4 per cent.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee, while resisting inflationary pressures and working toward equilibrium in the country's balance of payments, to foster financial conditions conducive to cushioning recessionary tendencies and stimulating economic recovery.

OPERATIONAL PARAGRAPH

Alternative A

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

Alternative B

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

Alternative C

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

ATTACHMENT C

January 21, 1975

Changes in Draft Directives

The staff suggests two changes in the draft directives distributed yesterday to take account of the Board's action on reserve requirements. We suggest that the sentence beginning in line 38, which previously referred only to discount rates, be changed to read as follows:

> "Federal Reserve discount rates were reduced from 7-3/4 to 7-1/4 per cent in early January, and on January 20 the Board announced a reduction in reserve requirements on demand deposits estimated to release $1.1 billion in required reserves."

With respect to the operational paragraph, we suggest that the opening lines be changed to read as follows:

> "To implement this policy, while taking account of the forthcoming Treasury financing, developments in domestic and international financial markets, and the Board's action on reserve-requirements, the Committee seeks. . .."

ATTACHMENT D

January 21, 1975

Points for FOMC guidance to Manager in implementation of directive		Specifications (As agreed, 1/21/75)
A. Longer-run targets (SAAR): (First and second quarters combined)	M_1	6%
	M_2	8-3/4%
	Proxy	6-3/4%
B. Short-run operating constraints:		
1. Range of tolerance for RPD growth rate (January-February average):		6-1/4 to 9-1/4%
2. Ranges of tolerance for monetary aggregates (January-February average):	M_1	3-1/2 to 6-1/2%
	M_2	7 to 10%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		6-1/2 to 7-1/4%
4. Federal funds rate to be moved in an orderly way within range of toleration.		

5. Other considerations: account to be taken of forthcoming Treasury financing, developments in domestic and international financial markets, and the Board's action on reserve requirements.

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.