

April 12, 1975

Mr. Allan Meltzer
Department of Economics
302 JKB
Brigham Young University
Provo, Utah 84602

Dear Allan:

I appreciate your taking the time to send me the results of your simulations using the DRI model.

I must confess to some bewilderment as regards your interpretation of the results. The simulation of a one-time increase in M_1 , you say, "... shows lower inflation and higher real growth. In the final quarter of the projection period, however, your figures on the rate of inflation for the two simulations are almost identical -- that is, 4 to 4-1/4 per cent. The level of real GNP in that quarter, moreover, is 2-1/2 per cent higher in the control simulation than in the simulation with a large one-shot increase in M_1 .

My own view, however, is that either course of monetary action would be unwise. I do not believe we could add \$8-1/2 billion to the stock of money overnight and then return immediately to a 5-1/2 per cent growth of M_1 , without creating havoc in financial markets. And a course of action that permitted growth in M_1 at an average rate of around 9 per cent over the next 5 quarters would endanger our future.

Sincerely yours,

Arthur F. Burns

LEG:AFB;jrg;gmm



Brigham Young University

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OF THE
FEDERAL RESERVE SYSTEM
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April 2, 1975

Dr. Arthur Burns, Chairman
Board of Governors
Federal Reserve System
Washington, DC 20013

Dear Arthur:

When we met at the White House about two weeks ago, you expressed interest in the effects of my proposal to increase M_1 by \$8.5 billion. I have used the new DRI model to simulate the policy of increasing M_1 by \$8.5 billion at the end of the first quarter and maintaining an approximately 5 1/2 percent annual rate of increase in M_1 this year. The simulation has slightly more variable monetary growth than I would choose.

The results can be compared to the control simulation of DRI. Both have a program of fiscal expansion slightly larger than the recently signed into law. There are also some assumptions about energy prices, including gradual deregulation and some small tax increase.

The control simulation produces the same money stock in the fourth quarter of 1975 by having lower growth of money now and more later.

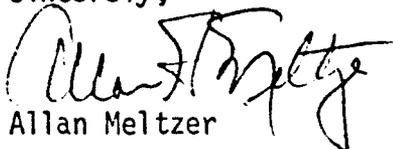
I do not wish to overrate the accuracy of the assumptions or of the simulation. The comparison is of interest since it shows lower inflation and higher real growth may result from the proposed one-time increase.

The simulation shows slightly higher real growth this year and no higher inflation. The GNP deflator rises less, and the CPI rises very little more. The control produces more real growth in 1976.

The outlook for future inflation, and the problem of getting back to stability are the principal benefits of the one-time large increase. The control simulation requires much higher growth of money in late 1975 and early 1976. The effect on future inflation does not require elaboration.

I will be at this address for the next two weeks, if you wish to reply.

Sincerely,


Allan Meltzer

1s 3/13

cc: William Seidman
Alan Greenspan

Assuming \$8.5 Billion Increase in M_1
 Followed by 5.5% Annual Increase in M_1

<u>Year and Quarter</u>	<u>1975 - 2</u>	<u>1975 - 3</u>	<u>1975 - 4</u>	<u>1976 - 1</u>	<u>1976 - 2</u>
Money Growth %	5.7	4.6	6.1	5.7	5.4
GNP (Billions)	1449.3	1503.8	1542.2	1561.8	1591.0
GNP 1958 \$	782.6	797.2	806.0	807.1	813.7
Real GNP % Change	3.9	7.7	4.5	0.6	3.3
Deflator %	6.0	7.4	5.5	4.5	4.1
CPI %	7.6	7.0	4.9	4.4	4.4

Control Simulation

Money Growth	7.6	9.4	10.3	7.5	10.1
GNP (Billions)	1421.5	1445.6	1486.7	1538.1	1575.1
GNP 1958 \$	780.2	789.5	805.3	815.1	833.3
Real GNP % Change	-0.4	4.9	8.3	4.9	9.2
Deflator %	7.4	6.7	5.8	4.8	4.3
CPI %	7.7	6.6	4.7	4.3	4.3