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, April 14 and 15, 1975, beginning at 4:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Baughman
Mr. Bucher[1/]
Mr. Coldwell
Mr. Eastburn
Mr. Holland
Mr. MacLaury
Mr. Mayo
Mr. Mitchell
Mr. Wallich

Messrs. Balles, Black, Francis, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Clay, Kimbrel, and Morris, Presidents of the Federal Reserve Banks of Kansas City, Atlanta, and Boston, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Mr. Gramley, Economist (Domestic Business)
Mr. Solomon, Economist (International Finance)
Messrs. Boehne, Bryant, Davis, Green, Kareken, Pierce, Reynolds, and Scheld, Associate Economists

1/ Left the meeting at the point indicated.

Mr. Sternlight, Deputy Manager for Domestic Operations
Mr. Pardee, Deputy Manager for Foreign Operations

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

Messrs. Parthemos, Jordan, and Doll, Senior Vice Presidents, Federal Reserve Banks of Richmond, St. Louis, and Kansas City, respectively
Messrs. Fieleke, Hocter, and Brandt, Vice Presidents, Federal Reserve Banks of Boston, Cleveland, and Atlanta, respectively
Mr. Keran, Director of Research, Federal Reserve Bank of San Francisco
Ms. Tschinkel, Manager, Securities Department, Federal Reserve Bank of New York

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on March 18, 1975, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on February 19, 1975, was accepted.

Chairman Burns noted that certain materials had been distributed to the Committee on April 10, 1975, relating to the

Concurrent Resolution recently passed by the Congress.[1/] He asked Mr. Axilrod to summarize the staff's recommendations.

Mr. Axilrod noted that the staff's memorandum was addressed primarily to the part of the Resolution which stated that "...the Board of Governors shall consult with Congress at semi-annual hearings...about the Board of Governors' and the Federal Open Market Committee's objectives and plans with respect to the ranges of growth or diminution of monetary and credit aggregates in the upcoming 12 months." He would list the five issues discussed in the memorandum and indicate briefly the nature of the staff's recommendations on each. The first issue was whether the "ranges" for the aggregates should be formulated in numerical or adjectival terms. The staff recommended the use of numerical ranges, in the interest of facilitating communication. A second issue related to the width of the ranges. Taking account of the conflicting considerations that growth rates within wider ranges were more likely to be attained and that narrower ranges conveyed more information, the staff recommended the use of relatively narrow ranges, on the order of 2 percentage points, with allowance for some variation among the different aggregates because of their differing degrees of volatility.

1/ These materials included a memorandum from the staff, dated April 10, 1975, and entitled "Proposed Procedures with respect to Concurrent Resolution," and a memorandum prepared in the Department of Research of the Philadelphia Reserve Bank, dated April 4, 1975, and entitled "FOMC Response to the Congressional Resolution on Monetary Policy."

A third issue, Mr. Axilrod continued, related to the specific list of monetary and credit aggregates for which targets should be expressed. The Committee was already using M_1, M_2, and the bank credit proxy for that purpose, and the staff recommended adding M_3, M_4, and M_5. M_3 included deposits at thrift institutions that were similar in nature to the time and savings deposits included in M_2 and that were critical to mortgage market conditions. M_4, which was defined as M_2 plus large-denomination CD's, was the aggregate most closely related to the sum of bank reserves plus currency--that is, to the sum of Federal Reserve liabilities. M_5, which was defined as M_3 plus large CD's, was a comprehensive measure of currency plus all deposits at banks and other financial institutions.

Mr. Axilrod observed that a fourth issue concerned the period for which the targets should be formulated. The Concurrent Resolution referred to ranges of growth "in the upcoming 12 months," and the staff accordingly suggested that the targets initially be set for the period from March 1975 to March 1976. The period could be shifted forward with the passage of time at quarterly or perhaps semi-annual intervals, depending on emerging circumstances and the amount of new information available. A September-to-September period, which might be adopted this autumn, would be particularly appropriate since it would coincide with the period of the new fiscal year for the Federal budget that was provided for under recent legislation.

Finally, Mr. Axilrod said, there was the question of how the longer-run targets were to be reported in the policy record. One possibility was to include them in a textual paragraph, together with any relevant explanatory material, just as the short-run targets were now reported. An alternative procedure would be to incorporate the longer-run--and also the short-run--targets in the directive itself.

Chairman Burns suggested that the Committee consider in turn each of the five issues Mr. Axilrod had outlined, starting with the choice between numerical and adjectival formulations for the ranges of growth rates.

Mr. Wallich remarked that while he was inclined to favor numerical ranges, adjectival formulations would represent a more cautious approach. He would find it helpful to know what kinds of language might be considered feasible. For example, would the choice be among such formulations as "moderate to strong" or "mild to moderate?"

The Chairman replied that those illustrations no doubt would be among the possibilities considered, and others could be added. He might note that an early draft of the Resolution called for the Federal Reserve to specify a "numerical target." In a subsequent draft the term "numerical range" was substituted. Then, when some members of the Senate Banking Committee objected to a

requirement for numerical specification, compromise language was agreed upon in which the word "numerical" was not used. That legislative history would support the use of either a numerical or adjectival approach. He personally thought it would be wiser to use numerical ranges, if only to avoid an unnecessary debate with those members of Congress who strongly favored the use of numbers. If that procedure were adopted, however, he thought it should be viewed as experimental and subject to change after experience was gained.

Mr. Mitchell remarked that one possible course would be to describe the growth desired in terms of its relation to the actual growth in some recent period. For example, the desired rate might be said to be half again as high as that recorded in the past quarter, or perhaps simply as a rate "substantially higher" than the recorded rate.

Chairman Burns observed that Mr. Mitchell's first example in effect implied a single-valued target. He thought it would be preferable to use a range, as called for by the language of the Resolution.

Mr. Coldwell remarked that even if the Committee were to decide to formulate its objectives in numerical fashion, those objectives were likely to be characterized in adjectival terms in the course of Congressional testimony, so that in the end

both methods of presentation would be used. In any case, he saw some merit in Mr. Mitchell's suggestion, particularly since he thought any range that might be specified would be automatically interpreted by observers in terms of its midpoint.

Mr. Balles noted that the Committee would no doubt be modifying its longer-term objectives for the aggregates from time to time in accordance with changes in its expectations for the economy, and the reasons for the modifications presumably would be set forth when the new objectives were reported in Congressional testimony. It might be indicated, for example, that the desired ranges of growth in the aggregates had been lowered because the Committee was concerned about overheating in the economy, or that they had been raised because it saw signs of a coming slowdown or recession. He was concerned about the risk that any such expectations might become self-fulfilling; that a forecast of inflation would cause consumers and businesses to modify their behavior in a way that would set inflationary forces in motion, and similarly with a forecast of recession. He was not sure how to assess that risk, but he suspected that it would be serious. If others agreed, it might be desirable to call it to the attention of Congress in the course of the planned testimony.

Chairman Burns said he thought it was partly because of the risk Mr. Balles had described that the Committee had been

reluctant in the past to publish its longer-run targets in numerical form. However, in view of the legislative history of the Resolution, and recognizing the strong feelings of some members of Congress about the value of numerical specifications, at least in the form of ranges, he would be inclined to accept the experiment. But he would want to approach it as an experiment, and to keep in mind the warning Mr. Balles had given.

Another risk that had to be kept very much in mind, the Chairman continued, was that of becoming wedded to the numerical ranges the Committee might initially agree upon. The Committee's basic objective was not to achieve any particular numerical target or range for growth in the aggregates but to achieve certain economic, financial, and social objectives, and pursuit of the latter might call for frequent modifications of the former. The language of the Resolution made it clear that the Federal Reserve should feel free to modify its objectives for the aggregates as often as it thought modifications were required by changing conditions.

Mr. MacLaury observed that, while the Resolution focused on aggregate growth rates over the coming year, it was clear that the basic interest of Congress--like that of the Committee--was not in the aggregates *per se* but in the state of the economy 12 months hence. He thought the Congressional Committees concerned would expect to be advised of the System's views about the economic

outlook for the next year, and would want to evaluate the System's current objectives for the aggregates in light of the economic outlook.

Chairman Burns said he might note in that connection that he had recently spent some time reviewing the successive projections of various economic magnitudes the staff had made over the past year. As the Committee knew, the staff reconsidered its projections every month in light of the latest information, and the figures for each calendar quarter were subject to continual change. To compare the forecasts made now for a particular quarter with those made 3, 6, 9, and 12 months ago was a useful exercise in humility; the differences were enormous. That fact underscored the necessity for the Committee to view the growth ranges for the aggregates that it might agree upon at any time as indicating its intentions at that time only, and as subject to change with changing circumstances. He saw a good deal of merit in the final version of the Congressional Resolution, and only one danger--that the Committee would not feel as free as it should to modify its objectives for growth ranges in the aggregates as conditions changed and its own thinking developed.

Mr. Hayes remarked that the problem to which Mr. Balles had pointed was inherent in the procedure contemplated by the Resolution; he could see no way of avoiding it. He agreed

strongly with the view that the Committee should not become wedded to any particular set of objectives for the aggregates. One aspect of the Resolution that distressed him was the emphasis placed on aggregate growth rates; he would have hoped for a less simplistic approach, involving a wider range of objectives along the lines the Chairman had suggested. He would prefer to use numerical ranges for expressing objectives for the aggregates rather than the procedure Mr. Mitchell had mentioned. As to the number of aggregates for which objectives were specified, he might note that the longer the list, the greater the likelihood of substantial misses on some. For that reason, he had some qualms about including all of the aggregates Mr. Axilrod had proposed.

The Chairman noted that the Committee found it necessary to consider a rather large number of financial variables in its deliberations. Public recognition of that fact would result in better appreciation of the problems the Committee faced.

Mr. Hayes then observed that the German experiment, under which the Federal Bank had announced that it would expand the monetary base at an 8 per cent rate over the coming year, was closely related to the procedures the Committee would now be following. Thus far, the German authorities were quite pleased with the experiment; one consequence was that it had helped induce the

trade unions to accept an 8 per cent increase in wage rates for the year. However, he questioned whether the effects would be beneficial over time in the United States--or in Germany--and he was somewhat disturbed by the procedure.

Chairman Burns remarked that the German method of formulating national economic policy was radically different from that used in the United States. In Germany, the trade unions were partners in making national policy, and the adoption of a monetary target by the German Federal Bank was one device for winning their cooperation with respect to wage rates. In the United States there was virtually no link between monetary policy and trade union decisions.

Mr. Eastburn expressed the view that the Committee had little choice with respect to the use of numerical or adjectival ranges for specifying its objectives for the aggregates. In responding to the Congressional desire for more information regarding Federal Reserve policy intentions, the System should be as cooperative and forthcoming as possible, and that required the use of numerical ranges. He also believed that it would be desirable to describe the System's expectations for the economy.

Mr. Black said he agreed that the ranges should be specified in numerical terms, for the reasons others had cited. On a more general point, he understood that the semi-annual hearings

before the Senate and House Banking Committees called for by the Resolution would be staggered, so that the System would be reporting on its monetary policy objectives at quarterly intervals. He wondered whether quarterly reports would be made only at the outset or whether they would continue indefinitely.

In reply, the Chairman said the proposal to stagger the two sets of hearings had not been considered by the House and Senate Banking Committees; it had originated in conference, and had been adopted without much discussion. He personally was not disturbed by it, since the System already was called upon for testimony repeatedly during the course of a year and, whatever the original purpose of the hearings, questions regarding monetary policy usually arose. He was prepared to proceed on the assumption that quarterly testimony under the Resolution would not prove to be excessive. However, in view of the origin of the arrangement, there was no reason to believe that Congress was committed to it. He thought everyone involved should approach the contemplated hearings in a cooperative mood, treating them as an experiment and expecting to learn from experience. If it turned out that a good case could be made for considering four appearances a year excessive, he would anticipate little or no difficulty in convincing the Chairmen of the two Banking Committees that the number should be reduced. In any case, he doubted the wisdom of raising the question now.

Mr. Wallich observed that since the Committee would be taking a flexible approach toward its objectives for the aggregates, quarterly appearances would have the advantage of providing more frequent opportunities for explaining the changes to Congress.

Chairman Burns agreed. He noted, however, that the Committee's targets would be reported not only in Congressional testimony but also in the policy records released 45 days after each meeting.

Mr. Baughman expressed the view that the Resolution offered the Federal Reserve the opportunity for a meaningful educational exchange with the Congress, from which substantial benefits could flow for the country and the System. The Committee's experience over the years with efforts to communicate in non-numerical terms suggested that it would be desirable to use numbers to the maximum possible extent in communicating with Congress.

The Chairman then asked the members who preferred to formulate the growth ranges in numerical terms to so indicate. A majority responded affirmatively.

Chairman Burns said he would expect that when the numerical ranges were presented to Congress, stress would be placed on their tentative character, on the flexibility of monetary policy, and on the difficulties of foreseeing economic developments. As

Mr. Coldwell had suggested earlier, the numerical ranges would no doubt be supplemented by a discriminating use of adjectives in the course of conveying to Congress the expected direction of monetary policy.

The Chairman then suggested that the Committee turn to the second of the issues Mr. Axilrod had mentioned, relating to the appropriate width of the numerical ranges--keeping in mind that the range might vary from one aggregate to another. While it was useful to consider that issue in the abstract, it would be well for the members not to feel bound by whatever conclusion was reached; when the time came to decide on specific numbers, the members might reach somewhat different judgments about appropriate ranges.

Mr. Eastburn noted that in the memorandum from his staff that had been distributed to the Committee it was suggested that rather narrow ranges be employed. He concurred in that view and favored ranges not more than one percentage point in width. First, to use unduly wide ranges would risk leaving the impression that the Committee was trying to avoid a meaningful response to the Resolution. Second, a review of the alternative targets considered in the past, as listed under the A-B-C headings in the blue book,[1/] suggested that the Committee had tended to attach

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

significance to differences of about one-half of a percentage point in longer-run growth rates for the aggregates. In his judgment, a range of, say, 2-1/2 percentage points would encompass an unduly wide degree of variation across the ease-to-tightness spectrum.

Mr. Hayes remarked that the staff's suggestion that the range be about 2 percentage points struck him as reasonable. A 2-point range was not so wide as to suggest that the Committee was trying to avoid a meaningful response, yet it was wide enough to allow a reasonable margin for error. He would be somewhat concerned if the range were as narrow as one point.

Mr. Coldwell said he would prefer a 3-point range, at least for certain of the aggregates, because of the potential problem of inconsistency among the targets for the different aggregates.

Mr. MacLaury remarked that Mr. Kareken of his staff had made a radical but interesting suggestion. After considering the likely state of the economy 12 months hence and its implications for policy over that period, the Committee might employ one variable over which it had direct control--say, nonborrowed reserves--for purposes of specifying an aggregative target. It might then list, for as many monetary and credit aggregates as it deemed proper, the ranges of growth rates it considered likely to prove consistent

with the desired growth rate for the target variable, perhaps employing ranges of different width for different aggregates.

Mr. MacLaury said he mentioned that suggestion in connection with the discussion of ranges because, if the Committee did not adopt such a suggestion, he would prefer to employ narrow rather than wide ranges--not more than 2 percentage points in width, and preferably not more than one point. As Mr. Coldwell had noted, and as the Committee's own past experience had demonstrated, the use of narrow ranges increased the chances that the targets for different aggregates would prove inconsistent. That, however, was not necessarily a disadvantage.

Mr. Mayo observed that he supported the staff's recommendation for ranges of 2 percentage points. A 2-point range was sufficiently narrow to be meaningful but not so narrow as to make it unduly difficult to meet performance standards. He would expect the public to focus on the midpoint of whatever range the Committee used, and a band of one point on either side of the midpoint seemed modest and appropriate. With respect to Mr. Eastburn's comment that a range wider than 2 points would encompass all of the longer-run alternatives typically listed in the blue book, he (Mr. Mayo) would conclude that the deficiency lay in the blue book rather than in the range; in his judgment the alternatives had not been sufficiently different from one another.

Mr. Balles said he thought it was significant that in the past, when the Committee had set longer-run targets for periods of 6 months or so, it had used single numbers rather than ranges. He considered ranges appropriate for short periods, such as 2 or 3 months, for reasons with which the members were familiar. When setting targets for 12-month periods, however, he had real doubts about the use of ranges as wide as those shown under the alternative longer-run targets in the current blue book, which for some aggregates were 3 percentage points. He would associate himself with the views Mr. Eastburn had expressed.

Mr. Wallich remarked that the appropriate width of the ranges was related to the frequency with which the Committee expected to change its targets, the length of the time period to which the targets applied, and the number of aggregates for which targets were specified. Both the expectation that targets would be changed often and the use of a 12-month time period argued for a narrow range. On the other hand, the use of a long list of aggregates would magnify the problem of potential inconsistency, suggesting the desirability of wide ranges.

Mr. Wallich noted that if one employed strict quantity theory reasoning, a 2 percentage point range for M_1 would imply a 2 percentage point range for nominal GNP--admitting that there was much uncertainty whether this increase would show up in real GNP, in prices, or in a mixture of the two.

A projection of nominal GNP for a year ahead that included a 2 percentage point margin of uncertainty would not be considered to be particularly useful. His inclination, therefore, would be to use narrower ranges if, as it appeared, the Committee was prepared to change its targets often. However, he would want to make appropriate qualifications if a large number of aggregates were used, since it was unlikely that a whole array of narrow targets would be achieved simultaneously.

Mr. Winn noted that there were substantial differences in the absolute levels of the various aggregates, so that the same percentage-point range of growth rates would result in markedly different absolute ranges. That raised the question of whether it might not be better to express the range in terms of a percentage spread about the desired value, rather than as a percentage range.

Mr. Morris asked whether the staff had given any consideration to specifying the targets in terms of desired absolute levels for the individual aggregates. He raised that question because a miss that might appear relatively small when viewed in absolute terms could appear quite large when interpreted in terms of rates of change.

Chairman Burns said he was somewhat disturbed by the trend of the discussion because it suggested, perhaps incorrectly, that

the Committee expected its performance to be judged--by itself and others--according to the degree to which the growth ranges specified were in fact achieved. That was precisely the danger that had to be avoided. As he had indicated earlier, the Committee's objective was to achieve not levels of the aggregates within particular ranges but desired conditions in the economy, in financial markets, and in the social sphere. The Committee had to continue to function as it had in the past and could not become the slave of numbers. Frequent changes in the numerical targets might well lead to some public confusion, but that price had to be paid if the Committee held to the position that its basic goal was to attain certain economic and social objectives.

Mr. Francis observed that the language of the Resolution made it clear that the Federal Reserve was not expected to achieve precisely whatever objectives it specified for the aggregates.

The Chairman added that the language also recognized that the objectives for the aggregates were subject to frequent change.

Mr. Kimbrel said it had been his understanding that the Resolution was intended to provide a means for the Federal Reserve to give Congress more information on recent and prospective monetary policy, rather than to call for any fundamental change in the procedures the Committee used in formulating policy.

The Chairman remarked that that was his understanding also.

Mr. Bucher said he had the same impression. Accordingly, unless there was some substantive reason for employing ranges, he would urge that serious consideration be given to retaining the present practice of formulating the longer-run targets in terms of single figures. The object was not to specify an achievable target but to convey the System's best judgment regarding the appropriate longer-run growth rates in the aggregates.

Chairman Burns commented that circumstances were altered by the fact that the longer-run targets would now be made public soon after their adoption. He added that some, and perhaps many, members of the Committee had not been particularly concerned in the past about the method of presenting the longer-run targets because the Committee had tended to focus primarily on the short-run specifications.

The Chairman went on to say that the question of the appropriate width of the ranges was not an easy one to resolve, and good arguments had been advanced today for the different positions that had been taken. It might be useful to note that the Chairman of one of the Banking Committees had indicated in a conversation that he was thinking in terms of ranges of 2 percentage points.

Mr. Mitchell said that Mr. Kareken's proposal, as described by Mr. MacLaury, struck him as a more elegant solution than any others that had been advanced today. Indeed, it might be more than elegant; it might also be practical, because the use of a single target for reserves--whether nonborrowed or total--would avoid completely the troublesome problem of overspecification, and because reserves were an aggregate over which the System had direct control. As Mr. Morris had suggested, the reserve target might be specified in terms of the absolute amount to be provided over the period. In connection with the list of growth rates in other aggregates expected to be consistent with the reserve target, it might be desirable to indicate the margin of error not in terms of percentage ranges but rather in terms of standard deviations, based on an analysis of past experience. In any case, the reserve target would be subject to modification over time if the results expected for the other aggregates were not being achieved.

Chairman Burns remarked that the proposal Mr. MacLaury had described had merit and was correctly characterized as an elegant solution. The difficulty he saw was that it had not been explored sufficiently. The Subcommittee on the Directive had submitted an initial report which called for putting some emphasis on nonborrowed reserves, but the full Committee had not yet considered that report and the Subcommittee had not completed its deliberations. The

decisions the Committee reached today on procedures for formulating longer-term targets would govern its actions at this meeting and would be reflected in the testimony under the Resolution scheduled for May 1. In the future, however, the Committee would be free to modify its procedures on the basis of experience and of any new insights it might gain about the economy or about approaches to policy formulation. If the Committee did not adopt the proposal in question today, it might well decide to do so in a few months, after it had had an opportunity to examine it further.

Mr. Hayes observed that there also might be some question as to whether the House and Senate Banking Committees would be satisfied with such a procedure.

The Chairman commented that the Banking Committees had been thinking in terms of major monetary and credit aggregates. As of today, they might find a nonborrowed reserve target foreign to their thinking.

Mr. Coldwell asked whether that observation would not apply with more force to the aggregate labeled M_5 than to nonborrowed reserves.

Chairman Burns remarked that M_5, which consisted of currency plus all deposits in financial institutions, was a simple concept. He had mentioned it frequently and he thought a fair number of Senators and Congressmen were familiar with it. In contrast, nonborrowed reserves was a difficult concept even for some economists.

Mr. Coldwell asked about the Chairman's views with respect to total reserves.

Chairman Burns replied that any choice between total and nonborrowed reserves presumably should await the report of the Subcommittee on the Directive. At the moment, however, he would prefer nonborrowed reserves, since the movement of total reserves was affected not only by the System's actions but also by the borrowing decisions of member banks.

Mr. Wallich said he would agree that the System had better control over nonborrowed than over total reserves in the short run, because member banks tended to react to System reserve-supplying or reserve-absorbing operations by changing their borrowings in an offsetting direction. For a period as long as a year, however, he thought the System should aim at control over total rather than over nonborrowed reserves.

Mr. Holland remarked that he would not favor using a reserve measure for longer-run target purposes. He viewed reserves as an instrumental variable, like discount rates and reserve requirements, to be modified as necessary to achieve economic objectives. He would be as reluctant to try to decide now on the level of reserves that would be desirable a year hence as he would be to specify the discount rates and reserve requirements that would be needed then.

Mr. MacLaury observed that the various monetary and credit aggregates also were instrumental variables of a sort.

Mr. Holland said he would be inclined to interpret the targets for those aggregates in the manner suggested in the specimen directive attached to the staff memorandum. After describing the Committee's goals for the economy in qualitative terms, that directive set forth certain growth ranges for monetary and credit aggregates for a 12-month period as the ranges "thought to be consistent" with the economic objectives.

Mr. Mitchell remarked that under Mr. Kareken's proposal the Committee would be giving full weight to the desired rates of growth in monetary and credit aggregates; the reserve measure would be used essentially as a mechanical device to avoid the problem of over-specification. If the Committee found at any time that growth in reserves at the target rate was not producing the desired consequences for the monetary and credit aggregates or for interest rates, it would have a perfectly good reason to change its reserve target.

Mr. Kimbrel said he thought the suggestion for a reserve target had considerable merit. He doubted, however, that it would be desirable to adopt that suggestion now, because any significant change in Committee procedures shortly before the first hearing under the Resolution was quite likely to be misinterpreted. It

would also be helpful to have more time to study the implications of the proposal.

Chairman Burns suggested that the Committee members indicate their preferences among ranges of the general orders of magnitude that had been mentioned in the discussion.

At Mr. MacLaury's suggestion, it was agreed that the range would be viewed as applying to M_1. It was understood that the ranges used for other monetary aggregates might differ, depending on technical judgments about relative degrees of variability.

Most members expressed a preference for a range of either one or two percentage points, with a larger number favoring a two-point range.

Mr. Baughman commented that a single number, with appropriate qualifications, might represent a less rigid target than a range.

Chairman Burns said he would be inclined to express the range in terms of its midpoint plus or minus some amount, rather than in terms of its upper and lower limits. Thus, instead of "5 to 7 per cent" he would describe the range as "6 per cent plus or minus one percentage point."

After some further discussion, the Chairman suggested that the members indicate their preferences between the two methods of

expressing the range. A majority concurred in the proposal that the midpoints rather than the limits be used.

Chairman Burns then suggested that the Committee turn to the third issue, relating to the specific list of monetary and credit aggregates for which targets should be specified.

Mr. Morris said he was attracted to the notion of including the broadly defined monetary aggregates in the list because the dynamics of the changes now under way in the country's payments mechanism were likely to produce basic changes in the concept of money over the next 5 years or so. On the other hand, unless the public, including scholars and market participants, understood the significance of the additional measures, their inclusion might be interpreted as an attempt to cloud the issue. If targets for the full list of aggregates suggested by the staff were to be cited in the testimony scheduled for May 1, he thought it would be desirable to issue a document demonstrating that there had been a close relationship historically between changes in the added aggregates and in GNP.

The Chairman remarked that it would be difficult to demonstrate that for any of the monetary and credit aggregates; the relationships between GNP and the aggregates traditionally used, as well as the proposed new ones, were unimpressive.

Mr. Morris agreed. He added that it would, nevertheless, be important to demonstrate that the new aggregates were about as closely related to GNP as M_1 and M_2 were. He thought that could be done on the basis of staff work already carried out for the Subcommittee on the Directive. It would also be important to demonstrate that the Federal Reserve could control the new aggregates about as closely as it could control M_1 and M_2.

Chairman Burns observed that in passing from one monetary aggregate to the next--for example, from M_1 to M_2--one could focus either on M_2 or on the component of the latter not included in the former; namely, time and savings deposits other than large-denomination CD's. In passing from M_2 to M_3, one added deposits at savings and loan associations, mutual savings banks, and credit unions; in passing from M_2 to M_4, and from M_3 to M_5, one added large-denomination CD's. The System was concerned with all of the various components in its own analyses of financial developments, and it should strive for an understanding of them in elucidating policy before Congressional Committees and other groups. The several aggregates simply represented different ways of summing components.

Mr. Hayes said he thought it was useful for the System to concern itself with the additional aggregates and to attempt to educate others about their significance. However, the focus in most public discussions of monetary policy--in the press, in

Congress, and elsewhere--was on M_1. It would be useful as a first step to broaden that focus to include M_2 and the bank credit proxy, which the Committee had been including among its longer-run targets for a number of years. To his mind, that was about as much as should be attempted at this stage. He agreed that it would be desirable to seek a further broadening of the focus at a later time.

Mr. Holland said he agreed with Mr. Morris that staff work for the Subcommittee on the Directive would justify a statement that the various monetary aggregates did not differ greatly in the degree to which they were correlated with GNP. In addition, theoretical papers had been prepared which supported the view that information useful to policy-makers could be obtained from the differences in the behavior of the various monetary aggregates, although rather sophisticated analyses were required to extract such information. For those reasons, he would favor using a list of aggregates for target purposes about like that proposed by the staff. He thought it would be desirable, when the aggregates were first presented to Congress, to say enough about the significance of each to convey a sense of its special value.

Mr. Eastburn remarked that the question at issue was how to communicate with Congress, which had expressed a desire for certain information, and with the public. To present a deluge of information

that was not differentiated in any way would, in his judgment, raise a credibility problem. He would lean toward confining the list of variables for which targets were specified to the relatively few indicators that had been subjected to extensive economic and empirical analysis in the past--namely, M_1, M_2, and perhaps the bank credit proxy. References to the additional information provided by other aggregates could be included in the text of the testimony that would be offered when the longer-run targets were presented to Congress.

Chairman Burns observed that the System could hardly be said to be communicating properly with the Congress if it conveyed a simplistic view of its thinking about money and credit.

Mr. Eastburn replied that the more sophisticated nuances could be dealt with in the testimony.

Mr. MacLaury said he agreed with Mr. Eastburn on the matter of the aggregates for which targets were to be specified. He thought the changes under way in the nation's payments mechanism, to which Mr. Morris had referred, might be cited in support of including M_3 in the list, but they had no bearing on M_4 and M_5. However, the whole argument seemed to be inherently flawed; if the institutional changes Mr. Morris had mentioned were in fact under way--and he believed they were--they would have the effect of creating instability in the relationships between the various monetary

aggregates and GNP, and one did not really help people by giving them numbers for which the relevant relationships were unstable.

To say simply that one could define M_5, Mr. MacLaury continued, was not to claim useful knowledge. It would be useful to know about the relationship between M_5 and GNP over time, and about the System's ability to control that aggregate. Even though the Subcommittee on the Directive might have studies in process which would demonstrate that the relationships involving M_5 were as stable as those involving more familiar aggregates, he at least had not yet had a chance to analyze that evidence. Accordingly, he would be much more content to rest on familiar ground, and he thought Congress would be also. Moreover, he agreed that the use of a long list of aggregates would expose the System to the charge that it was attempting to cloud the issue. To start with a short list, even at the risk of seeming simplistic, and to plan on adding additional aggregates as the analytical basis for doing so was developed, would be consistent with the idea that the whole procedure was an experiment.

In response to a question, Mr. MacLaury said he had in mind starting with the same aggregates as the Committee had used until now for longer-run target purposes--M_1, M_2, and the bank credit proxy.

Mr. Mitchell remarked that one taking that position might also find it useful to consider the components of the remaining aggregates excluded from the list.

The Chairman observed that Congress was deeply concerned about housing, and therefore about the flows of deposits to thrift institutions. Consequently, he thought M_3 would be a vital measure to Congress.

Mr. Black expressed the view that it would certainly be useful in testimony given at this time to discuss the components of M_3.

Mr. Mayo said he thought the Federal Reserve would be on much firmer ground if it used a relatively short list of aggregates for specifying targets. It would be quite appropriate in the course of the testimony to explain the limitations of the measures included--perhaps M_1, M_2, and the bank credit proxy--and to comment on the other aggregates. It might even be desirable to comment on nonborrowed reserves in that connection, even though no longer-run target was set for that measure. However, to include such aggregates as M_3, M_4, and M_5 in the list for which targets were specified would impute to the FOMC a degree of sophistication which in his judgment did not exist at present, and it could well lead to the charge that the System was attempting to cloud the issue.

Mr. Balles said he agreed essentially with Messrs. Eastburn and MacLaury and differed only a little with Mr. Mayo. Some work done recently by staff at his Bank, which had been shared with others present today, indicated that monetary aggregates which

included CD's were less closely related to GNP than the corresponding aggregates excluding CD's. The common-sense explanation for that finding was that, because CD's were a money market instrument, the demand for them would vary as a consequence of changes in interest rate relationships and other money market developments. While he agreed that the Committee should use a family of aggregates and not rely on any single measure, he would urge that it start with four aggregates--M_1, M_2, M_3, and the credit proxy--and leave M_4 and M_5 for future consideration. He was not optimistic about the chances that it would ever be found useful to add those two aggregates to the original four.

Chairman Burns remarked that it might be helpful to have Mr. Pierce's comments on the closeness of the relationships with GNP of M_4 and M_5 relative to those of, say, M_1 and M_2.

Mr. Pierce said the relationships of M_4 and M_5 to GNP were less close than those of M_1 and M_2, but the difference was not great. He thought that by conventional statistical tests no significant difference would be found between the closeness of the two sets of relationships.

Mr. MacLaury asked about the relative degrees of controllability of the two sets of aggregates.

Mr. Pierce replied that, in general, the more inclusive the aggregate the less controllable it was.

Mr. Axilrod observed that the degree of controllability would depend in part on the assumptions made about objectives. If the System placed high priority on controlling M_1, the volume of CD's outstanding obviously would be determined by the banks and the System would have little control over M_4 and the bank credit proxy. On the other hand, if priority was placed on controlling M_4 or the proxy, it would not be feasible to control M_1 closely. The purpose of employing a family of aggregates was to allow some trade-offs among the different possible objectives.

Mr. Wallich said he agreed with the arguments that had been advanced in favor of a limited number of aggregates. It seemed clear that there was a hierarchy among the aggregates, and that M_1 outranked the others in terms of both public acceptance and empirical and analytical support. Because M_3, M_4, and M_5 were new, relatively untested, and less controllable aggregates, they--and perhaps also M_2--should be treated somewhat differently from M_1. He would suggest that the Committee set a growth target only for M_1, and indicate the growth rates in the other aggregates it expected to be associated with expansion in M_1 at the target rate, on the understanding that it might change its M_1 target if those expectations were not realized.

In his judgment, Mr. Wallich continued, such an approach would be analytically correct. It also was likely to receive a better

public reaction; there was no denying that the use of 5 or 6 aggregates for target purposes would give the impression of defensiveness.

Chairman Burns said it should be kept in mind that Congress had used the phrase "monetary and credit aggregates" in the Resolution.

Mr. Coldwell observed that, as the Committee knew, he had not been particularly happy with any of the monetary aggregates as target variables. He was willing to associate himself with the position taken by Mr. Mayo today, although he would not strongly resist the inclusion of M_4 and M_5. He would suggest, however, that the list of aggregates for which targets were specified include reserves, if only because reserves were the variable over which the System had the closest control. Either total or nonborrowed reserves would be acceptable, although he happened to have a preference for the former. While there were uncertainties in the relationships between reserves and the real economy, the same was true for the relationships involving the other monetary and credit aggregates.

The Chairman remarked that there were some differences in the experience of the Committee and of the Board of Governors in connection with the various aggregates. The Board necessarily paid a great deal of attention to M_3 in connection with various regulations, and it sought to influence the behavior of that variable through changes in regulations. In view of that fact, and of the

interest of Congress in the flows of funds to thrift institutions, he thought the case for including M_3 among the target variables was very strong and almost decisive.

Mr. Mitchell said he could remember the days when the Committee operated in terms of the "tone and feel" of the money market. Later it had been swept up with "operation twist" and interest rates more generally, and now it was concerned with aggregates. There were aggregates galore, some of which were considered useful simply because they performed well in regression analyses, even though the results could not be explained. He had never been in favor of taking regressions seriously if there was no rationale available for the statistical relationships found.

In his judgment, Mr. Mitchell continued, there was a rationale for the list of monetary aggregates suggested by the staff. The measures in question could be used to indicate the state of liquidity, which had a vital influence on spending and lending decisions, in different sectors of the economy--corporate, household, and banking. Those measures could be disaggregated and recombined in different ways to yield useful information about developments in particular areas of interest.

Mr. Mitchell added that he was a long-standing believer in the desirability of quantifying the Committee's policy decisions, and he favored any procedure that involved explicit statements of

those decisions, so long as it made sense. That, essentially, was why he liked Mr. Kareken's suggestion as described earlier by Mr. MacLaury. It called for a straightforward statement of the Committee's intentions for a variable it could control closely and of its expectations for other variables; and it allowed for changes in the goals for the target variable if unexpected developments occurred.

Mr. Baughman said he agreed in general with Mr. Mitchell's position. If it were his task to communicate with Congress, he would want to begin by discussing the Committee's objectives for the economy, to move on to what might be accomplished in terms of injecting or withdrawing reserves, and finally to discuss the consequences that might be expected for all of the different monetary and credit aggregates of interest and for any other relevant variables.

The Chairman asked the members to indicate whether they would find acceptable various combinations of monetary and credit aggregates, which he listed, for target purposes.

None of the combinations mentioned won the adherence of a majority.

Mr. Coldwell suggested that the members be asked to indicate whether they favored adding total reserves to the list. Specifically, he would propose a list consisting of total reserves, M_1, M_2, M_3, and the bank credit proxy.

A majority of members indicated that such a list would be acceptable to them.

Chairman Burns remarked that it probably would be found desirable to comment on M_5 in testimony under the Resolution.

Mr. Mayo said he thought that would be quite appropriate; the Committee's discussion today was concerned with the aggregates for which targets were to be specified, not those on which comments would be useful in the course of testimony.

Mr. Axilrod said he would like to make a technical point about the addition of total reserves to the list of aggregates for which longer-run targets were to be specified. While total reserves might seem to be controllable, the movements of that aggregate were considerably harder to project than those of the monetary and credit aggregates included in the list. That was partly because total reserves could be sharply influenced by changes in Government deposits and CD's. In his judgment, the range of 12-month growth rates for total reserves that would be consistent with 2-point ranges for the other aggregates would probably be substantially wider than 2 points. He was not prepared at the moment to indicate how much wider the range for total reserves would have to be.

In reply to a question by the Chairman, Mr. Axilrod said he would not recommend the use of nonborrowed rather than total reserves for longer-run target purposes; if any reserve measure

were to be employed for that purpose, he thought total reserves would be appropriate. His point was that the possibilities of misses were as great or greater for total reserves as for the other aggregates--assuming the other aggregates were considered to be important targets to which total reserves had to be adapted-- because of the very large changes that could occur in the composition of deposits, and that the ranges for expressing reserve targets would consequently have to be quite wide.

Mr. Hayes said he understood that the Manager shared Mr. Axilrod's view.

Chairman Burns suggested that the Committee hold to its decision, recognizing that a wider range would be needed for total reserves. As to the appropriate width of that range, the Committee would be guided by the advice of Messrs. Axilrod and Holmes. In any case, it would not be bound to that or any other aspect of its decisions today beyond the next month.

The Chairman then noted that the fourth issue concerned the period for which targets should be formulated. He asked whether there was general agreement that the period initially should run from March 1975 to March 1976.

Mr. MacLaury observed that such a period would be agreeable to him. He wondered, however, whether it might not be better to express the targets in terms of growth rates between the calendar quarters ending in March 1975 and 1976, rather than between those 2 months taken alone.

Chairman Burns remarked that that was a question of measurement procedure which the Committee might best leave open. By and large, he was inclined toward the use of quarterly averages, since they offered a stabler base than monthly figures. However, it was not necessary or desirable for the Committee as a whole to resolve every detailed technical question that might arise.

The Chairman then noted that the only remaining issue concerned the method of reporting the longer-run targets in the policy record. Mr. Axilrod had mentioned the alternatives of reporting them in a textual paragraph, as the short-run targets were now reported, and of incorporating both types of targets into the directive. The first alternative was simpler and would involve the minimum change. He suggested that the Committee adopt it at this time, on the understanding that the members might want to consider the second alternative at a later meeting.

Mr. Holland remarked that that procedure would be acceptable to him. It might be desirable for the Subcommittee on the Directive to undertake the assignment of reviewing possible means of modifying the directive to include quantitative information on targets.

There was general agreement with the suggestions made by Chairman Burns and Mr. Holland.

The meeting then recessed. It reconvened at 9:30 a.m. on Tuesday with the same attendance as at the Monday afternoon session

except that Messrs. Rippey and Pierce were absent, and the following were present:

Mr. Guy, Deputy General Counsel

Mr. Keir, Adviser, Division of Research and Statistics, Board of Governors

Chairman Burns noted that a memorandum entitled "Proposed Revision of Procedures for Allocation of Securities in System Open Market Account," had been distributed to the Committee.[1/] He asked Mr. Sternlight to comment.

Mr. Sternlight observed that under existing procedures the Reserve Banks used their gold certificate holdings to settle daily clearings with one another. Because of the large volume of clearings now handled in the Interdistrict Settlement Fund, one or more Reserve Banks might on any one day have an inadequate balance of gold certificates to make settlement. The possibility that adverse clearings might eliminate a Reserve Bank's gold certificate holdings had made it increasingly difficult for Reserve Banks to earmark significant amounts of gold certificates as collateral for Federal Reserve notes.

A change was proposed now, Mr. Sternlight continued, in order to free the gold certificate holdings and make them fully

1/ The memorandum, from Messrs. McWhirter and Holmes, was dated April 11, 1975. A copy has been placed in the Committee's files.

available as collateral behind note liabilities. To do that, it was recommended that the clearings be effected through the use of inter-office accounts among the Federal Reserve Banks that would be settled once each year by increasing or decreasing each Bank's holdings of securities. That approach would obviate the need for monthly reallocations of the System Open Market Account to equalize gold-to-note liability ratios. The new procedure would take effect at the beginning of May--a convenient starting point since the end of April marked a coincidence of a month end and an end-of-week statement date.

The Chairman indicated that the Board planned to act shortly on the related recommendation to discontinue the use of gold certificates as the medium for interdistrict settlements. Once the Board had acted, the Committee would be informed by wire and asked to vote on the recommendation for yearly reallocations of securities held by the System Open Market Account.

After some discussion, it was agreed that the proposed revision of Account allocation procedures would be appropriate.

Before this meeting there had been distributed to the members of the Committee a report from the 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 March 18 through April 9, 1975, and a

supplemental report covering the period April 10 through 14, 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:

> The dollar has begun a solid recovery from the unrealistic levels it had reached earlier this year, enabling the Federal Reserve to make clear progress toward repaying its swap debt.
>
> As we had pointed out, the previous decline in dollar rates had largely reflected the market's misreading of our trade performance and prospects, expectations of an even sharper decline in interest rates here than abroad, and concern that the harsh debate over economic and energy policies in the United States would lead to actions that would rekindle inflation in this country. Many market participants shared our view that the dollar's extreme weakness was temporary and would pass. Even so, only the central banks could take the responsibility for maintaining orderly markets through forceful intervention. Since the dollar's slide began last October, the Federal Reserve, the German Federal Bank, and the Swiss National Bank intervened by some $3.5 billion, of which $2 billion was in early 1975 alone. Our own current indebtedness under swap lines reached a peak of $1,066 million in late March.
>
> After we began to intervene more forcefully in February and March, the exchange market was more orderly but the dollar's recovery remained stalled until market psychology itself improved. Since the last meeting, however, events have borne us out. The dollar pessimists could not explain away our February trade surplus, at a $10 billion annual rate. Clearly, that surplus was unsustainably high, but it helped foster a more realistic appraisal of our trade position. Moreover, dollar interest rates leveled off in March and have backed up in some cases more recently, particularly in the Euro-dollar market. By contrast, German and several other money markets have been highly liquid, with low interest rates opening clear arbitrage incentives in favor of the dollar. Finally, the market has

been receptive to the rather strong statements by government officials on both sides of the Atlantic, with European officials calling the dollar undervalued or unrealistically low against their currencies and American officials pointing to the sizable Federal Reserve intervention as evidence that the United States has not reverted to a posture of "benign neglect." The market remains cautious over events in Vietnam and the Middle East, and an occasional large sale of dollars by an OPEC country has temporarily depressed the dollar. Nevertheless, the dollar is clearly more buoyant than at any time since last summer.

Since the last meeting, the dollar has risen by some 4 to 5 per cent against the Swiss franc and the German mark and by lesser amounts against most other currencies. In contrast to earlier months, there were only 3 days during which the Desk intervened and then only in the combined amount of $27 million equivalent of marks and $2 million equivalent of Dutch guilders. Instead, beginning on March 21 we have been buying currencies to repay swap debt. Since then we have made modest daily purchases of marks, the bulk of which have been used for swap repayments. Within the past 2 weeks, the German Federal Bank has also begun to sell dollars and we have shared in part of that operation. We have thus reduced our indebtedness in marks by a net $172 million to $666 million. In addition, the Swiss National Bank has given us the opportunity to repay much of our recent indebtedness in that currency through direct transactions, reducing our current Swiss franc debt by $122 million to $37 million. The Dutch have asked us to hold off for a few more days, since their money market is tight and their currency is at the top of the snake. On the other hand, we have bought $10 million equivalent of Belgian francs, reducing our swap debt in that currency by that amount. Over all, we have reduced our market-related indebtedness by $303 million since late March to a level of $763 million. At current exchange rates we stand to make a sizable profit on the full phase of our operations since last October. We expect to make further gradual progress in the weeks ahead, keeping in mind that our eagerness to repay debt should not inhibit the dollar's recovery.

Mr. MacLaury referred to an exchange of correspondence between Congressman Reuss and Chairman Burns relating to System intervention in foreign exchange markets.[1/] He asked whether more information was available regarding the matter.

Chairman Burns noted that Congressman Reuss had asked for two kinds of information in his letter. One request was for an interpretation of the intervention policy the System had been following recently. In particular, he asked whether the objective of the intervention in February and March was to maintain orderly markets, or whether it was to prop up or peg the external value of the dollar. The other was for more detailed information on the System's operations in the foreign exchange market. Specifically, Congressman Reuss wanted a monthly report that would contain a daily accounting of intervention in each foreign currency, along with appropriate comments on market conditions or other factors that had made such intervention seem necessary.

In regard to the policy governing the System's intervention in the foreign exchange market, Chairman Burns observed that the Committee's instructions to the Desk clearly did not contemplate the pegging of the foreign exchange value of the dollar. On the contrary, the Committee had repeatedly indicated that the Desk

1/ Copies of the letters in question--from Congressman Reuss dated April 1 and Chairman Burns' reply dated April 8--have been placed in the Committee's files.

should interpret its instructions to maintain orderly markets in a relatively conservative manner. It had to be recognized that the concept of orderly markets was inevitably subject to some differences of interpretation. With regard to Congressman Reuss' request for more information, Board officials were presently engaged in conversations with the Treasury and the Federal Reserve Bank of New York. It was not clear that the specific information requested would prove useful, but Congressman Reuss might well need more information than he was receiving. When a Congressional request of a similar nature had been made some time ago a satisfactory compromise had been reached, and he was sure that a satisfactory arrangement could be worked out in response to the latest request.

Mr. MacLaury noted that Congressman Reuss' letter included a summary of some recent testimony by Secretary of the Treasury Simon on intervention policy. According to the letter, Secretary Simon had said that it was U.S. policy to intervene only to curb or to prevent disorderly conditions in exchange markets. If that was an accurate summary of the Secretary's testimony he hoped it would be possible to get a clarification, since in his view the interpretation was overly restrictive.

Mr. Holland said he wanted to commend the Desk on the progress it had made in repaying System swap drawings, and in

particular for the way in which it had taken advantage of opportunities to purchase foreign currencies in the market and directly from foreign central banks.

Mr. Holland then asked why, at a time when the German Federal Bank was making substantial purchases of marks for dollars, the System's mark purchases had been relatively small.

Mr. Pardee said the Germans apparently had decided to take advantage of opportunities to sell a sizable amount of dollars in their own market, which of course was a bigger market for marks than New York. The Desk had had some opportunities to buy marks in New York, but thus far it had preferred to acquire marks quietly in Europe through the BIS. As a result of recent discussions between officials of the System and the German Federal Bank, the System probably would acquire somewhat more marks directly from the Federal Bank than it would have otherwise. In any event, System purchases through the BIS had tended to make up for marks that might have come from the Federal Bank.

Mr. Morris said he had found interesting the money stock growth comparisons for various major industrial countries that were contained in the latest green book,[1/] and he hoped the staff

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

would include similar tables in future green books. The data indicated that monetary growth had been greater in Germany than in the United States during the 1972-74 period. That raised a question to which he had been unable to find a satisfactory answer--namely, why such relatively rapid growth had not been reflected in the performance of the German economy, the country's export position, its consumer price index, or the exchange value of the mark.

Mr. Bryant indicated that he too could not give a satisfactory answer. The staff had been looking into the various definitions of the monetary aggregates for other countries and how they had behaved, and had included some comments on its findings in the latest green book. But, for Germany and for other countries, the staff still had much to learn about the behavior of the aggregates and about financial institutions.

Mr. Solomon observed that the green book table in question indicated a remarkably low rate of M_1 growth in Germany for 1973. That experience was a reflection of the very tight monetary policy being pursued during that year, which in turn was associated with a tight fiscal policy. Thus, the Germans had adopted an anti-inflationary policy before most other countries, and that had the effect of depressing domestic demand and encouraging exporters to find markets abroad--which they did with much success. In short, he thought

a part of the explanation of the very favorable external performance of the German economy was the lagged response to policies adopted in 1973.

Mr. Morris commented that, if lagged responses were involved, the German mark could be expected to decline relative to the dollar in light of the expansionary policies pursued more recently by the Germans.

Mr. Solomon noted that the Germans were starting from a very strong export position. Despite an increase in oil payments of $6 to $8 billion in 1974, Germany still had a current account surplus of some $10 billion in that year. German exports were being assisted by an enormous volume of short-term credits to foreign buyers. However, while the underlying position remained strong, export orders had begun to fall off and the Board's staff thought the current account surplus would also begin to diminish. It was hard to say how much of the weakening was cyclical.

Mr. Axilrod said he might add a word about international comparisons of monetary growth rates. It was his impression that in most foreign countries the public made less active use of money market instruments as an outlet for their savings than was the case in the United States. Consequently, flows of savings into financial institutions tended to be relatively larger and the velocity of such

deposits therefore lower than in this country. In short, savings abroad tended to be lodged in institutions for longer periods.

Mr. Wallich observed that M_1 had grown less in the United Kingdom than in Germany over the 1972-74 period.

Mr. Bryant said that the British themselves placed more emphasis on broader measures of money. In their view, M_3, as they defined it, was a better indicator than the narrower measures of money.

Chairman Burns commented that comparisons of monetary growth in Britain and Germany were further complicated by significant differences in rates of increase in economic activity, productivity, and wages in the two countries.

In response to an inquiry from Mr. Balles, Mr. Broida indicated that the staff study of the Foreign Currency Authorization and Directive was expected to be completed in 2 or 3 months.

By unanimous vote, the System open market transactions in foreign currencies during the period March 18 through April 14, 1975, were approved, ratified, and confirmed.

Secretary's note: A report by Mr. Wallich on the April Basle meeting, which was distributed during this meeting, is appended to this memorandum as Attachment A.

Mr. Pardee reported that six System drawings on the National Bank of Belgium, totaling $230 million, would mature

for the fifteenth time during the period from May 5 to May 14, 1975. Those drawings had been outstanding since August 1971 and the System was close to an agreement with the Treasury and the Belgians on a Treasury takeover of the debt, largely by issuance of longer-term paper to the Belgians. He hoped that the takeover would be accomplished before the next meeting of the Committee, but he recommended that, if necessary, the drawings be renewed for further periods of 3 months.

Mr. Pardee also reported that two drawings in Swiss francs would mature for the fifteenth time on May 14, 1975, including a drawing of $371.2 million on the Swiss National Bank and one of $600 million on the Bank for International Settlements. It was his hope that the imminent Treasury takeover of Belgian franc debt would set a pattern for clearing up the rest of the System's long-standing swap drawings. However, a takeover of Swiss franc debt still had to be worked out. Accordingly, he recommended renewal of the drawings when they matured, if that proved necessary.

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 May 5 through 14, 1975, was authorized.

Mr. Pardee then indicated that eighteen drawings on the German Federal Bank, totaling $451.2 million, would mature in the

period from April 28 through May 23, 1975. Most of those drawings would be maturing for the first time, but three, totaling $57 million, would come up for second renewals on May 20 and 21, 1975, unless they were repaid in the interim. At the current rate of repayment, the Desk should be able to clear up the drawings due for second renewals before their maturity, but he would recommend renewal of all of the March drawings, if necessary. Other drawings that would soon mature for the first time were a drawing of $26.9 million on the Netherlands Bank and one of $0.7 million on the Belgian National Bank. Again, while he hoped further progress would be made in clearing up those drawings, he would recommend their renewal if necessary.

Renewal for further periods of 3 months of System drawings on the German Federal Bank, the Netherlands Bank, and the National Bank of Belgium, maturing in the period from April 28 to May 23, 1975, was noted without objection.

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

Mr. Partee made the following statement:

Economic developments since the last meeting of the Committee appear to have been broadly in line with our earlier expectations. Data for March indicate further

declines in over-all activity, as measured by industrial production, nonfarm employment and manhours worked. But the declines were notably smaller than in previous months, and there are now reports of recalls of workers in some industries. All of this suggests that we could be approaching a bottoming out in the economy, as does the maintenance of a reasonably firm upward trend in retail sales, aside from the post-rebate relapse in new car purchases last month.

Indeed, we may be nearer to a bottoming than we had been anticipating even a month ago. The data on business inventories, which are unfortunately quite laggard, suggest that a substantial amount of liquidation is already behind us. The book value of manufacturers' inventories showed very little increase in February--equivalent, it would seem, to a sizable liquidation in real terms--while wholesalers' stocks dropped for the second month in a row. Retail inventories declined significantly in January, in current dollar terms, and even more rapidly in February, though the latter decline was more than accounted for by autos alone. Altogether, we now think that the first-quarter GNP figures are likely to have shown an inventory liquidation of $15-$20 billion, and it could well have been larger. This is quite a shift from the $18 billion rate of accumulation in the fourth quarter--unprecedented, in fact, in the postwar years.

It is exceedingly difficult to know, of course, how far an inventory correction may go. In this instance, stocks are being reduced not only in response to lower sales, but also because we have moved abruptly out of a shortage economy--apparently for some time to come--and the widespread expectation of sharply higher prices on which prior inventory policies were in part based has been confounded, at least for the time being. Still, it seems unlikely that inventory liquidation can continue for long at the apparent recent rate. Retail sales have been tending to firm, as I noted, and many businessmen must expect a further near-term strengthening, now that the tax reduction legislation has become law. Accordingly, we have tapered off our projection of inventory liquidation for the second quarter--which has the effect of increasing the expected second-quarter GNP by some $10 billion, annual rate, compared with the previous staff projection--and we carry through most of this improvement for the remainder of the projection period.

Passage and Presidential approval of the tax bill has been, of course, a major development helping to ensure the prospects of a near-term upturn in the economy. The tax reduction--including the special social security payment, which is technically an expenditure--is somewhat larger than we had previously assumed, and it will take effect a little earlier than we had expected--with withholding schedules reduced as of May 1 and the tax rebate and special social security checks scheduled to be mailed beginning before mid-May. We therefore have increased our second-quarter consumption estimates somewhat, though the real upsurge is still not expected until the second half of the year, when consumption is projected to be rising at close to a 12 per cent annual rate.

This projected pattern of consumption, in juxtaposition with an upsurge and then a more orderly advance in disposable income, produces an unusual pattern for the savings rate. Personal saving is expected to jump to a 12-1/2 per cent rate this quarter, and then to decline rapidly to about 8-1/4 per cent by the first half of 1976, roughly where it has been in the past two quarters. This is not an unreasonable pattern, given the chunky character of the tax rebates, but it does point up the possibility of significant error in our estimates of the consumer sector. The upsurge in consumer spending could come sooner than we are projecting, which would mainly work in the short run to improve business attitudes, and it could be more sustained and push down the saving rate to a lower, more normal level. Consumer surveys recently have shown a little improvement in attitudes, albeit from a very depressed level, and I have been intrigued by the reports in the red book[1/] and elsewhere of very good resort business. This hardly seems to suggest that the consumer is in a demoralized state of mind.

To be sure, there are sources of probable further weakness in the economy. Expenditures on business plant and equipment seem likely to be moving down in real terms for some time yet, given the continuing declines in new capital goods orders and in the square footage of construction contract awards. The prospects are that net exports also will be declining in dollar terms, reflecting mainly

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

continued high prices for imported oil and declining transaction prices for agricultural exports. And the size and strength of the housing recovery is still in doubt. There is as yet no concrete evidence of a pick-up in starts or in sales of new housing units, though the new temporary tax subsidy should certainly help to clear out the large overhanging inventory of partially and fully completed units. We continue to project a strong upturn in starts as the year progresses, but we have our fingers crossed.

All in all, I cannot help but feel that the evidence points conclusively to an early bottoming out of the present cyclical decline in activity. And I believe also that the chances of a relatively strong upturn in the latter part of 1975 have improved, as the effects of the large tax cut take hold and bolster what seemed to be shaping up as a classic cyclical upturn in any event. The staff projection is for a 6-1/2 per cent rate of recovery in real GNP in the second half of this year and an increase of close to 5 per cent in the first half of 1976. I would now be inclined to expect a pick-up that, if anything, proves to be somewhat stronger.

There is, of course, lots of room for recovery without straining our productive capacity in any significant way. Real GNP in the second quarter of this year is projected at a level that is nearly 8 per cent lower than the peak reached 6 quarters ago. Production of major materials this quarter is projected to be at around 70 per cent of capacity, compared with more than 90 per cent throughout 1973 and well into 1974. And the unemployment rate is expected to rise to 9-1/4 per cent this summer, on average, and to edge down only to about the 9 per cent level in the first half of next year.

We continue to believe, moreover, that the economic recovery will begin to slow by early next year, given our policy assumptions. The impact of the current tax reduction package will be waning, and interest rates may well have risen to the point where they begin to jeopardize the housing recovery. The recent rise in long-term bond yields, though we believe it to be mainly the product of special factors and quite possibly temporary in character, is widely viewed as an ominous development by market participants. Mortgage yields in the secondary market have already moved up a little in response to bond market

developments, and managers of thrift institutions as well as banks are no doubt feeling vindicated in their emphasis to date on short- rather than longer-term investment commitments.

Given the high sensitivity of the institutions to their exposure in the competitive markets for savings funds, it seems very likely to me that significantly higher interest rates, when they come, will rather promptly work to reduce the availability of mortgage credit and put the brakes on the housing recovery. Moreover, higher interest rates, in an environment of receding inflation and ample productive capacity, could well serve to retard business plans to expand their capital spending and rebuild their inventory positions. How soon and how far interest rates may rise is therefore a major question conditioning the probable vigor and sustainability of the economic recovery.

In response to a question by Mr. Bucher, Mr. Partee said that the staff projection of housing starts reflected an assumption that conventional mortgage interest rates would decline further from the current level of just under 9 per cent to about 8-1/2 per cent in late spring and summer and then would rise to 9 per cent early next year and to about 9-1/4 per cent in the second quarter.

Chairman Burns remarked that it was reasonable to expect some further decline in mortgage interest rates in the months ahead in light of the enormous inflows of funds to the nonbank thrift institutions. In March inflows to the savings and loan associations were at an annual rate of 22 per cent.

Mr. Bucher observed that some representatives of the nonbank thrift institutions had suggested to him that for the foreseeable

future they would not be interested in making mortgage loans. Instead, they would use the funds flowing in to repay debts to the Home Loan Banks. Moreover, corporate bond rates were attractive relative to mortgage rates, and a large volume of Treasury securities would be coming to market.

The Chairman commented that such securities might be attractive to commercial and saving banks but would be much less so to the savings and loan associations. The latter institutions, even while improving their liquidity by repaying debt to the Home Loan Banks, still were expanding their mortgage commitments. In February, new commitments were about $2-3/4 billion, compared with about $1 billion last October. The recent rate of commitments, while lower than a year and a half ago, still was relatively high.

Mr. Partee observed that inflows of deposits to mutual savings banks in March were at a record annual rate of 14 per cent.

Mr. Morris remarked that data available for New England indicated that inflows of funds to savings banks were much heavier in March than in January and February.

Mr. Bucher asked whether the heavy inflows of deposits to the nonbank thrift institutions were attributable primarily to income tax refunds and, therefore, represented a temporary bulge.

Mr. Partee replied that tax refunds were running above year-ago levels, which was affecting a number of financial statistics.

However, deposit rates were attractive relative to market interest rates, and some interest-sensitive funds were flowing into the nonbank thrift institutions.

Mr. Axilrod added that rebates on 1974 income taxes would begin shortly, adding another temporary stimulus to the deposit inflows.

In response to a question by Mr. Wallich, Mr. Partee remarked that the inflows of funds to the savings and loan associations were concentrated in passbook accounts rather than in longer-term certificates. It was likely that the inflows included both the small deposits typically placed in passbook accounts and interest-sensitive funds attracted for the short term by payment of interest from the day of deposit to the day of withdrawal.

Mr. Black observed that the staff projection of little increase in nonfarm payroll employment--and of a slight decline in manufacturing employment--over the second half of this year along with projected growth in real GNP and industrial production at rates of about 6-1/2 and 5 per cent, respectively, suggested that productivity would rise at a rapid rate. He asked how the staff had weighted that rise in projecting the course of prices and profits.

Mr. Partee replied that output per manhour for the private nonfarm economy was projected to rise at a rate of about 5-1/2 per cent in the second half, representing a sharp turnaround from the decline that had occurred over the past several quarters. The gain in the period ahead was reflected partly in the increase in profits and partly in the moderation in the price rise. Prices were projected to increase at a rate of about 5 per cent in the fourth quarter of this year--a lower rate than almost anyone would have predicted just a few months ago--reflecting not only the productivity improvement but also a less rapid advance in compensation per manhour and more competitive conditions in product markets compared with those of a half year or so earlier.

Mr. Hayes asked whether the staff had projected the unemployment rate for quarters beyond mid-1976, when the expected rate was still as high as 9 per cent. He wondered whether slack in the labor market would be sufficient to be an anti-inflation force even during an extended period of recovery in economic activity.

In reply, Mr. Partee observed that the behavior of the unemployment rate depended essentially on the strength of the recovery, and the judgmental projection suggested rates of increase in real GNP that were not large enough to make much progress in reducing unemployment over the projection period. Moreover, as early as the first half of next year, forces would be set in motion

to retard the recovery; projections for quarters beyond mid-1976, which were based on the econometric model, did not show any improvement in the unemployment rate.

Mr. Hayes then said he agreed with Mr. Partee's view that the outlook for productivity had favorable implications for the course of prices, but at the same time, prices of sensitive world commodities had leveled out or turned up. He asked about the implications that the latter development might have for prices more generally.

Mr. Partee replied that the Board's index of sensitive industrial commodities had been essentially stable over the past 10 weeks, which was an indication that the decline in economic activity was coming to an end. A sharp rise in such prices, exerting upward pressure on prices generally, was unlikely to develop soon; if one occurred, it was more likely to develop as economic recovery here and in other industrial countries gained momentum.

Mr. Hayes, noting the staff expectation of an upturn in mortgage rates and other long-term rates early next year, asked whether realization of the projected improvement in price performance would not exert downward pressure on long-term rates.

In response, Mr. Partee remarked that improvement in price performance, while helpful, might have to persist for some period of time in order to lower the expected longer-run rate of inflation--

especially in view of the size of the tax-reduction package, of the apparent inclination of the Congress to raise expenditures, and of the size of the Federal deficit. Institutional investors in particular, it seemed to him, might now be more apprehensive about the longer-run rate of inflation than they had been 6 months ago and would be unlikely to expand the supply of long-term funds to the market unless interest rates were high enough to compensate for the expected rate of inflation. On the demand side of the market, expectations of significantly lower rates of inflation over the longer run could cause postponements of borrowing and capital spending plans, which might be a source of weakness in the period ahead.

Mr. Kimbrel asked what effect the exhaustion of supplementary unemployment benefits by Chrysler and General Motors might have on consumer spending and thus on the prospects for a near-term turnaround in economic activity.

Mr. Gramley replied that the exhaustion of benefits would reduce workers' spendable income by less than $1 billion at an annual rate. That amount was quite small in relation to the second- and third-quarter additions to disposable income resulting from the tax-reduction package.

Mr. Balles, noting recent developments affecting Federal revenues and expenditures, asked how the staff now appraised the so-called "crowding-out effect" in the money and capital markets

that might result as the Treasury financed sizable deficits at a time when economic activity was in recovery. He had been quite concerned about the danger of such a development, but he inferred--in part from the staff projection of a fairly strong expansion in housing activity--that the staff was not so concerned, at least for the quarters immediately ahead.

In response, Mr. Partee observed that in the current quarter there would be a bulge in net funds raised by all non-financial sectors, reflecting Treasury financings in large part to meet tax rebates and payments to recipients of social security benefits. As he had noted earlier, however, there would be a bulge in personal savings, and he did not expect marked upward pressures on interest rates. Difficulties were more likely to develop toward the end of the year and in the first half of 1976, when Treasury borrowing would remain high while private demands for funds would expand to finance residential construction, consumer spending, and business needs as liquidation of inventories gave way to accumulation. The flow-of-funds projections suggested that in the first half of next year the nonfinancial sectors would raise about $210 billion, at an annual rate, which was a higher level than had been sustained for any significant period in the past. Unless there should be a considerable expansion in the supply of funds, interest rates would be rising in that period. Thus the 3-month Treasury

bill rate, after changing little through this spring and summer, would rise to about 8 per cent in the fourth quarter and would continue to rise thereafter. With so high a bill rate, nonbank thrift institutions would not be very successful in attracting funds.

Mr. MacLaury--noting that the staff expected both short- and long-term interest rates to rise in the second half of this year when nominal GNP was projected to expand at an annual rate between 12 and 13 per cent--asked what rates of monetary growth had been assumed in making the GNP projections.

Mr. Partee responded that the staff had assumed a 6 per cent longer-run rate of growth for M_1. However, the assumed rate was temporarily higher over the second and third quarters of this year--nearly 7 per cent--in order to make up for the shortfall in the first quarter. Consequently, growth over the period from March of this year to March of next year was nearly 6-1/2 per cent. The staff also had assumed that the income velocity of money would increase by more than 5 per cent over the year ending in the second quarter of 1976--which was quite high by historical standards--but the substantial expansion in nominal GNP nevertheless would put pressure on the financial system.

Mr. Black inquired about the reasons underlying the staff projection of a persistent decline in net exports of goods and

services over the period from the second quarter of this year to the second quarter of next year.

Mr. Partee replied that the decline in net exports reflected a rise in imports of oil and a fall in exports of agricultural commodities, rather than any significant differences in the timing and pace of recovery in economic activity here and in other industrial countries; excluding oil imports and agricultural exports, exports and imports moved closely together throughout the projection period. With respect to oil, it was assumed that the price would remain high and that the physical volume would rise as economic activity expanded. For agricultural exports, on the other hand, it was assumed that prices would drop and that the physical volume of exports would decline as crop conditions around the world improved.

Mr. Partee added that the staff projections did not incorporate any energy conservation program, because of the great uncertainty about whether there would be any program at all. In the event of implementation of a forceful program, projected imports of oil would be reduced significantly.

Mr. Black then asked whether the deterioration in the export balance was expected to be offset by inflows of capital--especially in response to changes in the relationship between interest rates here and abroad--or was expected to lead to a steady deterioration in the value of the dollar.

Mr. Bryant replied that prospects seemed favorable for capital inflows that would at least offset the deficit on current account. With respect to interest rate relationships, the staff had not made explicit projections of rates in foreign countries. Recently rates abroad had continued to decline while rates here had leveled out or risen somewhat, and that had been a major factor in the strengthening in the value of the dollar. If the decline in rates here was about over, declines abroad would tend to be arrested.

Mr. Hayes remarked that foreign buying of equities had increased tremendously in February, and given the recent strength in the stock market, foreign buying might be substantial in the period ahead.

Mr. Solomon commented that, on the assumption that oil prices remained high, OECD countries as a group would have a current account deficit at a rate of between $30 and $40 billion. In light of that and of the size of the U.S. economy, the staff projections of the U.S. deficit on goods and services appeared reasonable.

Mr. Coldwell remarked that he inferred from the discussion that cyclical developments in the United States and other industrial economies were expected to remain in synchronization.

Mr. Bryant confirmed that the staff was continuing to project an evolution for foreign economic activity that was similar

in its cyclical timing to the projections for activity here in the United States.

Mr. Wallich observed that there was a certain similarity between now and 1968 in terms of the expected impact of fiscal policy changes. In 1968 a tax increase was enacted that was considered to be much larger than necessary to achieve the desired restraint, and the System proceeded to ease monetary policy. In the present situation fiscal policy was being heavily relied on to bring about recovery with relatively little contribution from monetary policy; the relative size of the tax reduction probably was larger than the increase in 1968. While he did not doubt that fiscal policy had strong effects, there was the historical precedent that fiscal policy without the support of monetary policy might prove to be disappointing. He asked Mr. Partee to comment.

Mr. Partee said the staff projection suggested that an upturn in the economy would develop and that it would be stronger than otherwise owing to the fiscal policy measures that had been taken. However, the fiscal stimulus by itself would run out of steam and the expansion in economic activity would run out of steam unless monetary policy also provided some stimulus.

Chairman Burns remarked that there was a dynamism in the private economy that existed quite apart from the effects of fiscal and monetary policies. That dynamism did not receive so much

attention nowadays because observers had got out of the habit of studying and thinking in terms of business cycles. However, there was still a business cycle process that reflected basically the inner workings of the private economy, no matter how much it might be influenced by fiscal and monetary policies.

Mr. Baughman commented that widespread resentment existed among people in the oil and gas industry in the 11th District because of the recent changes in taxes affecting that industry. The changes, although not as extreme as they had anticipated, nevertheless were expected to accelerate the decline in domestic production of oil and gas, and there was a view that the recent legislation was only the first in a series of measures affecting windfall profits, excess profits, and Federal regulation of intra-State pricing and use of gas. Some were distressed to the point of putting their properties up for sale.

Continuing, Mr. Baughman said there was a widely and firmly held belief among businessmen he had talked with that a renewed surge of inflation would begin within the next 18 months. Consequently, it was expected that interest rates would be much higher a year and a half from now; rates as high as 18 and 20 per cent were sometimes mentioned. While those businessmen were strong supporters of the Federal Reserve, they believed that the System was standing alone and was fighting a losing battle against

inflation. For that reason, it would be desirable for a national figure to make a statement in an effort to demonstrate that continuing substantial inflation was not inevitable, that upward price pressures could be contained or at least moderated. Particularly with respect to wages and to Federal programs affecting commodity prices, something could be done or said that would tend to lessen those expectations of continuation of a substantial rate of inflation.

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 March 18 through April 9, 1975, and a supplemental report covering the period April 10 through 14, 1975. Copies of both reports have been placed in the files of the Committee.

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

> Trading Desk operations since the March meeting have been directed rather steadily toward maintaining reserve availability consistent with a Federal funds rate remaining in the area of 5-1/2 per cent. At the start of the period, this approach to reserve availability was undertaken in line with the Committee's near-term growth objectives for monetary aggregates. Had monetary growth held to the moderate rates anticipated at the time of the last meeting, it would have been the intention of the Account Management to permit the funds rate to edge down a bit further to around the midpoint of the Committee's 4-3/4 to 5-3/4 per cent range. However, by late March, money growth measures for the March-April interval were estimated to be moving above their indicated ranges.

This would ordinarily have called for some restraint on reserve availability and a rise in the funds rate to 5-3/4 per cent. In light of continuing weakness in the economy and severe pressures in the capital markets, the Chairman recommended--and the Committee concurred--that a 5-1/2 per cent upper limit for the funds rate be retained for the time being. This stance continued through the end of the period, as new data on money growth continued strong while the credit market atmosphere remained fragile--though less despondent than it was earlier.

The day-to-day pattern of Desk operations was again dominated by the need to offset sharp swings in the Treasury's balances at the Reserve Banks. Through the first half of the period, a major rebuilding of Treasury balances drained some $3 billion or so of reserves, and the Desk supplied these through a combination of outright purchases and repurchase agreements. Among the outright purchases were about $1-1/4 billion of Treasury and agency coupon issues throughout the maturity range, which helped to relieve a heavy overhang of such issues in the market. Later in the period, the Treasury balance dropped back sharply, again by some $3 billion or more, creating an overabundance of reserves that was absorbed by maturities of RP's, outright sales and redemptions of bills, and substantial matched sale-purchase transactions. Partly because it was difficult to keep pace with the rapid drop in Treasury balances, somewhat easier than desired money market conditions developed in the last week or 10 days, with the funds rate often around 5-1/4 to 5-3/8 per cent. For the period as a whole, however, the funds rate averaged close to the desired 5-1/2 per cent level.

Notwithstanding the serene reserve climate, credit markets were under considerable pressure during much of the period. In the Treasury market, faced with high inventories of recent offerings, prospects of very heavy new supplies, and an absence of evidence that monetary policy was easing further, dealers marked down prices sharply in an effort to lighten their holdings. On several days the market atmosphere was extremely poor, with price quotes plummeting in thin markets and investors moving to the sidelines. The corporate bond market was also in disarray on a number of days,

with sharp price breaks and large underwriting losses. Toward the close of the period a steadier atmosphere was emerging in the capital markets, although the stability still appeared fragile and lacking in widespread confidence. The Desk's substantial purchases of coupon issues helped lay the basis for restoring a measure of stability by lifting out some of the oppressive inventory overhang, but those purchases did not prevent a substantial price and yield adjustment from taking place. That price adjustment, it should be noted, was at least as important as the System's buying in helping the market to regain its footing in recent days, as yields reached levels that brought in sizable customer demand. Net yield increases over the period ranged as high as 75 to 100 basis points in the 2-year maturity area, around 50 basis points in the 5- to 7-year area, and 25 to 30 basis points on long-term issues. The yield increases have been painful and costly to the dealers, but probably necessary in the process of attracting commercial banks and other buyers.

Bill rates also moved up during the period, as the Treasury concentrated an increasing portion of its new borrowing in this area. Three- and 6-month bills were auctioned the day before the last meeting at average rates of 5.38 and 5.47 per cent and at highs of 6.02 and 6.35 per cent on April 7. Those higher yields stimulated increased demands and a broad decline in bill yields in the past week, so that rates in yesterday's bidding averaged about 5.54 and 5.84 per cent.

Currently, there seems fairly widespread acceptance of the view that monetary policy is no longer easing further, but there is little expectation of an imminent shift away from ease. Even a modest move toward lessened reserve availability could engender further significant rate increases as the market remains fearful of a huge Treasury deficit and dubious about the willingness of the banking system to finance a large part of the debt.

Today the market is bidding for $1.5 billion of 2-year Treasury notes. There seems to be good interest in this auction with yields at current higher levels and dealers' inventories well below what they were a month ago. After this auction there will be a brief but welcome lull before the Treasury comes back to announce additional coupon issues on May 1.

> Finally, a word on New York City. A last-minute move by the State of New York to advance the City $400 million has provided a brief respite, but the underlying problem of market unwillingness to take on additional New York City obligations remains, and can only be resolved through a convincing demonstration that the City's financial affairs are being handled on a sound, responsible basis. In the meantime, there is only a very limited market in New York City notes and bonds. Federal Reserve Bank representatives have participated in a number of meetings with City, State, and financial community representatives, as we want to remain closely informed on the situation, but it has been made clear to the other participants that there is no likelihood of direct Federal Reserve assistance to New York City.

Mr. Kimbrel asked whether the large volume of Federal Reserve purchases of coupon and agency issues had been perceived by the market as an "operation twist" action.

Mr. Sternlight said he thought not. While System purchases of such issues had helped to restore some stability to the longer-term market, he believed they had been correctly interpreted as reflecting System efforts, in providing reserves, to buy issues that were in abundant supply. If the market had concluded that the System was engaged in a large-scale operation twist, the immediate reaction probably would have been favorable but the longer-run consequences might well have been counterproductive.

Mr. Mitchell noted that RPD's had declined at a rate of more than 4 per cent in the first quarter, according to the blue book. He asked whether that figure was adjusted for the mid-February reduction in reserve requirements on demand deposits.

Mr. Axilrod replied that the blue book figures on changes in RPD's were adjusted for reserve requirement changes. However, they were not adjusted for changes in the mix of deposits. There apparently had been a shift in recent months in the composition of time deposits, from deposits subject to a 6 per cent reserve requirement into those subject to a 3 per cent requirement. Consequently, although total time deposits other than large CD's had increased, required reserves for those deposits had declined.

Mr. Mitchell remarked that his basic concern was with the effect of the Committee's funds rate constraint on the rate of growth in bank time and demand deposits. He asked whether Mr. Axilrod thought the funds rate constraint had been a factor in the first-quarter decline of RPD's.

Mr. Axilrod replied that in a technical sense the funds rate constraint had caused the decline in RPD's, since the provision of sufficient additional reserves to achieve positive growth in RPD's would have resulted in a drop in the funds rate. However, if one was satisfied with the first-quarter rates of growth in M_1 and M_2, he presumably would also be satisfied with the behavior of RPD's in the quarter that proved to be consistent with such growth rates, given lagged reserve accounting and shifts in the mix of deposits.

In reply to a further question by Mr. Mitchell, Mr. Axilrod said he would expect growth in RPD's to resume in the second and third quarters, perhaps at a rate of about 4 or 5 per cent, if M_1 and M_2 expanded at the rates of roughly 7 and 11 per cent shown for them under alternative A. That alternative called for roughly unchanged money market conditions.

Mr. Coldwell asked whether dealers were rebuilding their inventories of coupon and agency issues in anticipation of additional Federal Reserve purchases in the near future.

In reply, Mr. Sternlight noted that dealer positions in Treasury issues maturing in more than one year were now about $1 billion lower than 5 weeks ago. During that interval dealers had acquired about $2 billion in new Treasury issues and had sold net about $3 billion--$1 billion to the System and $2 billion to other buyers.

Mr. Coldwell then asked about dealers' attitudes in general with respect to stockpiling longer-term issues.

Mr. Sternlight replied that the dealers appeared to be rather cautious at the moment, and probably would be hesitant to rebuild their inventories to month-ago levels. Nevertheless, it was difficult to predict dealer activity from week to week; any opportunities for profit that emerged might well overcome their present caution.

In response to a further question by Mr. Coldwell, Mr. Sternlight said that there had been no significant increase in the volume of System lending of securities during the past month, although in recent months the volume had been high relative to that of a year or two ago.

In reply to a question by Mr. Eastburn, Mr. Sternlight said he thought that for the time being, at least, dealers did not expect any further easing in monetary policy.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period March 18 through April 14, 1975, were approved, ratified, and confirmed.

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

Following a period of shortfalls relative to expectations, demand deposits--and hence M_1--most recently have been coming in stronger than anticipated, given the Federal funds rate. In terms of factors that affect the demand for money, the chief reason for the shortfalls was the development of a much weaker economy than had been expected. In addition, demand deposits in late 1974 and early 1975 turned out to be even weaker than would have been predicted by our models if nominal GNP had been correctly forecast. Deposits were, in other words, off the demand curve.

The recent sharp expansion in M_1 appears to represent, in part, a movement back toward the estimated demand curve. In part, also, it reflects the special effect of the greatly enlarged tax refunds paid out to the public in late February

and early March as a result of early filing and more expeditious processing by the Treasury. But one might also wonder whether or not the rapid growth in M_1 is indicating a quicker turnaround in the economy than the staff has been projecting, just as the previous shortfall was a sign of the unexpectedly rapid decline in GNP. Because of the special factors at work enlarging money growth recently, it would certainly be hazardous to conclude, on the basis of the behavior in M_1, that the economy was in fact stronger than anticipated. But sustained overshoots in M_1 growth would lend additional credence to such a conclusion.

In any event, a substantial recovery in GNP is projected by the staff by the third quarter. In order to accommodate this recovery, and also to provide leeway for a temporary rise in the public's demand deposits as a result of large tax rebates scheduled to begin in May, the various alternatives presented to the Committee[1/] all include substantial acceleration of M_1 growth in the spring and summer relative to the first quarter as a whole. Growth rates for M_1 in those quarters are also projected to be more rapid than may be desired over the longer run by the Committee.

Two of the alternatives--including the alternative thought to be consistent with a longer-run M_1 growth rate on the order of 6 per cent--nonetheless indicate that a rise in the Federal funds rate may be needed in the period immediately ahead. The short-run specifications associated with alternative B suggest, for Committee consideration, a rise in the funds rate over the next few weeks to the mid-point of a 5-1/2 to 6-1/2 per cent range. The staff would expect that such an approach would facilitate achievement of longer-run control over the monetary aggregates once the economic recovery, and transactions demands for money, begin to gather steam.

Shorter-run specifications including a Federal funds rate range centering near recently prevailing conditions are shown under alternative A. Such a funds rate would seem broadly consistent with higher longer-run growth rates for the aggregates than those shown under alternative B. Specifically, a 5-1/4 to 5-1/2 per cent funds rate over the next few weeks might be deemed consistent with longer-run rates of growth that

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

> include M_1 expansion on the order of 7 per cent. However, given the long length of time to run in a 12-month planning horizon based on March, an unchanged funds rate between now and mid-May also would not be inconsistent with a longer-run 6 per cent M_1 growth. The risk the Committee may wish to evaluate, if it considers such a strategy, is the probability that interest rates later may have to rise more rapidly than otherwise--with consequent rather sudden pressure on financial markets and institutions--if M_1 growth over the longer run were to be maintained at a 6 per cent annual rate, assuming nominal GNP growth does turn out to be as strong as currently projected.

Mr. MacLaury noted that the projections of M_1 growth in April made by the staffs of the Board and the New York Bank were quite different--5.9 per cent and 2.5 per cent, respectively. He asked Mr. Axilrod to comment.

Mr. Axilrod observed that differences of the magnitude mentioned were not uncommon. Neither set of projections had been consistently better than the other in the past, and he could not say which figure for April was likely to prove more accurate.

Mr. Eastburn remarked that, to the best of his recollection, it had been the practice until recently to associate the assumption of unchanged money market conditions with the intermediate alternative--alternative B--in the blue book. In recent months, however, that assumption had been associated with alternative A, and both B and C had involved firming. Under such a procedure those Committee members who favored some easing of money market conditions were not presented with specifications reflecting their position and had to formulate their own.

Mr. Axilrod commented that he had not been aware of any change in procedure. He thought the only convention followed in the presentation of blue book alternatives was the gradation of growth rates for the monetary aggregates, with the highest growth rates shown under alternative A and the lowest under C.

Mr. Partee added that, for practical reasons, the number of alternatives presented in the blue book had to be limited. An alternative calling for the continuation of prevailing money market conditions was always included. Where that alternative was placed in the spectrum depended on how prospects for monetary growth compared with the growth rates the Committee was likely to favor. At times in the past, for example, when prospective growth in the monetary aggregates appeared likely to be weaker than the Committee desired, alternative C had been associated with unchanged money market conditions and both B and A with easing conditions. Now that the aggregates appeared to be coming in on the stronger side, it seemed reasonable to associate unchanged conditions with alternative A. Of course, Committee members were not limited to the alternatives specified in the blue book; as Mr. Eastburn had suggested, they could offer their own specifications.

Mr. Mitchell asked whether the funds rate was likely to act as a constraint on increases in the aggregates during the next month or so.

Mr. Axilrod observed that under alternative A, which called for a funds rate in the neighborhood of the current 5-1/2 per cent level, M_1 was projected to grow at about an 8 per cent annual rate during the April-May period--about 6 per cent in April and 10 per cent in May.

Chairman Burns remarked that, before calling for the discussion of policy, he would offer a word of advice to the members. The Committee should approach its task with a view to stressing its broad economic, financial, and social objectives. The Concurrent Resolution would, unavoidably, result in some increased emphasis on and debate about numerical targets, but he hoped that tendency would not be overdone--that numbers would not be overemphasized, and that too much importance would not be attached to small differences--particularly in light of the limits on the Committee's ability to foresee the future. Those limits had been recently demonstrated by the difference between the actual growth rate of M_1 in March and the initial projection of that growth rate, and surprises would continue to occur.

The Chairman then called for the discussion of monetary policy and the Committee's policy directive.

Mr. Hayes commented that, to his mind, the major factors that should influence today's policy decision tended on balance to justify a policy of essentially no change in money market

conditions. The business outlook had changed little over the past month, but there were some signs that a turnaround might not be too far off and public sentiment appeared to have become somewhat more optimistic. The price outlook had become relatively encouraging, but it had to be recognized that projections of inflation through mid-1976 were unacceptably high by any but the most recent historical standards. And, although the dollar's performance in the exchange markets had been favorable most recently, the international situation remained sensitive. Uncertainty over the size of the prospective Federal budget warranted a cautious attitude toward further easing, while the sensitive state of the capital markets suggested that an unexpected move toward firmer short-term interest rates might have undesirable consequences for business recovery.

Against that background, Mr. Hayes continued, he would favor a continuation of present policy. At some point a move toward less ease would be needed, but before taking that step he would prefer to see stronger evidence of an upturn in the economy. As for the aggregates, he would not be too concerned if they rose fairly rapidly for a few months, in light of the slower-than-desired growth in earlier months. He would be content to maintain the targets adopted at the last meeting for the December-September period--6 per cent for M_1, 8-1/2 per cent for M_2, and

8 per cent for the credit proxy, but he would also be reasonably content with targets shown under alternative B in the blue book for that 9 month period and for the 6- and 12-month periods beginning in March 1975. He had no major objection to the short-run ranges of tolerance under alternative B, but he would be inclined to widen the ranges for M_1 and M_2 by 1/2 percentage point on either end, to 6 to 9 per cent and 9 to 12 per cent, respectively. He would also suggest adding a short-term target for the bank credit proxy--perhaps 6-1/2 to 9-1/2 per cent.

However, Mr. Hayes said, he differed with the alternative B specification for the Federal funds rate. He found the B range of 5-1/2 to 6-1/2 per cent too high and would prefer a range of 5 to 5-3/4 per cent, with the understanding that--in light of the continuing delicate state of the capital markets--the funds rate would be kept close to the current 5-1/2 per cent level unless the 2-month growth rates in the aggregates appeared to be approaching an outer limit of the wider ranges he had proposed.

Mr. Hayes observed that the language of alternative B struck him as appropriate. He saw no need for a further signal of ease, in the form of either a discount rate reduction or a reserve requirement change, in the present circumstances.

Mr. Black remarked that today's policy decision was a rather difficult one. He agreed fully with Mr. Partee's judgment

that a vigorous recovery was a distinct likelihood, but he also noted that the solid evidence indicating the imminence of such a recovery remained quite fragile. He was concerned that the large Federal deficits in prospect might have an adverse impact on the financial climate and thus on the recovery. Recent difficulties in the bond markets might be indicative of the kinds of problems that could lie ahead. Although the capital markets had weathered those difficulties, they still were in a rather shaky condition; it was his judgment that they would react strongly to any sign of a move toward less ease. He saw a real danger that any upward movement in interest rates could seriously retard the recovery in housing and complicate business financing problems. He thought the successful refunding of short-term corporate debt and improvement of business liquidity were crucial to the achievement of a sustainable recovery.

At the same time, Mr. Black continued, he was reluctant to accept longer-run target growth rates for the monetary aggregates higher than those presented under alternative B. In particular, he did not favor 12-month targets above 6 to 6-1/2 per cent for M_1 and above 9 to 10 per cent for M_2. In fact, he thought all of the long-run targets shown under alternative B were rather ample and he preferred growth rates near the lower rather than the higher limits of the B ranges.

However, Mr. Black observed, he was less concerned at the moment about the appropriate 12-month targets than he was about the immediate need to foster financial conditions that would promote the beginning of a recovery in the next 2 or 3 months. He would be prepared to accept 2-month growth rates in the aggregates somewhat higher than those specified in alternative B if necessary to prevent a back-up in the Federal funds rate; he would not want to see the funds rate go above its current 5-1/2 per cent level unless a sharp spurt in the aggregates--to, say, a 10 per cent growth rate for M_1--appeared rather certain. For the next few weeks he would be inclined to hold the Federal funds rate in a narrow range of about 5 to 5-1/2 per cent while waiting for indications of the likely pattern of growth in the aggregates. If the aggregates should prove weaker than expected and if interest rates abroad moved down significantly further, he believed a 1/2 percentage point reduction in the discount rate--to a level more nearly in line with the funds rate--might be appropriate. Under such circumstances, he thought that it would be better to lower the discount rate than the target for the funds rate.

Mr. Bucher commented that in his judgment the signs pointed, at best, to the beginning of a fragile recovery. The most encouraging development was the more favorable outlook for prices that appeared to be emerging. At the same time, there was still a great deal of

uncertainty in the business and financial communities and also, apparently, in the consumer sector. Moreover, unemployment was discouragingly high and was projected to continue high.

The first priority of monetary policy, Mr. Bucher remarked, should be to provide financial conditions conducive to a strong recovery in economic activity. In light of the trade-off between prices and unemployment, it seemed clear to him that more rapid growth in the monetary and credit aggregates in the months ahead would have little inflationary impact, but could boost economic activity and reduce unemployment from the levels forecast under the assumption of a continuation of current policy. It was his judgment that the adoption of any of the alternatives presented in the blue book would produce adverse reactions in the financial markets that, in turn, would have spillover effects in other areas of the economy. Even under alternative A, the Federal funds rate was estimated to change little over the next few weeks and, as indicated in the blue book, upward pressure on interest rates--mainly in the Treasury market--could develop.

Against that background, Mr. Bucher said, it was his strong belief that there was much to gain and little to lose by renewing for at least another month the Committee's previous policy of gradual ease. If interest rates rose, financial market participants might become more cautious lenders, thrift institutions might

not move toward a more aggressive lending posture, businesses might find financing capital needs more difficult and costly, the stock market might retreat, and consumer and business confidence might well be further eroded. To his mind, those were all real dangers. Therefore, although he could accept the language of alternative A for the directive, he would propose for Committee consideration what he might term alternative "A prime," calling for a Federal funds rate range of about 4 to 5 per cent.

Mr. Holland remarked that he continued to favor the broad objective of recent monetary policy--fostering financial conditions that would facilitate recovery without fueling a resurgence of inflation. Most of the economic and financial information received since the last meeting indicated movement in the direction of that objective; on balance the economic news of the last month had been encouraging. He thought the bottoming out of the recession was quite close, and that policy had to be formulated in light of that fact, even while recognizing that the effects of any actions taken today would continue for a year or more in the future.

Mr. Holland observed that the adjustment that had just occurred in long-term markets, although probably unavoidable, had left those markets in a delicate condition. For that reason, he thought it would be inappropriate for the System to give signals either of further ease or of tightening at this juncture. He would

prefer to maintain a steady Federal funds rate in the period until the next meeting in order to foster a degree of stability in the financial markets. Specifically, he would favor the short-run specifications of alternative A, but he would not want to see the funds rate rise above 5-1/2 per cent if that could be avoided. In addition, he would not take any action to reduce the bulges in monetary growth projected for May and June. Since staff analysis suggested that those bulges were related to tax rebates and would be temporary, he would look beyond that period in the effort to assess the underlying conditions on which policy decisions should be based.

Mr. Holland said he would prefer to speak of the longer-run growth rates for the aggregates in terms of projections or patterns rather than targets, since he believed too little was known about the likely shape of events over the coming year to adopt targets for such a period. In thinking about longer-run growth rates, he was not yet ready to assume that fiscal policy would be as easy as implied in the staff projections. The intent of Congress would become clearer with the passage of time, and he would want to reassess the prospects more closely before accepting that degree of fiscal stimulus as given in framing decisions on monetary policy. While he would, perhaps, be most comfortable with long-run growth rates somewhere between those shown under

alternatives A and B, in the present circumstances he could pledge very temporary and tentative allegiance to the alternative B rates. He hoped the Committee would feel free to change those numbers from meeting to meeting--substantially, if need be--as its perceptions of the economic environment changed. For the language of the directive he favored alternative B.

Mr. MacLaury said he assumed that in the forthcoming hearings members of the Senate Banking Committee would inquire about the System's expectations for the economy over the next 12 months--the period for which Congress had asked for specifications of monetary growth targets. If he were representing the System, he would reply by citing the staff projections, with which he personally agreed--indexed by an unemployment rate of 9 per cent, a rate of inflation of about 5-1/2 per cent, relatively rapid growth in GNP in the second half of calendar year 1975, and a likely slowdown in the recovery as 1976 proceeded. That outlook was predicated on an M_1 growth rate of 6-1/2 per cent; if asked whether he considered it satisfactory, he would have to answer that he did not. For that reason, among others, he would favor targets for the monetary aggregates for the 12-month period ending March 1976 indexed by an M_1 growth rate of 7 per cent--a little below the midpoint of the 6 to 8-1/2 per cent range shown under alternative A.

Mr. MacLaury remarked that exchanges along the lines of that he had described seemed likely to develop at hearings under the Resolution. For that reason, he thought the Committee would have no choice but to play the "numbers game," despite the risks the Chairman had mentioned earlier. In his judgment, there could be real advantages in doing so. He had in mind the likelihood that in the fourth quarter of 1975 and the first quarter of 1976 it would be necessary to permit interest rates to move up if the rate of growth in M_1 was not to exceed 7 per cent. At least that would be the case if, as he assumed, the staff's projections of nominal GNP were reasonablly close to the mark.

Ordinarily, Mr. MacLaury continued, such a rise in rates would elicit sharp criticism in Congress. However, if the Committee and Congress could agree now that a 7 per cent increase in M_1 would be reasonable for the coming year, and if the Committee did not change its mind in the meantime, Congress would be less likely--or at least would have fewer grounds--to criticize the interest rate increases needed to achieve that target. Moreover, he would hazard the guess that those who might now be arguing for a year-to-year M_1 target lower than 7 per cent would be quite reluctant to allow interest rates to rise late in the year, even if necessary to hold M_1 growth down to a rate as low as 7 per cent. In sum, he thought

the economy required an increase in M_1 of at least 7 per cent for the coming year because he was not satisfied with the projections based on a 6-1/2 per cent M_1 growth, although he recognized that those projections could not be considered firm. Moreover, he thought a 7 per cent long-run target would be more acceptable to Congress than a 6-1/2 per cent target.

Turning to short-run targets, Mr. MacLaury continued, he would prefer ranges for the aggregates similar to those shown under alternative B. He would not want to see the aggregates grow, even in the short run, at rates so high that the difficulties of bringing them under control later would be enhanced. For the Federal funds rate, however, he favored a range centered near the present 5-1/2 per cent level instead of the 5-1/2 to 6-1/2 per cent range shown under B. He had long advocated the use of a range wider than the one percentage point employed in recent months; if the Committee was serious about its targets for the aggregates, it had to be prepared to see interest rates move. Ordinarily, he preferred a width of 2 percentage points, but in view of the existing sensitivity of financial markets he would not want the funds rate to rise above 6 per cent at present. The funds rate should be permitted to move that high, however, if the aggregates appeared to be growing at rates near the upper limits of the alternative B ranges.

Some downward flexibility also was needed, particularly in light of the uncertainty about the short-run movements in the aggregates reflected in the large differences between the New York Bank and Board staff projections. On balance, he favored a range of 4-3/4 to 6 per cent for the funds rate.

Mr. Morris observed that during the years he had participated in the Committee discussions on monetary policy, he had generally opposed policy prescriptions formulated in terms of maintaining prevailing money market conditions, which had been frequently espoused by other participants. Today, however, he found himself in the rather awkward position of advocating precisely that approach.

One of the things that impressed him, Mr. Morris continued, was the _prima facie_ case that a level of rates had been reached which would generate sufficient monetary flows to produce a turnaround in the economy. The evidence was not conclusive; he recalled that, at the time of the November meeting, staff projections indicated strong monetary growth in December and January at the then-prevailing level of interest rates, but such growth had not materialized. He did not think today's situation was comparable to November's, but he could not be certain--and the New York Bank projection of weak M_1 growth in May was sobering.

Secondly, Mr. Morris said, there was a _prima facie_ case that the economy was already beginning to turn. Again the evidence was not conclusive; he would want to see at least another month's data before reaching a conclusion, and at this time he certainly did not have the strong conviction on the point that would be required to advocate pushing up short-term rates while economic activity was still declining and unemployment was rising. Accordingly, he advocated maintaining prevailing money market conditions at present.

Mr. Morris added that, while he would not have supported a policy alternative calling for easier money market conditions, he would not consider such an alternative to be outside the realm of reasonableness. For that reason, he shared Mr. Eastburn's unhappiness over the absence of such an alternative in the blue book.

Turning to the longer-run specifications, Mr. Morris said it seemed to him that optimal policy would involve the attainment of faster monetary growth over the next two or three quarters than would be desirable beyond that period. He favored the 12-month targets shown under alternative A, and he felt confident that those targets--involving ranges of 6 to 8-1/2 per cent for M_1 and 10 to 12 per cent for M_2, and midpoints of 7-1/4 and 11 per cent--could be defended in both the business and academic communities.

While he was not too concerned about the short-run specifications, particularly in light of the difference between the projections of the New York Bank and Board staff, he would assume that if the longer-run specifications of alternative A were adopted, growth in real GNP would be somewhat higher and unemployment a little lower than currently projected. He would like to see that outcome. Consequently, he would favor both the short-run and long-run specifications of alternative A.

Mr. Balles commented that, although the prospects were good, the recovery was not yet a certainty. He would not want to abort the recovery by allowing interest rates to rise prematurely. Therefore, he would join those who wanted to maintain relatively stable money market conditions over the near term; in sum, he favored the short-run specifications of alternative A. He might also note that, because of shortfalls, the longer-run targets agreed upon last August--indexed by a 5-3/4 per cent growth path for M_1--had not yet been achieved; even if the longer-run alternative A path were followed for the months ahead, M_1 would not reach the levels implicit in that 5-3/4 per cent path until November 1975. Thus, while he considered the longer-run targets of alternative A too expansionary if followed indefinitely, he favored them at this time. For the language of the directive he preferred alternative B.

Mr. Francis remarked that he agreed with the staff's projections regarding the economic outlook, and he thought the business community in general considered the recession to be at or near its bottom. Growth in the monetary aggregates recently had been at higher rates than it would be desirable to sustain, but as a short-run development that would not be a matter of concern. Although there was some uncertainty about the timing of the turning point and about the recovery itself, he was concerned about the risk that as the economy moved into recovery the Committee would follow an overly expansive policy, as he thought it had done in some past recovery periods. He would point out that even under alternative C M_1 would grow, on a quarterly average basis, at a rate of about 6 per cent from the first quarter of 1975 to the first quarter of 1976. He thought that rate of expansion in M_1 would be adequate to support the recovery in economic activity he anticipated during the next 12 months.

In response to the Chairman's request for his advice to the Committee, Mr. Partee commented that his position was close to that of many who had already spoken today, particularly to Mr. Holland's. Although it was not unreasonable to consider a policy of fostering lower interest rates now, he thought the time for such action had passed, given recent money market pressures and the high probability that a turning point in economic

activity was near. In his judgment, however, it was certainly too early to think in terms of significantly higher interest rates. He would point out that the current levels of interest rates--a 9 per cent mortgage rate and a 9-1/2 per cent corporate bond rate, for example--were extremely high by historical standards. Even short-term interest rates were quite high considering that the country was in the deepest recession of the postwar period. Consequently, he felt a move toward a higher level of rates at any time in the immediate future would be quite risky. In sum, he thought the Committee should aim to limit fluctuations in short-term interest rates within a fairly narrow range. For the Federal funds rate, he thought a constrained range of 4-3/4 to 5-3/4 per cent or 5 to 6 per cent would be appropriate; he did not view the difference between midpoints of 5-1/4 and 5-1/2 per cent as crucial.

With respect to the longer-run ranges of monetary growth to be sought by the Committee, Mr. Partee continued, it seemed to him that the Committee's decision would necessarily be based on political as well as economic considerations, and he did not have any strong views. He would point out, however, that the nation was a long way from maximum utilization of its resources of labor and plant capacity; there was a great difference between current rates of use and the rates that would be considered acceptable under any reasonable standards. He would also suggest that if

the Committee wanted to encourage any degree of contracyclical behavior in the monetary aggregates, the appropriate time for a higher-than-normal rate of expansion in the aggregates was during the initial stage of recovery--say, during the first year or so. That would seem to argue for a higher-than-normal M_1 target. It was unlikely that such a target would be misinterpreted as inflationary, particularly since observers were generally aware of the unusually low rates of monetary growth over the past three quarters and of the desirability of making up for those shortfalls. If the target were set too high, of course, it might still be interpreted as an indication that the Federal Reserve had adopted a course that would prove to be inflationary over time. Therefore, if a rather high range were adopted, he would recommend that it be explained as an interim objective.

Mr. Eastburn said he was impressed by two aspects of the staff's projections--that the unemployment rate would remain 9 per cent or higher through mid-1976 and that the rate of inflation would decline to relatively low levels. Those expectations, which were shared by the staff at the Philadelphia Reserve Bank, suggested the need for substantial growth in the aggregates over the longer run. Nevertheless, there would eventually be a need for somewhat slower growth in the aggregates than had prevailed on the average in recent years--quite likely before the end of the

12-month period for which the Committee was now formulating its longer-run objectives--if reasonable price stability were to be maintained following recovery. On balance, he favored growth in the aggregates over that period at rates near the midpoints of the ranges shown under alternative B, including the 6-1/4 per cent midpoint shown for M_1.

In general, Mr. Eastburn continued, he thought the desired longer-run growth rates should be achieved by seeking more rapid growth early in the period and slower growth later. While it would be necessary to permit interest rates to rise at some point, he thought that point had not yet been reached. He was concerned about the present state of financial markets, and would not want to signal any type of policy movement now--either towards further ease or in the opposite direction. For those reasons, he favored the short-run specifications shown under alternative A, except that he would set the upper limit for the Federal funds rate at 5-1/2 per cent.

Mr. Kimbrel observed that indications of optimistic sentiment were continuing in his District. Such optimism would argue for maintaining a relatively stable posture for a brief period in order to observe some of the rather significant influences already operating on the economy. Business leaders with whom he had spoken were extremely concerned about the prospective Federal deficit, particularly in light of the increased Federal spending which might result

from Congressional efforts to combat the recession. He hoped interest rates could be maintained at a level that would prevent disintermediation and stimulate a housing recovery. He feared, however, that Federal financing activity would tend increasingly to exert upward pressure on interest rates. Thus, if it seemed necessary to moderate growth in the aggregates, he would permit some slight rise in the Federal funds rate now in order to avoid a bulge in interest rates at a later time. Accordingly, he preferred the specifications and language of alternative B.

Mr. Winn remarked that at a meeting last week some of the directors of the Cleveland Reserve Bank had reminded him of the danger of placing too much emphasis on financial factors and not enough on psychological factors when thinking about policy. In an effort to bolster business and consumer confidence, therefore, they had recommended a reduction in the discount rate. They felt such a reduction would have had little impact on the financial environment, since the discount rate was not closely in line with the Federal funds rate, and since borrowing at the discount window was at a minimal level. At the same time, they hoped it would serve as a signal that would strengthen confidence and help the System maintain interest rates at current levels without having to inject large amounts of funds. In sum, they thought it was the best of several alternative actions designed to assure businesses and

consumers that the recovery many felt was in prospect would, indeed, occur.

With respect to short-term specifications, Mr. Winn said he would be governed by Federal funds rate considerations; he would not want to see any adverse effects on the financial environment by a signal of less ease in the coming weeks. For the long-run targets he favored those shown under alternative B.

Mr. Wallich said he thought that in the current situation two ceilings were relevant: a physical ceiling on potential output, which was quite distant, and a financial ceiling within which the Committee had to live, which was not nearly so far away. The simple action of rapidly increasing the money supply was not a viable policy alternative because it would create wholly erroneous expectations. For the long run he viewed a growth rate in M_1 of about 6 per cent as a responsible course. If velocity increased by 2 per cent as a result of trend growth and by another 2 per cent as a result of a reduction in the demand for money associated with higher interest rates, nominal GNP would rise by about 10 per cent, perhaps reflecting a 4 per cent rise in real GNP and 6 per cent inflation. Assuming the System was able to hold to a 6 per cent M_1 growth rate, such a scenario probably would produce a slow recovery in which inflation was gradually wrung out of the system, fostering an era of relative price stability along the lines of 1961-1965.

Mr. Wallich remarked that because monetary policy actions generally affect the economy with a lag--the near-term effects were limited mainly to housing--he would view the short-run targets in terms of the economic situation likely to be prevailing in the fall or at the end of the year. If the projections were right, there would be substantial upward pressures on interest rates at that time. Under such conditions, he saw two possible strategies for the Committee. It could opt to move cautiously in expanding the aggregates now, in order to have more leeway for accommodation later, or it could resolve to stand firm later--to resist pressures to pump up the money supply in the face of rising interest rates--and thus be able to tolerate somewhat higher rates of monetary growth and a lower Federal funds rate in the immediate future. He leaned toward the second course.

Mr. Wallich observed that he favored the short-run specifications shown under alternative B. The 2-month ranges of growth for the aggregates, including the 6-1/2 to 8-1/2 per cent range for M_1, were on the high side, and according to the specifications growth could be held down to those ranges only by permitting the funds rate to move up into a 5-1/2 to 6-1/2 per cent range. Although he recognized the sensitive state of the markets, he thought it might be better to adopt the B specifications and allow some of the existing upward pressure on interest rates to show through. Otherwise,

upward pressures might be so much stronger at a later time that the Committee would find it difficult to hold the line on monetary growth. Accordingly, he would prefer to move as far as feasible in that direction at the present time.

Turning to the longer-term targets, Mr. Wallich said he thought the main objective should be to attain Congressional sanction for reasonable rates of growth in the monetary aggregates and thus to receive implicit sanction for whatever interest rate consequences might be consistent with those targets. That led him to consider unsatisfactory a target range for M_1 of 5 to 7-1/2 per cent because the 7-1/2 per cent upper bound was likely to be interpreted as the target. He preferred a narrower range--say, 5-1/2 to 6-1/2 per cent--or even a single-valued figure such as 6 per cent, on the understanding that the Committee would not expect that figure to be achieved precisely.

Mr. Mayo commented that he was not as optimistic about an imminent recovery as others who had spoken earlier or as some private economic forecasters seemed to be. While he thought economic recovery in the summer or fall was quite likely, he doubted that much real evidence would exist by the time of the May, or even the June, meeting of the Committee. Because of the length of the interval before he expected the recovery to be under way he felt quite relaxed about the alternative A range

for the Federal funds rate of 4-3/4 to 5-3/4 per cent for the next 5 weeks. In his judgment any rise in interest rates now would be entirely premature, unless brought about by market forces outside the System's control. As he had indicated last month he preferred a Federal funds range wider than 1 percentage point, but since a range of 4-3/4 to 5-3/4 per cent had been adopted then he would not want to change it now.

Mr. Mayo then noted that all of the key measures of reserves had declined in the first quarter of 1975. If one reviewed the quarterly changes in reserves during the past 15 years, he would find only one quarter of the 60 in which total reserves had declined at a greater rate than in the first quarter of this year; only seven in which nonborrowed reserves had declined at the same or a greater rate; and only one each in which required reserves and RPD's had declined at a greater rate. Although he recognized that quarterly data might obscure some of the factors at work during various periods--including, in particular, the most recent period--those comparisons were quite sobering.

Chairman Burns observed that the findings would be rather different if one compared the changes in reserves--particularly nonborrowed reserves--in the last 6 months rather than the last 3 months with previous experience. Growth in nonborrowed reserves

had been extraordinarily rapid in the fourth quarter of 1974, and it averaged 17.3 per cent in the 6 months ending in March 1975.

Mr. Mayo remarked that the crucial point he had wanted to make was that the System had not been creating an overabundance of reserves. Consequently, he preferred to wait a little longer before embarking on a policy designed to moderate an upturn in economic activity; in his judgment it was too early in the cycle for such a policy stance. Accordingly, he favored the short-run specifications shown under alternative A. For the language of the directive he preferred alternative B.

Turning to the longer-term targets, Mr. Mayo said he shared Mr. Partee's view that the choice involved some political considerations, which he believed should be weighed carefully. However, he was in basic agreement with those who favored ranges of aggregate growth rates for the next 12 months somewhere in the general area of the ranges shown under alternative A. Just where the midpoint of the range was did not concern him greatly; he thought a figure above 6 per cent was defensible and appropriate, and he could accept either 6-1/2 or 7 per cent. He also thought there was little likelihood that the targets adopted today would serve as the basis on which the System's performance would be judged at a later time. Because the figures would be subject to frequent reconsideration the Committee would, in effect, have a moving target.

As a final point, Mr. Mayo observed that, although it might be a little late in the cycle, there still was an opportunity for another reduction in the discount rate--perhaps of only 1/4 of a percentage point--in order to indicate that the System was not satisfied with the present levels of the prime rate and some market interest rates. The directors of the Chicago Bank had recommended such action 3 weeks ago, partly to provide the market with some reassurance that policy had not moved in a tightening direction at a time when the corporate market was being flooded with new issues. They had not renewed that recommendation after its initial denial because the problem of sensitivity in the corporate market had become less immediate. Nevertheless, in the next 3 or 4 weeks there might be an appropriate time to lower the discount rate.

Mr. Mitchell observed that he was in basic agreement with Mr. Hayes and some others who had spoken in favor of a "no change" policy. He had drawn on the comments of others during the course of today's discussion to formulate his own interpretation of the appropriate specifications for such a policy. In that regard, Mr. MacLaury had been most helpful when he suggested a wider range for the Federal funds rate in order to permit some flexibility in achieving the desired growth of the monetary aggregates. He agreed with that suggestion.

In his judgment, Mr. Mitchell said, the ranges specified for short-run growth rates in M_1 and M_2 could reasonably encompass those shown under all three alternatives--6 to 9 per cent for M_1 and 9 to 11-3/4 per cent for M_2. Although he would not similarly broaden the funds rate range to cover the full gamut of the alternatives, he would widen it to 4-3/4 to 6 per cent. He favored that approach because he thought the market needed leeway to adjust to developments that were taking place without interference by the System. He did not know, for example, whether the recent back-up in long-term interest rates was transitory or not; in his judgment, however, long-term debt currently was undervalued. In any event, he thought the Committee should avoid influencing the market in either direction so that market participants could better assess underlying market conditions.

Mr. Coldwell remarked that the Committee's objective should be a resumption of real economic growth and increased utilization of resources. He was concerned about the projection of a prolonged period of 9 per cent unemployment, but he was hopeful that prospective measures of fiscal stimulus might reduce unemployment. Because the economy was still in a deep recession he did not want to see a rebound in interest rates. While he would not favor several months of double-digit rates of growth in the money supply, he would not be unduly disturbed by rapid

M_1 growth now--just as he had not been greatly concerned about previous shortfalls. He was particularly distrustful of the current M_1 projections, because the March growth rate had been influenced by the disbursement of tax refunds and the underlying pattern of M_1 growth in future months was likely to be distorted somewhat by the tax rebates.

As for his policy prescription, Mr. Coldwell continued, he favored a relatively wide Federal funds range centered at about 5-1/4 per cent--a range, say, of 4-1/2 to 6 per cent--which would be consistent with a short-run rate of growth in M_1 of about 7-1/2 to 8 per cent. He hoped the Manager would allow the funds rate to decline to the 4-1/2 per cent lower limit if growth in reserves and the monetary aggregates was not satisfactory. He would focus on adequate reserve expansion and on maintaining reasonably steady money market conditions until a clearer view of the likely course of the economy became available.

Mr. Baughman commented that in conversations with bankers and savings and loan managers he found they were continuing to follow rather restrictive lending policies. Such conservative attitudes had to be changed in order to bring the economy out of the recession. In his judgment that could be done only by providing more liquidity to the banking system. He would also point out that, although recently enacted fiscal policy measures had been

designed explicitly to stimulate the economy, there was as yet no evidence that fiscal policy would in fact be overly stimulative. Until such evidence emerged, he thought monetary policy should be accommodative.

Accordingly, Mr. Baughman said, he favored the short-term specifications of alternative A. However, the rather close historical relationship between the rate of monetary growth and the rate of inflation led him to favor a more moderate long-run growth in the money supply. Therefore, he would retain the longer-run targets adopted at the last meeting. For the language of the directive, he preferred alternative A.

Mr. Baughman observed that he did not have strong feelings about a change in the discount rate at the present time. He doubted that the directors of his Bank would initiate a reduction but they probably would follow if another Reserve Bank took the first step.

Mr. Clay remarked that evidence of a continuing economic decline was widespread. Real GNP declined at about an 11 per cent seasonally adjusted annual rate during the first quarter; the unemployment rate rose to a 34-year high of 8.7 per cent; and industrial production fell another 1.0 per cent in March for a total decline of about 13 per cent since September 1974.

Nevertheless, Mr. Clay continued, some signs of a bottoming out of the recession had begun to appear. Industrial production

data suggested that substantial inventory liquidation had taken place--laying the groundwork for a subsequent turnaround in production; and a report by the National Association of Purchasing Managers indicated that two-thirds of its members expected to reach their lowered inventory targets by May. Other encouraging signs included the marked improvement in the Conference Board's index of consumer confidence, the record $3.1 billion net inflow to Federally insured savings and loan associations in February, increases in new factory orders and new durable goods orders in that month, and the February increase in the composite index of leading economic indicators, following a 6-month decline of over 13 per cent. Moreover, the tax package signed by the President, coupled with new Congressional spending programs, could be expected to have a moderately stimulative effect on the economy. He would remind the Committee, however, that there was still weakness in the economy and that prospects for recovery remained uncertain.

Against that background, Mr. Clay observed, a 6 per cent rate of growth in M_1 for the 9-month period ending September 1975 appeared reasonable. Because of the shortfall in the first quarter, that would involve a growth rate of about 7 per cent during the second and third quarters. Such a course might necessitate some upward movement in short-term interest rates, but he hoped that a sharp rise in the Federal funds rate during the inter-meeting period

could be avoided. For the short-run specifications, he favored those shown under alternative B with the lower limits of each range reduced by 1/2 percentage point. That would result in ranges of 5 to 6-1/2 per cent for the Federal funds rate, 6 to 8-1/2 per cent for the growth rate of M_1, and 9 to 11-1/2 per cent for the growth rate of M_2.

The meeting then recessed. It reconvened at 2:50 p.m. with the same attendance, except that Mr. Bucher was absent.

Chairman Burns said he thought this morning's discussion had been a good one and had covered all the considerations the members needed to keep in mind. In listening to his colleagues, however, it had seemed to him that too much emphasis was being given to the growth rate of the money stock--however it was defined--as a factor influencing short-run movements in the economy. In his own studies over the years he had found that, for relatively short periods of time ranging up to a year or so, it was not the stock of money that was of decisive significance but its turnover--the willingness to use the existing stock. That willingness in turn depended partly on the rate of interest but much more heavily on the state of confidence. In asking himself what the best contribution was that the Federal Reserve could make at the present time, he could not escape the answer that the kind of moderate policy course the System had been

following would do the most to help strengthen confidence across the country. Such a course would encourage decision-making units to pursue policies that would further the growth of the economy and serve to reemploy people at a pace that could be sustained.

The Chairman then asked whether his impression was correct that the wording of alternative B was acceptable to the Committee for the operational paragraph of the directive. A majority of the Committee members indicated that that language was acceptable.

Chairman Burns observed that a majority of the members appeared to favor the alternative B ranges for aggregate growth rates for the period from March 1975 to March 1976, indexed by a range of 5 to 7-1/2 per cent for M_1. There was more divergence among the members on the 2-month ranges of tolerance for the aggregates; while a slight majority appeared to favor the ranges of alternative A, a substantial number preferred those of B. In any event, the differences between the A and B short-run ranges were quite small and in his view not really significant. As to the range of tolerance for the Federal funds rate, most of the members had indicated a preference for a lower limit of 4-3/4 per cent and an upper limit of 5-3/4 or 6 per cent.

In response to the Chairman's inquiry, most of the members said they could accept the 12-month growth ranges for the aggregates shown under either alternative A or B. However, a majority preferred the alternative B ranges.

Chairman Burns then asked the members to indicate their preference for ranges of tolerance for the April-May aggregate growth rates. Several members expressed a preference for the 2-month ranges associated with alternative A but a majority also said they could accept the ranges of alternative B. After further discussion, a consensus developed in favor of ranges that would encompass both alternatives, including a range of 6-1/2 to 9 per cent for M_1.

The Chairman next inquired about the members' preferences with regard to the inter-meeting range of tolerance for the Federal funds rate. There was a consensus on a lower limit of 4-3/4 per cent. With respect to the upper limit, a few members preferred 5-1/2 or 6 per cent, but a majority favored 5-3/4 per cent.

Mr. Eastburn asked how the Desk would approach the Federal funds rate during the intermeeting period if a 4-3/4 to 5-3/4 per cent range of tolerance were adopted.

Mr. Sternlight said the Desk initially would continue to aim for a rate centering on 5-1/2 per cent, with subsequent development depending on the behavior of the aggregates. If the aggregates were coming in around the middle of their desired ranges, he would think it appropriate for the funds rate to be permitted to drift down toward the middle of the 4-3/4 to 5-3/4 per cent range, but he would want to avoid aggressive action to achieve that result.

Chairman Burns then proposed that the Committee vote on a directive consisting of the general paragraphs as drafted by the staff and alternative B of the staff's drafts for the operational paragraph. It would be understood that the directive would be interpreted in accordance with the following specifications. The longer-run targets--that is, the ranges of growth rates for the period from March 1975 to March 1976 for the selected aggregates--would be as shown under alternative B. The related ranges of tolerance for growth rates in the April-May period would be 1-1/2 to 4-1/4 per cent for RPD's, 6-1/2 to 9 per cent for M_1, and 9-1/2 to 11-3/4 per cent for M_2. The range of tolerance for the weekly average Federal funds rate in the intermeeting period would be 4-3/4 to 5-3/4 per cent.

Mr. Eastburn said he planned to cast a dissenting vote, partly because he disagreed with the range proposed for the Federal funds rate, and partly because, in specifying the longer-run targets, he preferred to use fewer aggregates and narrower ranges. On the latter issue, having registered his objections once he would not consider it necessary to do so again on every occasion in the future when the Committee followed the same practices.

Mr. MacLaury remarked that the proposed directive language and short-run specifications were quite acceptable to him. However, he was not prepared to accept the longer-run targets shown under alternative B; for reasons he had indicated earlier, he preferred

March-to-March growth rates in the aggregates indexed by a rate of 7 per cent for M_1. Consequently, if all of the specifications were to be treated as a group, he also would have to cast a dissenting vote. He wondered, however, whether it might not be feasible to consider the longer-run targets separately. He recognized that that might not have been desirable in the past, when the longer-run targets applied to periods of about 6 months and thus were closely related to the short-run targets. When the longer-run targets related to a full year, however, the relationship was much looser, since there were many paths by which particular 12-month growth rates could be achieved.

Chairman Burns said he had not contemplated a departure from the Committee's previous practice of taking a single vote on the directive. No numerical specifications were presently included in the directive, but it was understood that the Committee had in mind a set of such specifications which would appear in the policy record.

In subsequent discussion, Messrs. Coldwell, Mayo, and Mitchell said they thought it would be reasonable to consider the longer-term targets separately, since they were not necessarily linked to any one set of short-term specifications.

Chairman Burns asked for the views of the Committee's Secretary and General Counsel on the procedural question that had been raised.

Mr. Broida noted that the Committee's practice in the past had been to consider the adoption of the directive as its formal policy action; the related specifications represented an understanding of the manner in which the directive would be interpreted. In keeping with that practice the directive was published in the Federal Register and included in the Committee's minutes of actions, but specifications were reported only in the Committee's record of policy actions. If the Committee chose, it could vote formally on the specifications; the latter would then be sent to the Federal Register for publication along with the directive and would also be recorded in the minutes of actions. He did not see any reason why the Committee could not have separate votes on the directive and on various elements of the specifications.

Mr. Hayes commented that separate votes might tend to complicate the Committee's procedures unduly.

Chairman Burns agreed that separate votes would complicate matters. He added that he was not sure he understood the full implications of the suggestion.

Mr. O'Connell said he thought Mr. Broida was suggesting that if the Committee changed its procedures and voted separately on the specifications, it would be raising them to the level of a formal action. Presently, they were viewed only as an interpretation for the purpose of implementing the directive.

Chairman Burns said he would suggest that the Committee retain its customary practice at this time. While he thought the proposed change in procedure should be given careful consideration, he would not want to make the change without carefully weighing its implications.

Messrs. Hayes and Mayo agreed with the Chairman's observation. Mr. Hayes added that in his judgment the Committee would be well advised to make as few changes as possible in its procedures at this point.

Chairman Burns noted that the only procedural changes contemplated were the use of 12-month periods for the longer-run targets and the release of information on those targets in the policy record and in Congressional testimony. He added that the question Mr. MacLaury had raised about separate consideration of the longer-run targets was not necessarily related to the Concurrent Resolution and might well have been raised earlier.

Mr. Mitchell noted that Mr. MacLaury's objections concerned only the proposed longer-run targets. He himself thought the Committee's policy action encompassed only the instructions governing the Manager's operations in the period until the next meeting. While the Committee also reached a judgment regarding desirable longer-run growth rates for the aggregates, he considered that to be an entirely separate matter since there were many different

paths by which those longer-run rates could be achieved. Indeed, individual members could readily agree either on operating instructions or on longer-run targets while disagreeing on the other. He personally did not have strong views on the longer-run targets at the moment, and he might well be able to go along with those favored by Mr. MacLaury.

Mr. Mayo said he considered the choice of longer-run targets by the Committee to be simply a statement of preference.

Chairman Burns expressed the view that the staff had struck the right note in the "specimen directive" attached to its memorandum on the Concurrent Resolution, where the longer-run targets were introduced by the statement that "...the following growth ranges for the major monetary credit aggregates are presently thought to be consistent" with certain economic objectives.

Mr. MacLaury observed that Mr. Mitchell had articulated well his own rationale for suggesting separate consideration of the longer-run targets. He asked whether the staff agreed that that procedure would be feasible now that the longer-run targets would apply to a 12-month period.

Mr. Axilrod replied that in his judgment the difference was one of degree rather than of kind. He recalled instances in the past when the staff had suggested that more than one set of short-run specifications would be consistent with some particular set of longer-run targets, even though the latter applied to 6-month periods.

Mr. Partee said he was not in full agreement with Mr. Axilrod. In his opinion, the difference between a 6-month and a 12-month target was significant, because the lag that was presumed to exist between changes in interest rates and in the demand for money covered a period of some months but not a whole year. Thus, he shared Mr. MacLaury's view that the link between 2-month and 6-month targets was much closer than that between 2-month and 1-year targets. It was his feeling that in the future the Committee would repeatedly encounter today's situation, in which some members who agreed with the short-run operating strategy favored by the majority disagreed on the long-run targets. For that reason he would be inclined to recommend that consideration of the two matters be separated.

Mr. Coldwell commented that in the past the Committee members had been polled on their preferences with respect to both short-run and longer-run targets, but had voted formally only on the directive. Against that background, he thought it would be appropriate for Mr. MacLaury to be recorded as voting for the directive today. Whether, in addition, he would want his views on the longer-run targets reported in the policy record was a separate matter.

Mr. MacLaury said he would want his views reported in this instance. Like Mr. Eastburn, he would not consider it necessary to repeat his objection in the policy records for future meetings, should the position of the majority remain unchanged.

Chairman Burns said the Committee might vote on the directive on the understanding that it would be interpreted in accordance with the short-run specifications. He assumed that Mr. MacLaury would join the majority in such a vote, but that Mr. Eastburn would not. The Committee might separately reach a consensus with regard to the longer-run ranges of growth for the aggregates that presently appeared to be consistent with its broad economic objectives. Those desired growth rates would be reported in the policy record, along with a statement--perhaps in a footnote--of the views of any members who did not concur in the Committee's consensus.

Mr. Hayes observed that the policy record could become unduly complicated if every Committee member who had reservations about particular specifications favored by the majority was to have those reservations reported in the policy record.

Chairman Burns said he was confident that that problem would not arise. It was necessary, of course, for the Committee members to continue exercising self restraint in such matters, since a spirit of compromise was essential to the effective conduct of the Committee's business. He did not think an individual Committee member should ask to have the policy record report any reservations he might have with respect to short-run specifications so long as he was prepared to vote for the directive; if his

reservations were strong enough, he obviously should dissent. Rather, his proposal related to strongly held differences of view with respect to the longer-run specifications. In the present instance he understood that both Mr. Eastburn and Mr. MacLaury would want their views reported in the record.

After some further discussion, it was agreed that the procedure suggested by the Chairman should be followed.

The Chairman then said that, before calling for a vote on the directive, he wanted to raise two matters stemming from the Committee's deliberations yesterday afternoon. The first related to the decision to include total reserves among the measures for which longer-run targets were specified. The staff had indicated to him that it had serious technical reservations about such a procedure, and he thought the matter should be studied further. Specifically, he would propose omitting total reserves from the list at this time, on the understanding that the Committee would reconsider the question at an early meeting.

Chairman Burns noted that his second point related to the understanding reached yesterday that the ranges for the longer-run growth rates should be expressed in terms of midpoints plus or minus some amount, rather than in terms of upper and lower limits. Upon further reflection, he had concluded that no substantive issue was involved in the method of presenting the ranges and that it might be best to leave the matter open, so that the method of presentation could be adapted to the circumstances.

After further discussion, the members concurred in the Chairman's suggestions.

Mr. Coldwell indicated that he had reservations about the decision to publish the Committee's long-run targets in the policy records. Since the latter were now released about 45 days after each meeting, the long-run specifications would on occasion be published prior to the quarterly hearings under the Concurrent Resolution. He wondered whether it might not be better to continue the present practice of including only the short-run specifications in the policy record, and plan on releasing the longer-run targets only in the course of the Congressional hearings.

Messrs. Holland and Mayo said they would prefer to publish the desired longer-run growth rates in the policy records.

Chairman Burns agreed with that view.

The Chairman then called for a vote on the directive he had proposed earlier, on the understanding that it would be interpreted in accordance with the short-run specifications that he had set forth.

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

The information reviewed at this meeting suggests that real output of goods and services fell sharply in the first quarter. However, retail sales strengthened during the quarter, and the rate of decline in over-all activity has slowed in recent weeks. In March industrial production and employment declined less than they had on average in the preceding 4 months, but the unemployment rate increased from 8.2 to 8.7 per cent, as the civilian labor force grew. Average wholesale prices of industrial commodities rose little in March and prices of farm and food products declined sharply. The advance in average wage rates during the first quarter was large, but it was still below the increases of last spring and summer.

The prospect of an upturn in economic activity has been strengthened by enactment of the Tax Reduction Act of 1975, which will be adding soon to growth in disposable personal income.

The foreign exchange value of the dollar has risen since early March, as short-term interest rates abroad have declined further and market attitudes toward the dollar have continued to improve. In January-February the U.S. foreign trade balance was in surplus, as agricultural exports reached a new high and the volume of imports other than fuels declined. Net outflows of funds through banks continued large in February but appear to have diminished in March. In early April reserve requirements on foreign borrowings by member banks were reduced from 8 to 4 per cent.

The narrowly defined money stock rose moderately on balance over the first quarter, while broader measures of the money stock expanded more rapidly. Growth was substantial in March, apparently in part because of the effects of accelerated tax refunds on deposits at banks and nonbank thrift institutions. Business demands for short-term credit remained weak, both at banks and in the commercial paper market, while demands in the long-term market continued exceptionally strong. Since mid-March short-term market interest rates have increased somewhat and longer-term yields have risen considerably further.

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

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 on average in recent months.

Secretary's note: The desired longer-run growth rate ranges and the short-run specifications agreed upon by the Committee, in the form distributed following the meeting, are appended to this memorandum as Attachment B.

Chairman Burns then noted that a memorandum from the Manager, dated March 7, 1975, and entitled "Recommendations on System Lending of Securities,"[1] had been distributed to the Committee. He asked Mr. Sternlight to comment.

Mr. Sternlight remarked that, as noted in Mr. Holmes' memorandum, the Account Management recommended an extension of the authority to lend securities from the System Account, contained in paragraph 3 of the Authorization for Domestic Open Market Operations, for another year. It also recommended an increase in the lending charge, from 3/4 per cent per annum to 1-1/2 per cent per annum.

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

In the judgment of the Desk, Mr. Sternlight continued, the lending facility remained reasonably necessary to the effective conduct of System open market operations. At the same time, the sharp increase that had occurred in dealers' use of the facility raised some question about whether they were being sufficiently diligent in seeking alternative sources of supply. The proposed increase in the lending charge should encourage greater diligence in that regard and also had some justification in view of higher costs.

Mr. Sternlight observed that the Manager's memorandum also noted a proposed procedural change which would involve lending securities against cash during the day on the understanding that collateral in the form of securities would be provided by the end of the day. That should expedite Desk operations and help the securities clearance mechanism work better. If the Committee did not object to the proposed new procedure the Desk would make the change as soon as operational details were worked out. To make sure that collateral in the form of securities was forthcoming by the end of the day, the Desk would temporarily debit the dealer's clearing bank by double the amount of the securities being loaned. That overnight penalty charge should minimize instances of failure to provide securities collateral by the end of the day.

Mr. Sternlight added that the overnight penalty charge would, incidentally, absorb reserves. It was expected, however, that instances of that type would be minimal. If there proved to be a problem, the Desk would recommend abandonment of that procedural modification.

In response to questions by Mr. Mitchell, Mr. Sternlight indicated that under present procedures the Reserve Banks did not release the securities being borrowed until a dealer had delivered other securities being pledged as collateral. On occasion this practice meant that a dealer did not receive the borrowed securities in time to meet his own delivery deadline. The Manager was now proposing that the borrowed securities be released early in the day prior to the delivery of other securities as collateral by the dealer; in the interim, the System loan of securities would be collateralized by a charge against the reserve account of the nonbank dealer's clearing bank, or the bank's own reserve account in the case of a bank dealer, and the amount of that charge would be twice the par value of the loaned securities. The Desk was still working on the specific procedures that would be followed for lending against cash. For example, a deadline of perhaps 4 p.m. might be set for delivering securities to be used as collateral; after that time the double debit to a reserve account would remain outstanding overnight.

In answer to further questions by Mr. Mitchell, Mr. Sternlight indicated that the added costs to dealers stemming from the Manager's proposal for a higher lending charge would not be expected to prove prohibitive for the dealers. The standard charge for borrowing securities in the private sector was 1/2 per cent. The System had initially set its charge at 3/4 per cent, but the 1/4 percentage point margin above the market rate did not seem to be enough under current circumstances to foster active efforts by dealers to find other lenders of securities; the advantage in borrowing from the System was, of course, the convenience of a large and varied portfolio. A spread of a full percentage point above the standard rate in the market should have more effect in helping to make the System a lender of last resort.

Chairman Burns inquired whether there would be any financial risk to the System in the new procedures and Mr. Sternlight replied in the negative.

Mr. Mayo asked whether the recommendation for a higher borrowing rate was intended only to cover increased System costs or whether it was designed to help police borrowings by the dealers. In the latter connection, the Chicago Bank suspected that on occasion some dealers were making use of the System borrowing facility to execute short sales rather than to meet potential delivery failures, which was the intended purpose of the facility.

Mr. Sternlight said that the rate increase was not in itself designed to police borrowing by the dealers but to encourage them to seek alternative lenders of securities. He thought it was important, as a separate matter, for the Reserve Banks to exercise diligence in policing the borrowers. The large increase in borrowing transactions had also raised questions at the New York Bank as to whether some dealers were making proper use of the lending facility, and the Bank intended to pursue the matter.

Mr. Mayo said that, while he would concur in the Manager's recommendations, he thought the more important issue was the enforcement of the rules regarding the proper nature of dealer borrowings. He was not sure, however, how the problem of policing should best be resolved.

Mr. Coldwell indicated that he shared Mr. Mayo's concern. He, too, would vote in favor of the Manager's recommendations, but he was more concerned about the apparently growing practice among dealers of committing themselves to transactions in the expectation that the System would make the necessary securities available for them to effect timely deliveries. He wanted to echo Mr. Mayo's view that dealer borrowing needed to be policed.

> Secretary's note: In a memorandum dated March 12, 1975, a copy of which has been placed in the Committee's files, the General Counsel expressed the opinions that (1) the

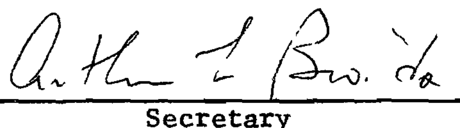
Committee could reasonably find that the continued lending of securities from the System Account to dealers and clearing banks was reasonably necessary for the effective conduct of open market operations, and (2) the continued lending of System securities was within the "incidental powers" of the Reserve Banks.

It was agreed that the authorization for the lending of Government securities from the System Open Market Account, contained in paragraph 3 of the Authorization for Domestic Open Market Operations, should be retained at this time, subject to annual review.

By unanimous vote, the Committee approved the changes in the terms and conditions for lending securities from the System Open Market Account recommended by the Manager in a memorandum dated March 7, 1975.

It was agreed that the next meeting of the Committee would be held on May 20, 1975, at 9:30 a.m.

Thereupon the meeting adjourned.



Secretary

ATTACHMENT A

April 15, 1975
Henry C. Wallich

Report on BIS Meeting - April 7, 1975

Conversations at the meeting, while lacking a major theme, produced a number of interesting observations in a variety of areas.

(1) The new EEC intervention scheme which seeks to limit daily fluctuations in the value of EEC currencies against the dollar to something like one per cent was not exposed to a significant test during the preceding month.

(2) The Bundesbank, in supporting the DMark which is now at the bottom of the Snake, wants to operate both in dollars and in Snake currencies, since operation in Snake currencies only might create excessive tensions in exchange markets. When selling substantial amounts of dollars, the Bundesbank is willing to do some of these sales for account of the Federal Reserve, in order to help us repay DMark swaps.

(3) The Belgians have shown some interest in receiving part of the repayment of the old, pre-August 1971 swaps in the form of SDRs (as well as in the form of Treasury Belgian-franc denominated bonds), and might be willing to take SDRs in excess of their acceptance limit.

(4) At the governors' dinner, Managing Director Witteveen as a guest discussed problems related to gold that are of interest to the IMF. He is concerned to know the position of individual countries prior to the Interim Committee meeting in June. Principal importance attaches to the disposition, if any, to be made of the IMF's own gold. In the subsequent discussion, very divergent national viewpoints with regard to gold were expressed. The possibility was broached that, in the absence of an agreement among major countries about the treatment of gold, the role of gold might evolve in some direction not previously agreed.

ATTACHMENT B

April 14, 1975

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on April 14-15, 1975

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that real output of goods and services fell sharply in the first quarter. However, retail sales strengthened during the quarter, and the rate of decline in over-all activity has slowed in recent weeks. In March industrial production and employment declined less than they had on average in the preceding 4 months, but the unemployment rate increased from 8.2 to 8.7 per cent, as the civilian labor force grew. Average wholesale prices of industrial commodities rose little in March and prices of farm and food products declined sharply. The advance in average wage rates during the first quarter was large, but it was still below the increases of last spring and summer.

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The narrowly defined money stock rose moderately on balance over the first quarter, while broader measures of the money stock expanded more rapidly. Growth was substantial in March, apparently in part because of the effects of accelerated tax refunds on deposits at banks and nonbank thrift institutions. Business demands for short-term credit remained weak, both at banks and in the commercial paper market, while demands in the long-term market continued exceptionally strong. Since mid-March short-term market interest rates have increased somewhat and longer-term yields have risen considerably further.

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

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 on average 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 on average 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

April 15, 1975

Points for FOMC guidance to Manager in implementation of directive		Specifications (As agreed, 4/15/75)
A. Desired longer-run growth rate ranges: (March '75 to March '76)	M_1	5 to 7-1/2%
	M_2	8-1/2 to 10-1/2%
	M_3	10 to 12%
	Proxy	6-1/2 to 9-1/2%
B. Short-run operating constraints:		
1. Range of tolerance for RPD growth rate (April-May average):		1-1/2 to 4-1/4%
2. Ranges of tolerance for monetary aggregates (April-May average):	M_1	6-1/2 to 9%
	M_2	9-1/2 to 11-3/4%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		4-3/4 to 5-3/4%

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 and of developments in domestic and international financial markets.

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.