FEDERAL RESERVE BANK
OF ST. LOUIS

MARCH 1973

REVIEW

CONTENTS

Vol. 55, No. 3

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The 1973 National Economic Plan: Slowing The Boom

by KEITH M. CARLSON

THE ADMINISTRATION recently presented its national economic plan for the eighteen-month period ending June 30, 1974. The Administration's plan is contained in three documents – the *Federal Budget,* the *Economic Report of the President,* and *The Annual Report of the Council of Economic Advisers.*[1] Included in the economic plan is (1) a proposed program for the Federal budget, (2) goals for gross national product (GNP), output, prices, and employment, and (3) general recommendations for monetary actions by the Federal Reserve System.

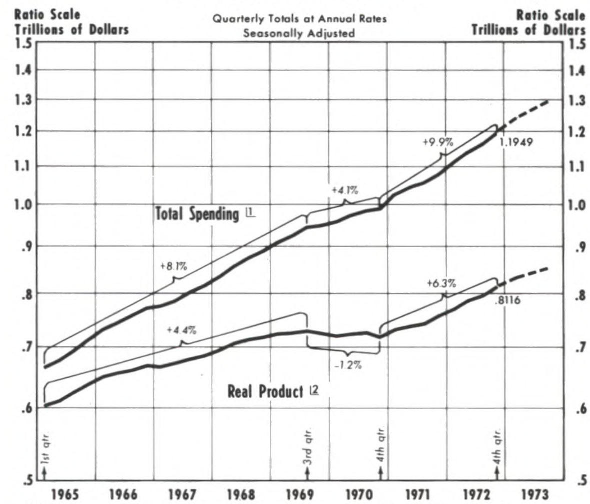
The goals for the U.S. economy in the months ahead are stated most explicitly in the 1973 CEA *Report.*[2] The goals include: a 10 percent advance in GNP from calendar 1972 to 1973 (9 percent from fourth quarter 1972 to fourth quarter 1973); a reduction in the annual rate of inflation, as measured by the consumer price index, to about 2.5 percent by the end of 1973; and a reduction of unemployment to about 4.5 percent of the labor force by the end of the year.

Proposed as consistent with the achievement of the 10 percent increase in GNP from 1972 to 1973 is a Federal budget program consisting of an expenditure increase (on a national income accounts basis) of 9.3 percent from calendar 1972 to 1973, and an increase in the average tax rate because of previously legislated social security tax changes. Though the Administration is vague in its recommendation for monetary policy, the CEA does indicate that their target for GNP

> is likely to require a slower increase of the supply of money and credit than was proper when the main objective was to encourage a quickened economic expansion in an environment of substantial unused resources.[3]

This article summarizes and evaluates the Administration's economic plan. First, as background, last year's plan is compared with the record of achievement. Second, the proposed Federal budget program is presented in some detail, along with some discussion of monetary policy recommendations. Third, the economic plan is evaluated in terms of feasibility and internal consistency. To aid in this evaluation, alternative projections with the St. Louis model are presented as a basis for comparison.

Demand and Production



1 GNP in current dollars.
2 GNP in 1958 dollars.
Percentages are annual rates of change between periods indicated.
Latest data plotted: 4th quarter 1972; dashed line indicates half-year estimates by this Bank based on the fiscal 1974 Federal Budget and the 1973 Annual Report of the Council of Economic Advisers

Source: U.S. Department of Commerce

1972 ECONOMIC PLAN IN RETROSPECT

In early 1972 the U.S. economy was still in the process of adjusting to the major policy changes which were implemented on August 15, 1971. At that time, convertibility of the dollar into gold and other reserve assets was suspended, a surcharge was imposed on imports, the Federal excise tax was removed on automobiles, and a system of mandatory price-wage controls was introduced. Then in early 1972, the Administration took additional actions which reflected some doubts at that time about the strength of economic expansion. The Administration proposed a stimulative

[1]*The Budget of the United States Government, Fiscal Year Ending June 30, 1974* (Government Printing Office, 1973), and *Economic Report of the President,* together with *The Annual Report of the Council of Economic Advisers* (Government Printing Office, 1973).

[2]1973 CEA *Report,* chap. 3.

[3]*Ibid.,* p. 75.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

fiscal program to be accompanied by an accommodative monetary policy.

The following section summarizes the economic record for 1972 and compares that record with the Administration's goals. The record indicates that the Administration's overall goals came very close to being realized.

Economic Goals vs. Realizations

The CEA's *Report* of a year ago projected an increase in GNP of 9.4 percent from 1971 to 1972. The realized increase was 9.7 percent. This error of 0.3 percent was the smallest for the CEA since 1964 and well below the average absolute error of 1.2 percent for CEA forecasts over the past eleven years.

Table I

CEA Projection Accuracy of GNP

	CEA Projected Change	Actual Change*	Error**
1962	9.4%	6.7%	2.7%
1963	4.4	5.4	−1.0
1964	6.5	6.6	−0.1
1965	6.1	7.5	−1.4
1966	6.9	8.6	−1.7
1967	6.4	5.6	0.8
1968	7.8	9.0	−1.2
1969	7.0	7.7	−0.7
1970	5.7	4.9	0.8
1971	9.0	7.5	1.5
1972	9.4	9.7	−0.3
Average absolute error			1.2%

*Based on data given in the CEA *Report* for the year following the forecast year.

**No adjustment is made for deviations of policy realizations from plans, or for major strikes.

To further assess the accuracy of the Administration's 1972 projection for GNP, an analysis by components is presented in Table II. The CEA displayed uncanny accuracy on the GNP total, but, typically, this accuracy consisted of offsetting errors among the components. Estimates of the increases in personal consumption and Federal purchases were very accurate, but the increase in fixed investment – that is, business fixed investment plus residential construction – was underestimated by about $11 billion. This underestimate was largely offset by overestimates of inventory accumulation, state and local government purchases, and net exports. The error in projecting inventory accumulation may have been attributable, in part, to the underestimation of fixed investment. The overestimation of state and local purchases related to the timing of the revenue sharing program, but the error in estimating net exports was simply a miscalculation of the impact of changes in international economic arrangements in late 1971.

Table II

Projected and Actual Changes in GNP and Components: 1971 to 1972

(Billions of Dollars)

	CEA Projection*	Actual**	Error
Personal Consumption	$53.0	$ 56.2	$−3.2
Business Fixed Investment	8.7	14.6	−5.9
Business Inventories	5.9	2.2	3.7
Residential Construction	6.1	11.3	−5.2
Federal Purchases	8.8	8.1	0.7
State and Local Purchases	16.2	13.9	2.3
Net Exports	−0.5	−4.8	$ 4.3
GNP	$98.2	$101.7	$−3.5

*Estimated by this Bank and based on 1972 CEA *Report*.

**Based on preliminary data in the 1973 CEA *Report*.

The relatively accurate projection of total GNP carried through to projections of output, prices and unemployment (Table III). The CEA projected an increase of 5.9 percent in output, which actually grew at a more rapid 6.5 percent rate. Prices were projected to increase 3.2 percent; the actual increase was 3 percent. Unemployment was expected to average 5.6 percent in 1972, declining from 6 percent in late 1971 to about 5 percent late in the year. The actual unemployment rate followed this projected pattern almost perfectly, and did in fact average 5.6 percent for the year.

Table III

Projected and Actual Changes in Economic Activity: 1971 to 1972

	CEA Projection	Actual	Error
GNP	9.4%	9.7%	−0.3%
Output	5.9	6.5	−0.6
Prices	3.2	3.0	0.2
Unemployment Rate	5.6	5.6	0.0

In summary, the CEA was very accurate in its prognosis of the course of the major economic aggregates for 1972. GNP, output, prices, and unemployment generally moved in accordance with the CEA targets. The projected change in total GNP was, for practical purposes, realized, but consisted of offsetting errors in the individual components of GNP.

Policy Plans vs. Realizations

Assessment of the accuracy of any economic forecast depends on more than just a comparison of real-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ized and projected values of GNP, output, and prices. A more complete evaluation also takes into account a comparison of policy plans with policy realizations. In other words, was the projection realized *because of* realized policy plans, or *in spite of* discrepancies between policy plans and realizations? This section compares the record of monetary-fiscal policy actions in 1972 with the original programs and recommendations.

Federal budget plans are compared with realizations in Table IV. Examination of NIA receipts and expenditures indicates that there was a substantial underestimate of receipts and a small overestimate of expenditures. The error in both of these estimates worked in the direction of making the realized deficit smaller than projected. Since receipts projections depend mainly on the forecast of GNP, it is surprising, given the accuracy of the GNP forecast, that the receipts estimate was so far off the mark. The reason, of course, was that the CEA did not forecast the extent of overwithholding of personal income taxes. Adjustment for this unexpected high flow of receipts indicates that the basic receipts estimate was much closer to realization, though still underestimated. U.S. Treasury estimates of the amount of overwithholding are in the neighborhood of $9 billion, so the economic expansion and its greater-than-expected effect on receipts resulted in an error of about $4 billion in the estimate of receipts.[4]

Table IV

Planned and Actual Changes in the Federal Budget: 1971 to 1972

(Billions of Dollars)

	Budget Plan	Actual	Error
NIA Receipts	$ 16.3	$ 29.2	$ −12.9
NIA Expenditures	29.0	26.0	3.0
NIA Surplus or Deficit	$ −12.8	$ +3.2	$ −15.9
High-Employment Receipts	$ 13.8	$ 17.8	$ −4.0
High-Employment Expenditures	29.5	26.4	3.1
High-Employment Surplus or Deficit	$ −15.7	$ −8.5	$ −7.2

Note: Estimates of high-employment receipts do not include the effects of overwithholding personal income taxes.

On the expenditure side, the estimate was quite close, considering the magnitude of the increase which was planned. Furthermore, the error was attributable primarily to the delayed enactment of the revenue sharing program.

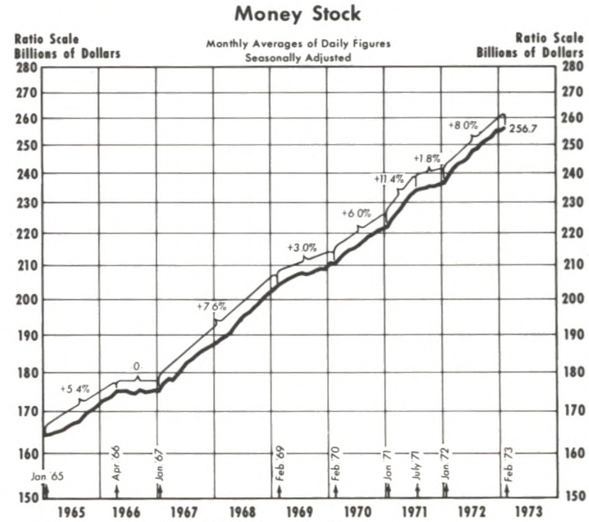
When the errors for receipts and expenditures are combined, they show that the NIA deficit was overestimated by almost $16 billion. In general, these errors were of the type that suggest that the fiscal stimulus was not nearly as large as originally planned. However, examination of the NIA budget does not reveal the extent to which the budget was reflecting an underestimate of the strength of economic expansion.

To determine more accurately the extent of fiscal stimulus which occurred, the high-employment budget serves as a more appropriate, though still approximate, measure. By this measure, receipts were underestimated by only $4 billion. This error indicates there was a miscalculation of the economic stimulus related to the Revenue Act of 1971 and the continuing effects of the Tax Reform Act of 1969. On the other hand, the estimate of high-employment expenditures was in error by about the same amount as for NIA expenditures.

As a result, examination of the change in the high-employment deficit indicates that the fiscal stimulus was about $7 billion less than planned. Despite the stimulus being less than planned, GNP grew slightly faster than projected.

Consider now monetary actions as a part of the overall economic plan for 1972. The Administration did not indicate a specific growth rate for money; however, they did emphasize that monetary policy should be accommodative. Actual money growth was

Money Stock



Percentages are annual rates of change for periods indicated.
Latest data plotted: February

[4]Charles A. Waite and Joseph C. Wakefield, "Federal Fiscal Programs," *Survey of Current Business* (February 1973), p. 20.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Table V

Projected Changes in Spending, Output, Prices, and Unemployment: 1971 to 1972

	GNP (Billions)	GNP	Output	Prices	Unemployment Rate
CEA Projection (1/24/72)	$ 98.2	9.4%	5.9%	3.2%	5.6%
Actual	101.7	9.7	6.5	3.0	5.6
St. Louis Model Projections					
Changes in money and Federal spending as actually occurred	90.1	8.6	4.6	4.1	5.9
Changes in money and Federal spending consistent with CEA assumptions of 1/24/72	92.9	8.8	4.6	4.1	5.8

Note: St. Louis model projections are based on latest data with coefficients estimated from data through III/1971. Because of tracking considerations, III/1970 is used as a projection base. Also, these projections make no special allowance for the possible impact of price-wage controls.

7.4 percent from fourth quarter 1971 to fourth quarter 1972, indicating that, relative to past experience, monetary actions were very expansive. The 1972 growth of money was faster than 92 percent of all previous years from 1947 to the present.

Analysis Based on St. Louis Model

In general, the CEA projections proved to be very accurate, though the reasons why they were accurate are not clear. For purposes of comparison, some alternative simulations with the St. Louis model were conducted. Such simulations shed little direct light on the CEA projections, yet they provide a systematic basis for evaluating the 1972 economic experience.

Two projections of the St. Louis model are shown in Table V. The first projection uses money and high-employment expenditures as they occurred in 1972. The second projection is the result of using money and high-employment expenditures as recommended in the Administration's economic plan in January 1972.[5] The first projection using actual movements of the two key policy variables indicates that, after the fact, the St. Louis model estimated the increase in GNP to be $90.1 billion. The second projection indicates that movements of the policy variables in line with Administrative recommendations would have increased GNP by $92.9 billion. Comparison of the projections indicates that the total impact of realized policy actions turned out to be less than if the initial policy recommendations had been realized. Nevertheless, it is clear that the St. Louis model underestimated the momentum of the economy in 1972, which, when viewed within the framework of the St. Louis model, translates into an underestimation of the growth in the income velocity of money.

POLICY PLANS AND RECOMMENDATIONS FOR 1973

The Administration has projected a 10 percent increase in GNP for 1973. This GNP projection is offered as being consistent with about a 4.7 percent target for unemployment for the year (4.5 percent by year end) and a 3 percent rate of inflation for the year (2.5 percent by year end). These projections represent a continuation of the progress made in 1972 in reducing both unemployment and inflation.

Though the projections of the broad economic aggregates are very similar to actual experience in 1972, there are some differences in the composition of GNP (Table VI). The most notable differences are with reference to business inventories, residential construction, net exports, and Federal purchases. Business inventory accumulation is projected to be much stronger in 1973 than in 1972, while residential construction is expected to slow considerably compared to the very rapid 1972 advance. Net exports are projected to show a smaller deficit, though it should be noted that the CEA projections were released before the U.S. devalued the dollar on February 12. Federal purchases are projected to show little change in 1973, in contrast to the 8 percent increase in 1972.

Table VI

Projected Changes in GNP and Components: 1972 and 1973

	1972* Billions of Dollars	1972* Percent	1973** Billions of Dollars	1973** Percent
Personal Consumption	$ 56.2	8.6%	$ 68.9	9.5%
Business Fixed Investment	14.6	13.8	16.6	13.8
Business Inventories	2.2	—	6.7	—
Residential Construction	11.3	26.5	1.6	3.0
Federal Purchases	8.1	8.3	0.6	0.6
State and Local Purchases	13.9	10.3	18.1	12.2
Net Exports	—4.8	—	2.6	—
GNP	$101.7	9.7%	$114.9	10.0%

*Based on preliminary data in the 1973 CEA *Report.*
**Estimated by this Bank and based on 1973 CEA *Report.*

[5]After the fact, a growth of money at a 7 percent rate was deemed consistent with the CEA forecast for 1972. This 7 percent rate was the average of two alternatives considered in an evaluation of the 1972 economic plan in this *Review*. See Keith M. Carlson, "The 1972 National Economic Plan: An Experiment in Fiscal Activism," this *Review* (March 1972), pp. 3-10.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Budget Program for Calendar 1973

The budget plan for calendar 1973 calls for no further fiscal stimulus from calendar 1972. The high-employment budget, as estimated by this Bank, is projected to be in deficit by about $7 billion in calendar 1973, which compares with a $6 billion deficit in 1972 and a $3 billion surplus in 1971. The budget plan calls for a reduction in this deficit during the year, with an $11 billion annual rate of deficit in the first half and a $4 billion rate of deficit in the second half.

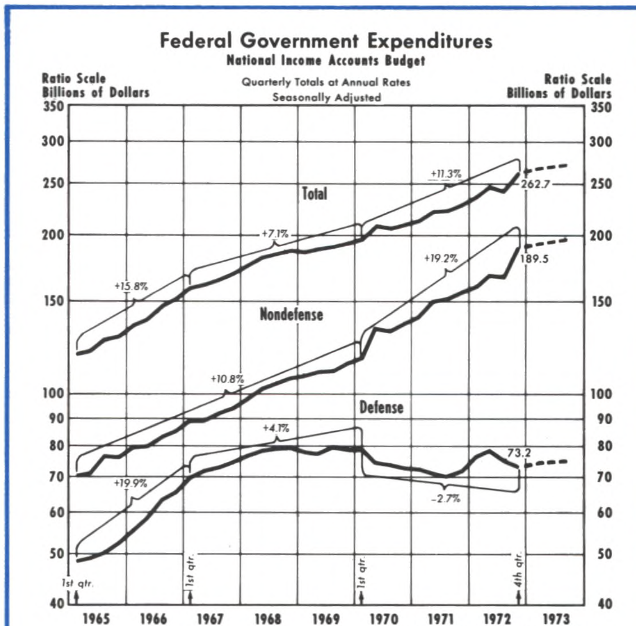
Expenditures – The budget program indicates a $23 billion increase, or 9.3 percent, in Federal expenditures on an NIA basis for calendar 1973 (Table VII). This compares with an 11.8 percent advance in 1972 and a 6.8 percent average rate of increase from 1968 to 1971.

Defense spending is projected to decline in 1973 by 1.8 percent, compared to a 6.7 percent increase in 1972. However, defense spending is projected to advance 1.1 percent from the second half of 1972 to the second half of 1973. The effect of cessation of Vietnam hostilities has already occurred as defense spending declined at a 3 percent average annual rate from 1968 to 1971, after increasing at a 16 percent average rate from 1965 to 1968.

Nondefense spending, according to the Administration's budget, is projected to advance 14.2 percent in 1973, the same rate of increase as in 1972, and in line with the 13 percent average rate of increase from 1965 to 1971. As with defense spending, year-to-year comparisons are misleading, because nondefense spending is projected to increase at a 2 percent annual rate from the first half 1973 to the second half of 1973. Nondefense spending in the first half of 1973 reflects the temporary effects of retroactive revenue sharing, the continuing effects of a permanent increase in social security benefits, and a $2.2 billion pay increase for government employees.

Receipts – Federal receipts on an NIA basis are projected to rise by $19 billion in 1973, or by 8.4 percent. By comparison, receipts rose by 15 percent in 1972. These year-to-year comparisons are influenced in considerable measure by the effects of the overwithholding of personal income taxes in 1972.

To identify more precisely the basic trends for receipts, the sources of change are shown in Table VII. The only major tax change is the increase in the social security tax rate from 10.4 to 11.7 percent, effective January 1, 1973, and the expansion of the base for social security taxes from $9,000 to $10,800. The rise



Source: U.S. Department of Commerce
Percentages are annual rates of change for periods indicated.
Latest data plotted: 4th quarter 1972; dashed line indicates half-year estimates by this Bank based on the fiscal 1974 Federal Budget and the 1973 Annual Report of the Council of Economic Advisers

in receipts in 1973 is reduced relative to the increase in 1972 because of settlements attributable to overwithholding in 1972. In addition, receipts estimates for 1973 reflect the assumption that taxpayers will adjust downward their rate of withholding in 1973. After consideration of these tax changes, the estimate of the rise in receipts attributable to the advance of economic activity is about $25 billion.

Table VII

Planned Changes in Federal (NIA) Budget: 1972 to 1973*

(Billions of Dollars)

NIA Receipts	$ 19.1
Change due to growth	17.4
Change due to cycle	8.2
Change due to tax rate adjustments	–7.5
NIA Expenditures	$ 23.0
Change in defense	–1.3
Change in nondefense	24.3
NIA Surplus or Deficit	–4.0
High-Employment Receipts	$ 23.6
High-Employment Expenditures	$ 24.7
High-Employment Surplus or Deficit	$–1.1

*Estimated by this Bank from the Federal Budget for fiscal 1974.

Surplus/deficit position – The combined effect of rising expenditures and receipts is a slight increase in the NIA deficit by $4 billion, from $18.5 billion in 1972 to $22.5 billion in 1973. However, since the NIA budget is influenced by the projected pace of eco-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

nomic activity, a more accurate indication of the economic impact of the budget can be obtained by examining the high-employment budget. Even on this basis, the estimate of the economic impact of the budget program is very approximate.

On a high-employment basis, the NIA budget is projected to be in deficit by $7 billion in 1973. The plan of the Administration is to have the high-employment budget moving toward a surplus position by early 1974. This plan is predicated on the assumption that inflationary pressures will be developing in 1973 and a movement in the direction of fiscal restraint will be necessary to combat these pressures. This budget strategy stands in marked contrast to 1972 when a large fiscal stimulus was planned to accelerate economic expansion.

Monetary Policy Recommendations

The Administration's overall economic plan is focused on the Federal budget, with very little mention of the role for monetary actions. The *Economic Report of the President,* for example, makes no mention of monetary policy. Furthermore, the 1973 CEA *Report,* in contrast to recent past reports, placed little emphasis on monetary actions, either with reference to their role in the 1972 expansion or in terms of recommendations for 1973. Monetary actions in 1972 were summarized simply as "accommodating" with respect to the financial requirements of last year's expansion.

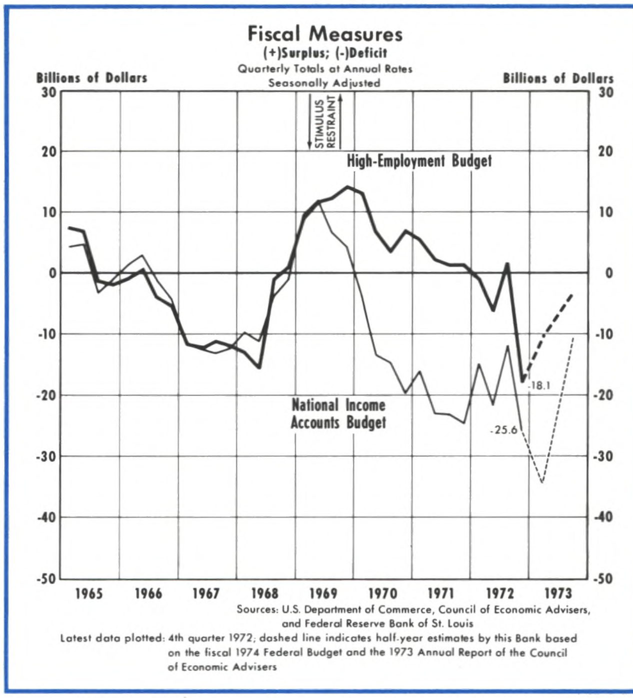
The role for monetary policy in 1973 is summarized by the CEA as follows:

> A gradual slowing of the expansion of money GNP to a steady rate consistent with the long-run potential growth rate of the economy and reasonable price stability is also an appropriate goal for monetary policy. This is likely to require a slower increase of the supply of money and credit. . . .[6]

EVALUATION OF 1973 ECONOMIC PLAN

The Administration's projection for 1973 is very close to the consensus of other forecasts. For purposes of comparison, the CEA projections are evaluated with reference to the St. Louis model. This section focuses on two considerations: (1) Is the projected increase in total spending consistent with the proposed set of stabilization policies, and (2) are the price and unemployment goals consistent with the projected increase in total spending?

[6]1973 CEA *Report,* p. 75.



Feasibility of Total Spending Goal

To determine the feasibility of the Administration's projection of a $115 billion, or 10 percent, increase in GNP, two combinations of policies were conducted with the St. Louis model. These combinations of policies are:

(1) increases of Federal spending as proposed in the budget and an expansion of money at a steady 6 percent annual rate from fourth quarter 1972;[7]

(2) increases of Federal spending as proposed in the budget and an expansion of money at a steady 8 percent annual rate from fourth quarter 1972.

The two alternatives for money growth represent two illustrative courses of monetary action. It should be emphasized that they are illustrative and in no way directly attributable to the CEA or the Federal Reserve System. The steady 6 percent path of money growth is presented as being consistent with the recommendation of the CEA, at least in direction if not

[7]The assumed path for Federal spending reflects special considerations which are necessary to assess the economic impact of fiscal actions within the framework of the St. Louis model. The impact of fiscal actions on GNP in the St. Louis model works only through a direct effect on GNP. As a result, large variations in Federal expenditures tend to introduce distortions in the results because the sample period used for estimation of the coefficients is relatively free of such variations. And even to the extent such variations are evident in past experience, the process of estimating regression coefficients is itself an averaging process. More specifically, the rise in expenditures in the fourth quarter of 1972 was attributable in large measure to retroactive revenue sharing. Information relating to the special nature of this expenditure increase was used to introduce a judgmental element into the model inputs so as to reduce distortions in the outputs of the model.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Table VIII

Projected Changes in Total GNP: 1973 and 1974

	1973		1974	
	Billions	Increase	Billions	Increase
CEA Projection (1/31/73)	$114.9	10.0%	$ —	—%
St. Louis Model Projection				
1) With 6 percent money growth and Federal spending based on fiscal 1974 budget	111.9	9.7	85.3	6.8
2) With 8 percent money growth and Federal spending based on fiscal 1974 budget	119.2	10.3	108.8	8.6

in precise magnitude. The steady 8 percent money path would represent an approximate continuation of the course of monetary actions in 1972.

The results for these combinations of policies are shown in Table VIII. The combination of a steady 6 percent growth of money and government spending based on the fiscal 1974 budget yields results which are roughly consistent with the CEA projections. The conclusion is offered here that the CEA projection is indeed feasible if the impact of retroactive revenue sharing is distributed more evenly over time than the NIA expenditure estimates would indicate.

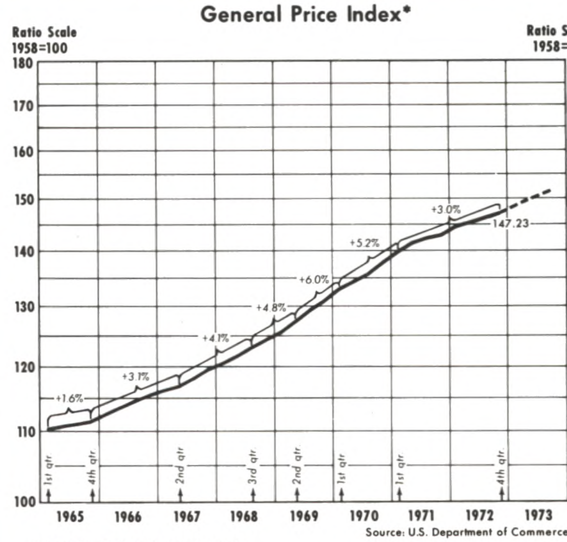
The case with steady 8 percent money growth is shown for illustration. If money should grow at a rapid 8 percent rate, the St. Louis model indicates that GNP would increase by about $5 billion more than the CEA forecasts. Furthermore, it should be remembered that the St. Louis model contains an implicit assumption that velocity will grow at a relatively slow rate in the range of 2.2 to 2.8 percent from 1972 to 1973.

In summary, the CEA projection appears to be feasible and realistic. There is a definite possibility, however, that the expansion of nominal GNP will be stronger than planned if (1) money grows faster than at a 6 percent rate, (2) velocity increases more rapidly, or (3) some combination of the two.

Implications of Total Spending Goal

Aside from the possibility of attaining the GNP goal, attention is now focused on the Administration's price and unemployment goals. Table IX, on the following page, shows the implied paths of output, prices and unemployment as given by the St. Louis model using an estimated path for GNP consistent with the CEA forecast. There are two St. Louis model projections which reflect different assumptions about the longer-run effects of the price-wage control program.

General Price Index*



*As used in National Income Accounts.
Percentages are annual rates of change for periods indicated.
Latest data plotted: 4th quarter 1972; dashed line indicates half-year estimates by this Bank based on the fiscal 1974 Federal Budget and the 1973 Annual Report of the Council of Economic Advisers

Examination of the table indicates the critical importance of the assumption about the success of Phase III of the price-wage control program, as well as the lasting effects of the earlier phases of the program. The two alternatives reflect assumptions about these lasting effects. The first St. Louis model projection assumes that past controls *were effective* in permanently reducing the price level from what it otherwise would have been, and that the 1973 price-unemployment mix will be determined within that context. The other alternative assumes that price-wage controls *were not effective* in permanently reducing the price level, and prices will thus show a catch-up effect toward the basic trend as determined by monetary-fiscal actions during the period of controls.

Examination of these alternatives indicates that the Administration's forecast is roughly consistent with the "effectiveness of controls" version of the St. Louis model. With this version of the model, prices are projected to rise 3.3 percent in 1973, only slightly higher than that projected by the CEA. Unemployment is projected to average 4.7 percent, about the same as the Administration's projection.

Consider now the "ineffectiveness of controls" version of the St. Louis model. This model shows a rapid run-up in prices in 1973, which illustrates the assumption that prices will reflect a level consistent with the longer-run path of monetary growth. In other words, the assumption underlying this version of the model is that it is not possible to control prices by *fiat* over the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Table IX

Projected Changes in GNP, Output, Prices, and Unemployment: 1973 and 1974

(Percent)

	1973 I	1973 II	1973 III	1973 IV	1973 Year	1974 I	1974 II	1974 III	1974 IV	1974 Year
CEA Projections (1/31/73):										
GNP	10.5	9.8	8.5	8.0	10.0	—	—	—	—	—
Output	6.0	6.3	5.4	5.2	6.8	—	—	—	—	—
Prices	4.0	3.5	3.0	2.5	3.0	—	—	—	—	—
Unemployment Rate	5.0	4.8	4.6	4.5	4.7	—	—	—	—	—
St. Louis Model Projections:										
(1) With CEA GNP and controls effectiveness										
GNP	10.5	9.8	8.5	8.0	10.0	8.0	8.0	7.8	7.8	7.2
Output	6.4	5.9	4.8	4.4	6.5	4.4	4.7	4.5	4.5	4.6
Prices	3.9	3.8	3.6	3.5	3.2	3.4	3.3	3.2	3.1	3.5
Unemployment Rate	4.9	4.7	4.6	4.6	4.7	4.6	4.6	4.5	4.5	4.6
(2) With CEA GNP and controls ineffectiveness										
GNP	10.5	9.8	8.5	8.0	10.0	8.0	8.0	7.8	7.8	8.1
Output	5.0	4.5	3.7	3.4	5.7	3.8	3.7	4.0	4.3	3.8
Prices	5.3	5.2	4.7	4.5	4.1	4.1	4.1	3.7	3.3	4.1
Unemployment Rate	4.9	4.9	4.9	4.9	4.9	5.0	5.0	5.1	5.1	5.1

longer run. This particular version of the model assumes that this catch-up process will take two years, though this is an arbitrary assumption. Given this version of the model and its assumptions, the outlook for employment is somewhat less optimistic, showing an average unemployment rate of 4.9 percent for 1973.

Any conclusions about the attainability of the Administration's price-unemployment goals are very tentative. In particular, it still remains to be determined whether the price-wage control program has had any lasting effects on price trends. Aside from such short-run considerations, it is perhaps more certain that monetary-fiscal actions over the next two years are crucial in the determination of price trends beyond 1974. An awareness of these longer-run considerations is demonstrated in the CEA *Report*, however, when they suggest the urgency of getting the economy on a noninflationary growth path.

SUMMARY

The Administration has projected another year of rapid growth in GNP. Accompanying this rapid growth is a belief that unemployment will be reduced further and inflation will continue to slow. Over the longer run the CEA has made it clear that it seeks the objective of slowing the pace of economic advance so as to be consistent with noninflationary growth.

To achieve their objectives, the Administration proposes a Federal budget program that maintains a stimulative posture in 1973, but with the degree of stimulus moderating during the year. At the same time, the Administration recommends a slowing in monetary growth from the rapid 7.4 percent advance in 1972.

Using the St. Louis model as an aid in evaluating the 1973 economic plan, it was found that the total spending goal was feasible. This goal for total spending leaves little margin for error, however, for any one or a combination of several eventualities could push GNP above the Administration's goals. The GNP goal requires that money growth does not exceed 6 percent, that Federal spending rises in line with projections, and that the income velocity of money increases at a rate of about 3 percent. To the extent that the income velocity of money rises at a more rapid rate, the growth of the money stock would have to be correspondingly slower.

Assessment of the Administration's goals for prices and unemployment is much more difficult. Due to the uncertainty that still exists as to the lasting effects of the price-wage control program, as it has been administered up to this time, achievement of these goals is much more tenuous. A version of the St. Louis model, which builds in the assumption of past success of price-wage controls, indicates that the Administration's price-unemployment goals are attainable in 1973, given their assumptions about monetary-fiscal actions. But any tendency towards a catching-up of prices will delay the attainment of either the price or the unemployment goal.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FOMC Policy Actions in 1972

by JERRY L. JORDAN

THE PRIMARY policy objective of the Federal Open Market Committee (FOMC) in early 1972 was to provide sufficient monetary growth to facilitate continued real economic expansion in an environment in which administrative controls on prices and wages had been imposed. Late in 1972 the directive of the Federal Open Market Committee specified slower growth of monetary aggregates as the policy discussions indicated an increasing concern for the possibilities of re-emergence of inflationary pressures.[1]

This review of policy actions of the FOMC in 1972 will include little reference to the "New Economic Program." No one, including members of the FOMC, would be able to say for certain how, or even whether, monetary policy decisions would have been different last year if underlying economic conditions had been the same but there had been no price-wage control program.

The primary source of information for this article is the "Record of Policy Actions" of the Federal Open Market Committee.[2] These "Records" of policy actions contain little reference to the Government's control program. Consequently, there is no explicit indication of the extent to which the various aspects of the Administration's program served as either a constraint on, or as an inducement to, FOMC actions.

PROVIDING SUFFICIENT STIMULUS — EARLY 1972

The "policy consensus" and "operating instructions" at the first meeting of 1972 were unchanged from the December 1971 meeting.[3] In fact, the policy consensus in January 1972 was identical to that of the last five meetings in 1971, all following the August 15 announcement of the New Economic Program. Specifically, the policy of the FOMC was to "foster financial conditions consistent with the aims of the new governmental program. . . ." These aims were said to include "sustainable real economic growth and increased employment, abatement of inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments."

Although the actions necessary to achieve each of these goals would involve some conflict if pursued simultaneously and equally, the operating instructions provide some indication of the weight given by the Committee to these goals. In November 1971 the Committee's instructions had indicated a desire to "promote somewhat greater growth in monetary and credit aggregates," while at the December 1971 meeting this seems to have become a more definite objective as the Committee sought to "promote the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates. . . ."[4]

---

[1]The membership, procedures, and terms used in connection with the FOMC are discussed in the screened section entitled "The Federal Open Market Committee in 1972."

[2]Unless specifically noted, all quotes in this article come from the "Record of Policy Actions" of the Federal Open Market Committee, released about 90 days after each meeting and later published in the Federal Reserve *Bulletin*. Supplementary information regarding monetary and financial developments during the year is contained in quarterly reports prepared by the staff of the Board of Governors, and sent to the Joint Economic Committee of Congress. These reports are published in the Federal Reserve *Bulletin* approximately every three months. They provide the views of the Board's staff regarding movements in interest rates and monetary and reserve aggregates over the course of the prior quarter.

[3]Throughout this article these terms refer, respectively, to the last two sentences in the directive. See Exhibit I for further reference to these terms.

[4]In February 1973 the Federal Reserve Board released revised data for monetary aggregates for the previous fourteen years. However, unless specifically noted otherwise, throughout this article references to monetary and reserve aggregates are based on the former series — the data available to the Committee at the time of their deliberations. Page 12 contains rates-of-change triangles for the money stock series on both the old and the revised basis. Also, all rates-of-change computations are on a compound annual basis unless contained within quoted material or specifically noted otherwise.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Federal Open Market Committee in 1972

The Federal Open Market Committee (FOMC) consists of the seven members of the Federal Reserve Board of Governors and five of the twelve Federal Reserve Bank Presidents. The Chairman of the Board of Governors is also, by tradition, Chairman of the Committee. The President of the New York Federal Reserve Bank is a permanent voting member of the Committee and, also by tradition, is its Vice-Chairman. All other Federal Reserve Bank Presidents attend the meetings and present their views, but votes may be cast by only four of these Presidents, who serve as voting members for one-year terms on a rotation basis.

Members of the Board of Governors for most of 1972 included Arthur F. Burns, J. L. Robertson, Andrew F. Brimmer, Jeffrey M. Bucher, J. Dewey Daane, George W. Mitchell, and John E. Sheehan. The term of Governor Sherman Maisel expired on January 31, 1972; however, Mr. Maisel continued to serve as a Governor and to participate in Federal Open Market Committee meetings through April last year. Jeffrey M. Bucher joined the Board on June 5 last year to fill the position vacated by Mr. Maisel. Mr. Bucher has participated in the FOMC meetings since last June. In addition to Alfred Hayes, President of the Federal Reserve Bank of New York, the following Presidents served on the Committee during January and February 1972: George H. Clay (Kansas City), Monroe Kimbrel (Atlanta), Robert P. Mayo (Chicago) and Frank E. Morris (Boston). In March the Committee was reorganized and the four rotating positions were filled by the following new members: Philip E. Coldwell (Dallas), David P. Eastburn (Philadelphia), Bruce K. MacLaury (Minneapolis) and Willis J. Winn (Cleveland).

The Committee regularly met once each month during 1972 to discuss economic trends and to decide upon the future course of open market operations. At these meetings they may discuss other possible policy actions for subsequent weeks and months. At each meeting, a directive was issued to the Federal Reserve Bank of New York stating the ultimate goals of the Committee and providing general guidelines as to how the Manager of the System Open Market Account[1] at the New York Federal Reserve Bank should conduct open market operations to achieve these goals. Each directive contained a short review of economic data considered and the general economic goals sought by the Committee. The second paragraph gave operating instructions to the Account Manager. These instructions were stated in terms of bank reserve and money market conditions to achieve desired growth rates of monetary aggregates, and any special factors to be taken into account, such as Treasury financing operations.

[1]The Manager of the System Open Market Account may be referred to as the "Account Manager" and the Trading Desk of the New York Federal Reserve Bank as the "Desk".

The decisions on the exact timing and amount of daily buying and selling operations of securities in fulfilling the Committee's directive are the responsibility of the Account Manager at the Trading Desk of the New York Bank. Each morning, he and his staff decide on a program for open market operations to be undertaken that day. In developing this program, money and credit market conditions and aggregate targets desired by the Committee are considered as well as other factors which may be of concern at that time. Each morning, the Account Manager places a conference call to staff members of the Board of Governors and one voting President to give information about present market conditions and open market operations which he proposes to execute that day. Other members of the Committee are informed of the daily program by wire summary.

A summary of the Committee's actions is presented to the public in the "Record of Policy Actions" of the Federal Open Market Committee. This "Record" is released about 90 days after each meeting and is published in both the *Annual Report of the Board of Governors of the Federal Reserve System* each spring and in the Federal Reserve *Bulletin* each month. The "Record" for each meeting generally includes:

1) a summary of recent economic developments, such as prices, employment, industrial production, and components of the national income accounts; also, staff projections concerning real output growth for the current and following quarters are usually discussed;
2) a discussion of the U.S. balance of payments, including international financial developments;
3) a discussion of interest rate movements;
4) a discussion of open market operations and growth of reserve aggregates since the last meeting;
5) a discussion of the movements of monetary aggregates such as M_1 and M_2, and the adjusted credit proxy[2];
6) a general statement of the views of the members of the FOMC;
7) conclusions of the FOMC;
8) a policy directive issued by the FOMC;
9) a list of the voting position of members and any dissenting comments.

[2]M_1 refers to the money stock, defined as private demand deposits plus currency in the hands of the nonbank public. M_2 refers to money stock plus net time deposits; net time deposits are defined as total time deposits at all commercial banks minus large time certificates of deposit at large weekly reporting commercial banks. Adjusted credit proxy is defined as member bank deposits subject to reserve requirements plus bank-related commercial paper, Eurodollar borrowings of U. S. banks, and certain other nondeposit items.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MONEY STOCK*
COMPOUNDED ANNUAL RATES OF CHANGE

TERMINAL MONTH	7-71	8-71	9-71	10-71	11-71	12-71	1-72	2-72	3-72	4-72	5-72	6-72	7-72	8-72	9-72	10-72	11-72	12-72	1-73	BILLIONS OF DOLLARS
8-71	3.2																			228.0
9-71	0.5	-2.1																		227.6
10-71	0.5	-0.8	0.5																	227.7
11-71	0.4	-0.5	0.3	0.0																227.7
12-71	0.8	0.3	1.1	1.3	2.7															228.2
1-72	1.2	0.8	1.6	1.9	2.9	3.2														228.8
2-72	2.9	2.8	3.8	4.7	6.3	8.2	13.3													231.2
3-72	4.1	4.2	5.3	6.2	7.8	9.6	13.0	12.6												233.5
4-72	4.5	4.6	5.6	6.5	7.9	9.2	11.3	10.3	8.0											235.0
5-72	4.3	4.4	5.3	5.9	7.0	7.9	9.0	7.6	5.3	2.6										235.5
6-72	4.4	4.5	5.3	5.9	6.8	7.5	8.4	7.2	5.4	4.2	5.8									236.6
7-72	5.3	5.5	6.3	6.9	7.8	8.6	9.5	8.7	7.8	7.7	10.4	15.2								239.4
8-72	5.3	5.5	6.2	6.8	7.6	8.2	8.9	8.2	7.3	7.2	8.8	10.3	5.7							240.5
9-72	5.3	5.5	6.2	6.7	7.4	7.9	8.5	7.8	7.1	6.9	8.0	8.7	5.6	5.6						241.6
10-72	5.2	5.4	5.9	6.4	7.0	7.5	7.9	7.3	6.5	6.3	7.1	7.4	4.9	4.6	3.5					242.3
11-72	5.3	5.4	6.0	6.4	7.0	7.4	7.8	7.2	6.6	6.4	7.0	7.2	5.4	5.3	5.1	6.6				243.6
12-72	5.9	6.1	6.7	7.1	7.7	8.2	8.6	8.2	7.7	7.6	8.4	8.8	7.6	8.1	8.9	11.7	17.0			246.8
1-73	SERIES DISCONTINUED AFTER REVISION																			
2-73																				
	7-71	8-71	9-71	10-71	11-71	12-71	1-72	2-72	3-72	4-72	5-72	6-72	7-72	8-72	9-72	10-72	11-72	12-72	1-73	

INITIAL MONTH

* PRIOR TO FEBRUARY 1973 REVISION

MONEY STOCK
COMPOUNDED ANNUAL RATES OF CHANGE

REVISED SERIES EFFECTIVE FEBRUARY 1973

TERMINAL MONTH	7-71	8-71	9-71	10-71	11-71	12-71	1-72	2-72	3-72	4-72	5-72	6-72	7-72	8-72	9-72	10-72	11-72	12-72	1-73	BILLIONS OF DOLLARS
8-71	2.6																			234.6
9-71	2.1	1.5																		234.9
10-71	2.8	2.8	4.2																	235.7
11-71	1.9	1.7	1.8	-0.5																235.6
12-71	2.0	1.8	1.9	0.8	2.1															236.0
1-72	1.8	1.6	1.7	0.9	1.5	1.0														236.2
2-72	3.7	3.9	4.3	4.4	6.1	8.1	15.8													239.1
3-72	4.7	5.0	5.6	5.9	7.6	9.5	14.0	12.2												241.4
4-72	5.1	5.4	6.0	6.3	7.7	9.2	12.0	10.2	8.3											243.0
5-72	5.0	5.3	5.7	6.0	7.1	8.1	10.0	8.1	6.1	4.0										243.8
6-72	5.1	5.4	5.8	6.0	7.0	7.9	9.3	7.7	6.3	5.3	6.6									245.1
7-72	5.8	6.1	6.6	6.8	7.8	8.6	10.0	8.9	8.0	8.0	10.0	13.5								247.7
8-72	5.7	6.0	6.4	6.6	7.4	8.1	9.2	8.1	7.3	7.1	8.1	8.9	4.4							248.6
9-72	5.8	6.1	6.5	6.7	7.4	8.0	9.0	8.0	7.3	7.2	8.0	8.4	6.0	7.5						250.1
10-72	5.9	6.2	6.5	6.7	7.4	8.0	8.8	7.9	7.4	7.2	7.9	8.2	6.4	7.5	7.4					251.6
11-72	5.9	6.1	6.5	6.6	7.3	7.7	8.4	7.7	7.1	6.9	7.4	7.6	6.2	6.8	6.4	5.4				252.7
12-72	6.4	6.6	7.0	7.2	7.8	8.3	8.9	8.3	7.9	7.8	8.4	8.7	7.7	8.6	8.9	9.7	14.1			255.5
1-73	6.0	6.2	6.5	6.6	7.2	7.6	8.1	7.5	7.0	6.9	7.2	7.3	6.3	6.7	6.5	6.2	6.6	-0.5		255.4
2-73	6.0	6.2	6.5	6.6	7.1	7.5	8.0	7.4	6.9	6.8	7.1	7.2	6.3	6.6	6.5	6.2	6.5	2.9	6.3	256.7
	7-71	8-71	9-71	10-71	11-71	12-71	1-72	2-72	3-72	4-72	5-72	6-72	7-72	8-72	9-72	10-72	11-72	12-72	1-73	

INITIAL MONTH

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This wording, which was repeated at the January 1972 meeting, indicates that at that time, with the existence of a price-wage control program, the Committee gave greater weight to providing the growth of money and credit which they viewed as essential to real economic recovery. A review of operating instructions issued in 1971 shows that for several months prior to the imposition of the price-wage freeze, the FOMC desired to slow the growth in monetary aggregates from the very high rates of the first half of the year. At the September and October 1971 meetings the Committee had agreed to seek "to achieve moderate growth in monetary and credit aggregates. . . ." However, by November, after a few months of slower growth, the consensus had moved to one of desiring more rapid growth.

This qualitative phrasing of the growth rates of monetary aggregates sought by the policymakers is characteristic of the "Record of Policy Actions" of each meeting in 1972. Thus, the reader has only a general impression of the rates of growth that would be satisfactory to the Committee. At previous meetings, mostly from February 1970 to May 1971, the directive indicated specific growth rates of the money supply or other monetary aggregates that were being sought. This practice was not followed in the second-half of 1971. Then, at the January 1972 meeting, the "Record" began to report an objective of the Committee in terms of a specific range for the rate of growth of a measure of bank reserves. Specified at each subsequent meeting was a "target" growth rate of reserves which was deemed consistent with the Committee's desired growth rates for monetary aggregates. However, the rates of monetary aggregates were not specified, and because of the possibility of anticipated changes in the reserve-money multiplier, one cannot assume that a change in the target growth rate of the reserve aggregate would be accompanied by a similar change in the desired growth of the money supply and other monetary aggregates.[5]

The policy consensus and the operating instructions included in the economic policy directive issued at the January 1972 meeting contained essentially the same wording as a month earlier. However, by this time there were apparently significant differences in the views of some members of the Committee. The policy directive had been adopted unanimously at the December 1971 meeting, but in January three votes were cast against the directive.

[5]For a more detailed discussion of reserve operating targets, see Charlotte E. Ruebling, "RPDs and Other Reserve Operating Targets," this *Review* (August 1972), pp. 2-7.

The reasons given for the dissents reveal some of the differences concerning the implementation of policy. The text of the "Record of Policy Actions" for the January meeting summarizes the majority view:

> In the Committee's discussion considerable concern was expressed about the persistent sluggishness of key monetary aggregates, and a number of members advocated action to provide sufficient reserves to support the faster monetary growth that they believed was required by the economic situation and outlook. It was noted in this connection that the level of member bank reserves, as well as that of M_1, had changed little during the fourth quarter despite a progressive easing of money market conditions. In the interest of assuring the provision of reserves needed for adequate growth in monetary aggregates, the Committee decided that in the period until its next meeting open market operations, while continuing to take appropriate account of conditions in the money market, should be guided more by the course of total reserves than had been customary in the past . . . .
>
> In placing greater emphasis on total reserves, the Committee took note of a staff analysis suggesting that moderate rates of growth in M_1 and M_2 in January and February were likely to be associated with a large increase in total reserves from December to January and then a decline in February — mainly as a consequence of recent and anticipated changes in U.S. Government deposits, and allowing for the 2-week lag between member bank deposits and required reserves. Against the background of this analysis, a majority agreed that an annual rate of growth in total reserves of roughly 20 to 25 per cent from December to January would be satisfactory, provided that it could be attained without undue easing of money market conditions.

Following the directive, the "Record" notes:

> Messrs. Hayes, Brimmer, and Kimbrel differed somewhat in their reasons for dissenting from this action. Mr. Hayes considered the emphasis placed on total reserves as an operating target to be an undesirable step; in his judgment, reserves were much less meaningful than other measures, such as the monetary and credit aggregates and interest rates, as an instrument for working toward the Committee's basic economic objectives. Also, he was reluctant to issue a directive that might involve a substantial further easing of money market conditions, since the Committee had already moved rapidly in that direction and since it appeared to him that the economic outlook had improved somewhat in recent months. He was concerned about the risk that a further sharp decline in short-term interest rates might subject financial markets to unnecessary whipsawing and might tend to rekindle inflationary expectations.
>
> Mr. Brimmer shared the majority's views concerning broad objectives of policy at this time, and he

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

EXHIBIT I

FOMC ECONOMIC POLICY DIRECTIVES — 1972

Date of FOMC Meeting	Policy Consensus	Operating Instructions	Operating Target
December 14, 1971	In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions consistent with the aims of the new governmental program, including sustainable real economic growth and increased employment, abatement of inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.	To implement this policy, the Committee seeks to promote the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates over the months ahead.[1] Dissents: None	
January 11, 1972	No Change	. . . while taking account of international developments and the forthcoming Treasury financing, the Committee seeks to promote the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates over the months ahead. Dissents: Mr. Hayes, Mr. Brimmer, Mr. Kimbrel	. . . a majority agreed that an annual rate of growth in total reserves of roughly 20 to 25 per cent from December to January would be satisfactory, provided that it could be attained without undue easing of money market conditions.
February 15	. . . to foster financial conditions conducive to sustainable real economic growth and increased employment, abatement of inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.	. . . while taking account of international developments, the Committee seeks to achieve bank reserve and money market conditions that will support moderate growth in monetary aggregates over the months ahead. Dissents: Mr. Hayes	The members decided that it would be desirable to seek growth in the reserve measure in the February-March period at an annual rate in a range of 6 to 10 per cent, while avoiding both sharp short-run fluctuations and undesirably large cumulative changes in money market conditions in either direction in the period between meetings.[2]
		FOMC REORGANIZED WITH NEW VOTING MEMBERS	
March 21	No Change	. . . while taking account of international developments and possible Treasury financing, the Committee seeks to achieve bank reserve and money market conditions that will support moderate growth in monetary aggregates over the months ahead. Dissents: None	The Committee decided to seek growth in the reserve measure employed at an annual rate in a range of 9 to 13 per cent during the March-April period while avoiding both sharp day-to-day fluctuations and large cumulative changes in money market conditions.
April 18	No Change	. . . while taking account of capital market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions that will support somewhat more moderate growth in monetary aggregates over the months ahead. Dissents: None	The Committee decided to seek growth in the reserve measure employed at an annual rate in a range of 7 to 11 per cent during the April-May period and to accept, if necessary, somewhat firmer money market conditions in order to achieve growth in that range in existing circumstances, while continuing to avoid sharp fluctuations and large cumulative changes in money market conditions.
May 23	No Change	. . . while taking account of capital market developments and possible Treasury refunding, the Committee seeks to achieve bank reserve and money market conditions that will support somewhat slower growth in monetary aggregates over the months ahead. Dissents: None Absent and not voting: Mr. Robertson	. . . the Committee decided to seek growth in RPD's at an annual rate in a range of 7.5 to 11.5 per cent during the May-June period while continuing to avoid sharp fluctuations and large cumulative changes in money market conditions.
June 19-20	No Change	. . . while taking account of possible Treasury financing and developments in capital markets, the Committee seeks to achieve bank reserve and money market conditions that will support moderate growth in monetary aggregates over the months ahead.[3] Dissents: None Absent and not voting: Mr. Hayes (Mr. Treiber voted as his alternate)	. . . the Committee decided to seek growth in RPD's at an annual rate in a range of 4.5 to 8.5 per cent during the June-July period while continuing to avoid sharp fluctuations and large cumulative changes in money market conditions.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

July 18	No Change	. . . while taking account of the forthcoming Treasury financing, developments in capital markets, and international developments, the Committee seeks to achieve bank reserve and money market conditions that will support moderate growth in monetary aggregates over the months ahead. Dissents: Mr. Coldwell Absent and not voting: Mr. Mitchell	. . . it [the Committee] decided to seek growth in RPD's at an annual rate in a range of 3 to 7 per cent during the July-August period while continuing to avoid sharp fluctuations and large cumulative changes in money market conditions.
August 15	No Change	. . . while taking account of developments in capital markets and international developments, the Committee seeks to achieve bank reserve and money market conditions that will support moderate growth in monetary aggregates over the months ahead. Dissents: None	It [the Committee] decided to seek growth in RPD's during the August-September period at an annual rate in a range of 5 to 9 per cent. . . .
September 19	No Change	. . . while taking special account of the effects of possible bank regulatory changes, developments in credit markets, and international developments, the Committee seeks to achieve bank reserve and money market conditions that will support more moderate growth in monetary aggregates over the months ahead. Dissents: Mr. MacLaury, Mr. Robertson Absent and not voting: Mr. Winn (Mr. Mayo voted as his alternate.)	The Committee took note of a staff analysis suggesting that an average rate of expansion in RPD's in September and October in a range equivalent to 9.5 to 13.5 per cent would be likely to lead to more moderate growth in monetary aggregates over the months ahead.[4]
October 17	No Change	. . . while taking account of the effects of possible bank regulatory changes, Treasury financing operations, and developments in credit markets, the Committee seeks to achieve bank reserve and money market conditions that will support more moderate growth in monetary aggregates over the months ahead than recorded in the third quarter. Dissents: None	. . . the Committee decided that its objectives for the aggregates would be fostered by growth in RPD's during the October-November period at an annual rate within a range of 6 to 11 per cent.[5]
November 20-21	No Change	. . . while taking account of the effects of recent bank regulatory changes, the Committee seeks to achieve bank reserve and money market conditions that will support more moderate growth in monetary aggregates over the months ahead than recorded in the third quarter. Dissents: None Absent and not voting: Mr. Coldwell (Mr. Francis voted as his alternate.)	. . . the Committee decided that its objectives regarding the aggregates would be served by open market operations directed at fostering growth in RPD's during the November-December period at an annual rate within a range of 6 to 10 per cent, while continuing to avoid marked changes in money market conditions.
December 19	No Change	. . . while taking account of Treasury financing operations and possible credit market developments, the Committee seeks to achieve bank reserve and money market conditions that will support slower growth in monetary aggregates over the months ahead than appears indicated for the second half of this year. Dissents: None	. . . they decided that open market operations should be directed at fostering RPD growth during the 2-month period within a range of 4 to 11 per cent, while continuing to avoid marked changes in money market conditions.

[1]On December 20, 1971, the phrase "while taking account of international developments" was added.

[2]At the February 1972 meeting the Committee decided to express its reserve objectives in terms of reserves available to support private nonbank deposits (RPDs), defined specifically as total member bank reserves less those required to support Government and interbank deposits.

[3]On July 6, 1972, the phrase "and international developments," was added.

[4]The figures cited were based on the assumption that Regulations D and J would not become effective during this period.

[5]The range of tolerance for the RPD growth rate was modified to 9 to 14 percent due to the amendments to Regulations D and J.

NOTE: Emphasis added by this Bank.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

indicated that he would have voted favorably on the directive were it not for the decision to give special emphasis to total reserves as an operating target during coming weeks. In his judgment the Committee should have had more discussion of the implications of that decision, and in any case it should have postponed the decision until after it had held a contemplated meeting to be devoted primarily to discussion of its general procedures with respect to operating targets.

Mr. Kimbrel favored supplying reserves at a rate that would accommodate orderly economic expansion. He voted against the directive because he thought it involved risks of depressing short-term interest rates to unsustainably low levels and of producing excessive rates of growth in the monetary aggregates in the future.

MODERATE GROWTH OF AGGREGATES — FEBRUARY AND MARCH

When the Committee met again in February it established a policy consensus which was similar to those adopted during the previous six months. The essential difference was deletion of reference to "the aims of the new governmental program. . . ." Throughout the remainder of the year there was no change in the policy consensus.

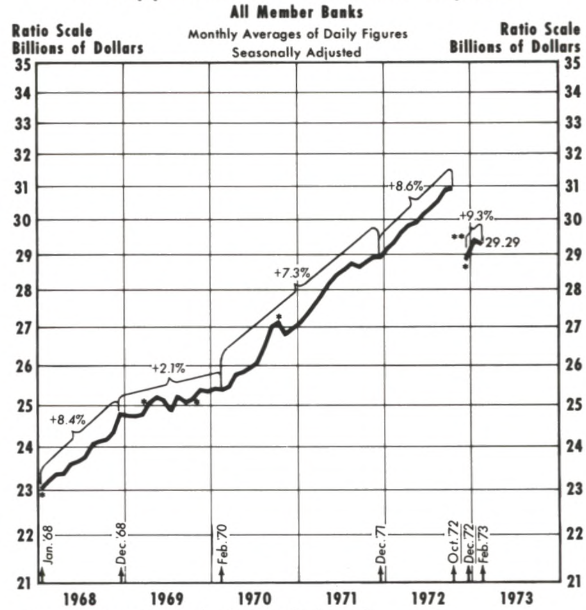
The operating instruction included in the directive issued at the February meeting was less expansive in tone than the previous two. As intended, a large growth in bank reserves had occurred between the January and February meetings, and the desired acceleration in the growth of monetary aggregates had begun. Consequently, the Committee decided to seek conditions that would "support moderate growth in monetary aggregates. . . ."

To achieve its near-term objectives, the Committee modified further the operating target. The use of total bank reserves had been adopted only a month earlier, but at the February meeting

. . . the Committee decided to express its reserve objectives in terms of reserves available to support private nonbank deposits [RPDs] — defined specifically as total member bank reserves less those required to support Government and interbank deposits. This measure was considered preferable to total reserves because short-run fluctuations in Government and interbank deposits are sometimes large and difficult to predict and usually are not of major significance for policy. It was deemed appropriate for System open market operations normally to accommodate such changes in Government and interbank deposits.

The Committee agreed that the economic situation and outlook at this time called for growth in the

Reserves Available to Support Private Nonbank Deposits [1]



[1] Data are on an actual rather than an effective basis.
*Change in reserve requirements.
**The break in the series was a result of the changes in Regulations D and J.
Percentages are annual rates of change for periods indicated.
Latest data plotted: February

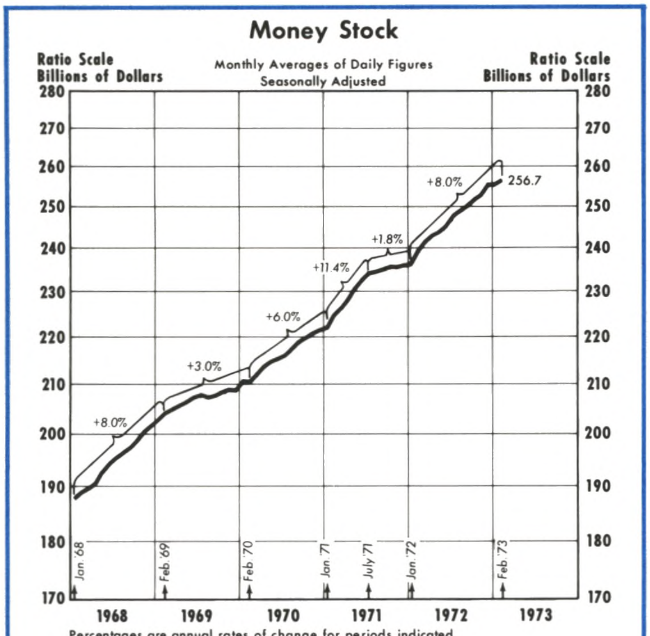
monetary aggregates at moderate rates. It took note of a staff analysis suggesting that, over the months of February and March combined, such growth was likely to be associated with expansion in the reserve measure employed at about an 8 per cent annual rate, and possibly with some firming of money market conditions. The members decided that it would be desirable to seek growth in the reserve measure in the February-March period at an annual rate in a range of 6 to 10 per cent, while avoiding both sharp short-run fluctuations and undesirably large cumulative changes in money market conditions in either direction in the period between meetings. They also decided that some allowance should be made in the conduct of operations for any significant deviations that might develop between the actual rates of growth in the monetary aggregates and the moderate growth rates expected.

Mr. Hayes dissented from this action

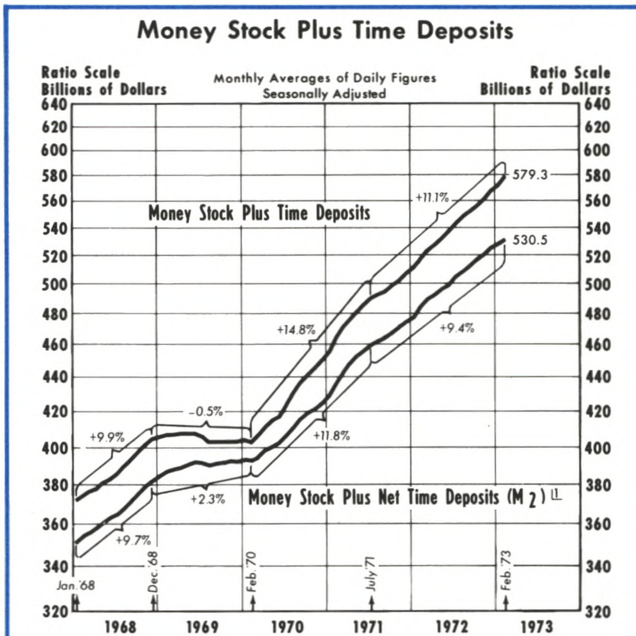
. . . for essentially the same reasons he had dissented from the directive adopted at the previous meeting. First, he did not favor placing as much emphasis as contemplated on reserves as an operating target; he preferred to place main emphasis on money market conditions for that purpose. Second, he thought the policy agreed upon could result in an easing of money market conditions to a degree that in his judgment would entail substantial risks both domestically and internationally.

Another new element at the February meeting was introduced:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



Percentages are annual rates of change for periods indicated.
Latest data plotted: February



Currency, demand deposits, savings deposits, time deposits open account plus time certificates of deposit other than negotiable time certificates of deposit issued in denominations of $100,000 or more by large weekly reporting commercial banks.
Percentages are annual rates of change for periods indicated.
Latest data plotted: February

> . . . it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions if it appeared during the period before the next scheduled meeting that the Committee's several objectives and constraints were not being met satisfactorily.

The understanding was repeated in the "Record of Policy Actions" for each of the subsequent meetings through the remainder of 1972.

Some perspective on a prominent view of the role of monetary policy early last year might be gained from reference to Chairman Burns' testimony on February 9, 1972 before the Joint Economic Committee. Regarding monetary developments, the Chairman noted

> . . . the role that monetary policy needs to play in furthering national objectives this year. Clearly, our monetary affairs — no less than our fiscal affairs — must be kept in order, so that public confidence in our monetary management is maintained. An unduly expansive monetary policy would be most unfortunate, particularly in view of the large Federal budgetary deficits now projected. We need always to be mindful of the fact that increases in money and credit achieved today will still be with us tomorrow, when economic conditions may no longer be the same as they are today.
>
> At this stage of the business cycle it is essential to pursue a monetary policy that will facilitate good economic recovery. Supplies of money and credit must be sufficient to finance the growth in consumer spending and in investment plans that now appears in process. Let me assure this committee that the Federal Reserve does not intend to let the present recovery falter for want of money or credit. And let me add, just as firmly, that the Federal Reserve will not release the forces of a renewed inflationary spiral.
>
> We are now in a favorable position to provide the monetary support needed for a quickening pace of production and employment. While expansion in the supply of money and credit was relatively brisk during 1971, we successfully avoided an unduly rapid growth of liquidity.
>
> No single measure of money or credit represents adequately the impact of monetary policy on the economy. Let me nevertheless cite a few salient facts. Growth of the narrowly defined money supply — that is, currency and private demand deposits — amounted to 6.2 per cent during 1971, compared with 5.4 per cent in 1970. If the money supply is defined more broadly, so as to include also consumer-type time and savings deposits at commercial banks, the rate of growth was 11.1 per cent during 1971, compared with 8.1 per cent in the previous year.
>
> These 1971 growth rates of money balances are at the upper end of the range witnessed over the postwar period. That is what should happen at a time of sluggish economic growth, as this committee has pointed out. [Federal Reserve *Bulletin* (February 1972), pp. 125-126.]

After reviewing the monetary policy actions of the previous year, Mr. Burns also remarked:

> In recent months, the Federal Reserve has sought to encourage a faster rate of monetary expansion than occurred in the late summer and fall of last year. Open market operations have been conducted

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

> with more emphasis on increasing the reserve base of the banking system. In the 5 months from September through January, total bank reserves rose at an annual rate of over 8 per cent. Thus far, much of this increase has supported an accelerated growth in time deposits. But, in due course, the narrowly defined money stock, on which so much emphasis is nowadays placed by some single-minded observers, will also respond; preliminary calculations indicate that this aggregate rose more rapidly in January than in the immediately preceding months. [Ibid, p. 127.]

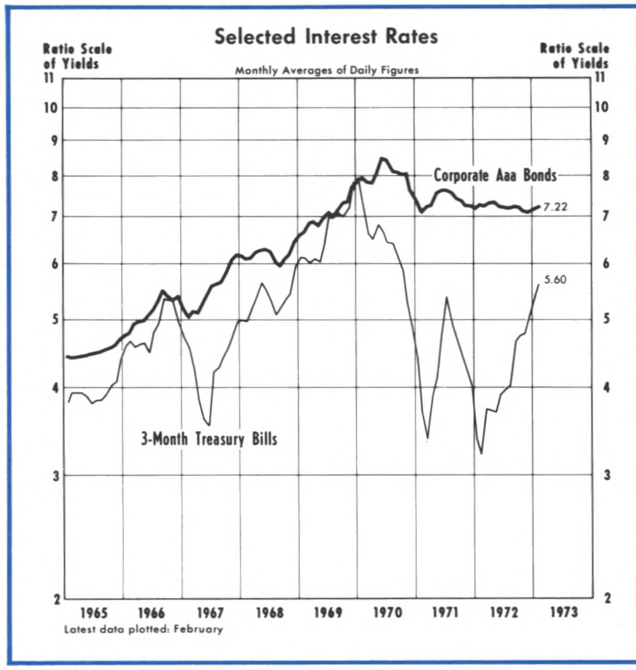
For the meeting on March 21 the "Record" notes the fact that yields on short-term market securities had risen considerably in recent weeks. This was a largely expected development following the very sharp declines in short-term rates that had occurred in late 1971 and the first few weeks of 1972. It was pointed out in the "Record" that the spread between rates on short- and long-term securities had been extremely wide by historical standards, and it remained wide even after the recent rise in short-term rates. The staff analysis indicated that a moderate growth in monetary aggregates during March and April combined would likely be associated with an 11 percent rate of growth in RPDs and some further tightening in money market conditions.

As cited above, the Committee directives for December 1971 and January 1972 had called for greater growth in the monetary aggregates over the months ahead. In order to achieve this greater growth, a majority of the Committee at the January meeting had voted to increase total bank reserves at a 20-25 percent annual rate from December to January. This effort was clearly successful by the March meeting where

> . . . it appeared that over the first quarter M_1 and M_2 would expand at annual rates of about 9.5 and 13.0 per cent, respectively, and that the bank credit proxy would rise at a rate of about 10.5 per cent.[6]

However, regarding this increase, it was noted that M_1 "increased sharply in February – in part because of a substantial reduction in U. S. Government deposits at commercial banks."

The growth of the narrowly defined money stock accelerated to a 9.6 percent annual rate in the period from December 1971 to March 1972, compared with a 1.1 percent rate of increase in the previous three months. Staff projections at the March meeting sug-



gested a somewhat faster growth in real GNP in the second quarter than in the first, and the Committee agreed that the

> . . . economic situation continued to call for moderate growth in the monetary aggregates, although at rates less rapid than those likely to be recorded for the first quarter.

SEEKING SLOWER MONEY GROWTH — APRIL AND MAY

According to the "Record" for the Committee meeting in mid-April, the economic outlook at that time appeared almost the same as a month earlier. In view of the projections of a continually strengthening economy in 1972, the monetary authorities indicated a desire to avoid providing excessive stimulus. At the April meeting

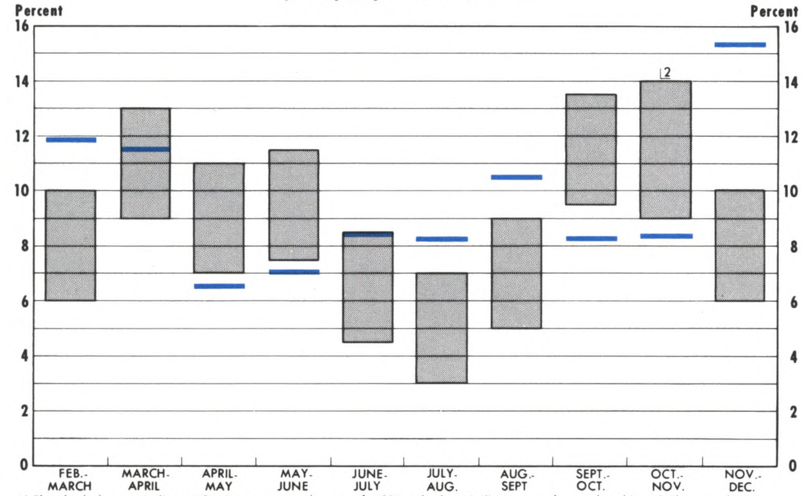
> The Committee agreed that the economic situation called for growth in the monetary aggregates at rates somewhat more moderate than those recorded for the first quarter of the year.

When the Committee met again five weeks later they "agreed that the economic situation called for growth in the monetary aggregates over the months ahead at rates somewhat slower than those recorded in recent months." However, to achieve this objective, after taking account of lagged reserve requirements and recent changes in deposits, the Committee specified a range of growth in RPDs that was slightly higher than the range indicated at the previous meeting, and

[6]Quarterly growth rates cited are calculated on the basis of the daily-average level in the last month of the quarter relative to the last month of the preceding quarter.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Reserves Available to Support Private Nonbank Deposits
Operating Target and Actual Growth [1]



[1] The shaded areas indicate FOMC target growth range for RPDs; the bars indicate actual growth achieved. The actual RPD growth rates were computed using the RPD series prior to the February 1973 revision. The figures represent simple annual rates over the two-month periods indicated.

[2] The original RPD growth range of 6 - 11 percent was modified to 9 - 14 percent as a result of changes in Regulations D and J.

Note: The actual figures for November and December were adjusted in order to compensate for changes in Regulations D and J.

the lower end of which was the same as recent experience. Thus, at the April meeting they had specified a range of RPD growth of 7 to 11 percent, and at the time of the May meeting it appeared their actions had resulted in growth of these reserves at a 7.5 percent rate. The consensus was to seek a somewhat slower rate of growth in monetary aggregates; the range of RPD growth for the May-June period was specified to be 7.5 to 11.5 percent.

ACHIEVING MODERATE GROWTH — JUNE TO AUGUST

A month later it appeared that growth of RPDs in the May-June period would be at the lower end of the specified range, and growth of the narrowly defined money stock had slowed further. The Committee lowered its desired target range of RPD growth to 4.5 to 8.5 percent during the June-July period. As usual, "the members also decided that some allowance should be made in the conduct of operations if growth in the monetary aggregates appeared to be deviating significantly from the rates expected. . . ."

The provision for a change in the conduct of operations under certain conditions would appear to have become of some importance in view of the events around mid-year. The decisions and actions of the preceding few months had been in the direction of less rapid growth of monetary aggregates than had occurred early in the year. The operating instructions of the April and May meetings had called for "somewhat more moderate growth" and "somewhat slower growth" in monetary aggregates over the months ahead, respectively. At the June meeting the desired range of RPD growth had been significantly reduced. Apparently, though, the results were different than expected. The "Record" for the July meeting, after noting that the growth of M_1 in June was at the same relatively slow rate of May, stated:

> Sluggishness in June, however, may have reflected temporary effects of the speculation in foreign exchange markets and outflows of funds from the United States after mid-month, and weekly data suggested a sharp increase in the rate of expansion in early July.

The idea underlying the reference to "outflows of funds from the United States" is complex. During such an "outflow" there is a change in ownership of demand deposit accounts at U. S. commercial banks, wherein deposits of domestic holders are reduced (initially and temporarily) and holdings of foreigners (individuals, governments, banks, or other firms) are increased. Since the U. S. money stock is defined to include deposits of foreigners, a change of ownership of demand deposits from U. S. residents to foreigners does not influence the quantity of money outstanding unless government deposits are also changed.

The reference to "a sharp increase in the rate of expansion in early July" is another matter. Mid-year "window-dressing" by commercial banks, and the occurrence of the July 4 holiday on Tuesday of the same settlement week, may have contributed to an unusually large increase in net demand deposits at member banks in the first week of July.[7] Similar temporary fluctuations have occurred on other occasions, and over the subsequent few weeks the growth of the money supply returned to its previous trend. However, instead of an offsetting drop in demand deposits following the mid-year bulge, the level of deposits plateaued at the high level. The growth rate of money for the month of July was at a 15 percent annual rate, and in August the growth rate of money was reduced to only a 5.7 percent rate.[8]

[7] For nonbusiness days, banks use the balance of the preceding business day. During the week ending July 5, banks carried the large June 30 balances for three days, resulting in a large increase in the weekly average net demand deposits.

[8] The "revised" money stock series shows an increase in money from June to July at a 13.5 percent rate, and an increase at a 4.4 percent rate from July to August.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This episode may illustrate some of the problems associated with short-run monetary management, especially under a system of lagged reserve requirements. The deposits of banks in any given week are relatively independent of the amount of reserves in the banking system that week, but the Federal Reserve is obliged to provide reserves — either through open market operations or through the discount window — to meet the requirements based on the deposits of two weeks earlier.

The operating instructions issued at the July 18 meeting were the same as had been issued at the June meeting, namely "the Committee seeks to achieve bank reserve and money market conditions that will support moderate growth in monetary aggregates over the months ahead." Mr. Coldwell dissented from this action

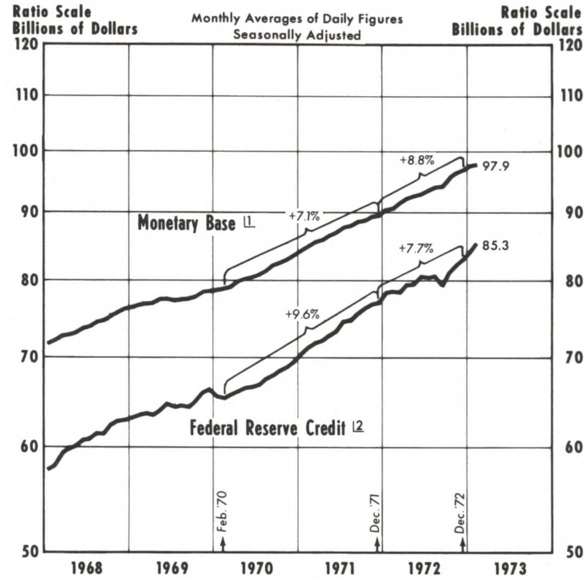
> . . . because in his judgment average growth in bank reserves within the specified range for July and August and the associated expansion in the money supply might build a base for excessive economic stimulation. He was concerned about the effects both on the domestic economic situation, in the context of heavy stimulation from fiscal policy, and on international financial problems.

The "Record" for the August 15 meeting noted the very rapid growth of the money stock in July, but no reason for the sharp rise was reported. The report to the Joint Economic Committee of Congress regarding the "Financial Developments in the Third Quarter of 1972" states, "Over the third quarter, M_1 grew at an 8.5 percent annual rate, but *this mainly reflected increased public demand for cash balances early in July*."[9] [emphasis added]

In view of the then current rapid growth of aggregates, the "Record" reports that following the July meeting "the System undertook to slow the increase in reserves to the extent feasible in light of the large-scale Treasury refunding then in process." While continuing to desire to hold down monetary growth in the coming period, an increased concern about interest rate movements was expressed:

> The Committee agreed that the economic situation continued to call for moderate growth in the monetary aggregates over the months ahead. It decided to seek growth in RPD's during the August-September period at an annual rate in a range of 5 to 9 per cent — a rate which was expected to be associated with some moderation in monetary growth. While recognizing that pursuit of the objective for RPD's might be associated with some firming of money market conditions, the Committee agreed that *a marked firming, which might precipitate unduly sharp increases in interest rates in a sensitive market atmosphere, should be avoided.* [emphasis added]

Monetary Base and Federal Reserve Credit



1 Uses of the monetary base are member bank reserves and currency held by the public and nonmember banks. Adjustments are made for reserve requirement changes and shifts in deposits among classes of banks. Data are computed by this bank.
2 Total Federal Reserve credit outstanding includes holdings of securities, loans, float, and "other" assets. Adjustments are made for reserve requirement changes and shifts in deposits among classes of banks. Data are computed by this bank.
Percentages are annual rates of change for periods indicated.
Latest data plotted: February

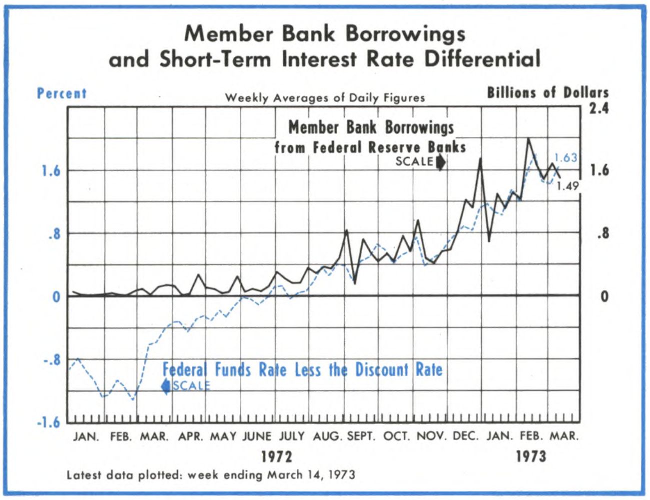
In commenting on the rapid growth of RPDs in the third quarter, the report to the Joint Economic Committee emphasizes the different avenues through which the Federal Reserve provides reserves to the banking system. The report notes that "reserves provided through open market operations were held back and more than half of the increased demand for reserves was obtained by banks through enlarged borrowing from Reserve Bank discount windows."[10] During that period short-term market interest rates tended to rise, with relatively sharp increases occurring in the second half of the quarter. Prior to August the Federal funds rate (the rate at which banks borrow reserves from each other) had been mostly below the Federal Reserve Banks' discount rate. Since that time the funds rate has generally been rising relative to the discount rate, making borrowing from Federal Reserve banks a relatively cheaper source of short-term funds to banks. The accompanying chart shows the movement of short-term interest rates in this period.

---

[9]Federal Reserve *Bulletin* (November 1972), p. 947.

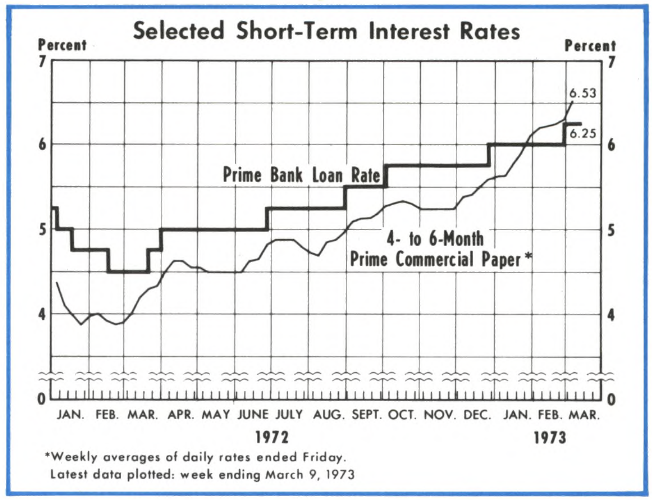
[10]Ibid.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



Member Bank Borrowings and Short-Term Interest Rate Differential

Latest data plotted: week ending March 14, 1973



Selected Short-Term Interest Rates

*Weekly averages of daily rates ended Friday.
Latest data plotted: week ending March 9, 1973

SLOWING THE GROWTH OF MONEY — SEPTEMBER TO DECEMBER

At the final meeting of the quarter, the economic outlook was for an even stronger growth of GNP in the fourth quarter than in the third. GNP growth was seen to remain at a fast pace in the first half of 1973. Analysis prepared for the September meeting included discussion of the factors contributing to sharp increases in short-term market interest rates in the period between meetings. The Committee's target from the previous meeting was for growth of RPDs between 5 and 9 percent "subject to the proviso that money market conditions should not be permitted to firm markedly."

> Pursuit of the RPD target was complicated by the need to absorb reserves at a time when the market supply of Treasury bills was increasing. Early in the period, RPD's — and the monetary aggregates — appeared to be expanding rapidly. As the System acted to restrain growth in reserves, short-term interest rates began to rise sharply and financial markets became increasingly sensitive; this was especially evident just before the Labor Day weekend when a number of banks misjudged their reserve needs and bid the Federal funds rate up as high as 5½ per cent. In order to avoid a marked firming in money market conditions and unduly sharp increases in interest rates, for a time the System supplied reserves more generously.

For the coming months the Committee desired to slow the growth in monetary aggregates from the rates of the third quarter; however, "the members noted that conditions in financial markets were still highly sensitive." Because of this condition and the possibility of regulatory changes, the members decided that in seeking an annual rate of RPD growth in a 9.5 to 13.5 percent range

> . . . the System Account Manager should have more than the usual degree of discretion in making operating decisions and that he should give more than customary attention to money market conditions, while continuing to avoid marked changes in such conditions.

There were two dissents from this directive, both based on concern about the rapid monetary growth.

> Mr. MacLaury dissented from this action because he had become increasingly disturbed by the rapid rates of growth in the aggregates, given the prospective strength of the economy, and he felt that the Committee's current operating procedures did not assure that money market conditions would be permitted to tighten sufficiently to slow this excessive monetary growth in the near future.

> Mr. Robertson dissented because of his belief that with the existing potentiality for increased inflationary pressures, the Committee was not doing enough to curb the rate at which reserves were being fed into the banking system by the Federal Reserve and to slow down the rate of growth in the monetary aggregates. In his view, the failure to do so might result in a new ground swell of inflation later on.

At the final three meetings of 1972, the Committee made explicit in its operating instructions that lower growth rates of monetary aggregates were being sought. The operating target adopted at the meeting of September 19 was for growth of RPDs in the range of 9.5 to 13.5 percent for the September-October period, "unless disturbances arose in financial markets or unless growth rates in the monetary aggregates appeared to be falling far short of expectations." At the October meeting RPD growth appeared to be at the lower end of the range, and it was noted:

> The Federal funds rate was about 5 per cent in the days before this meeting, unchanged from the level prevailing just before the preceding meeting.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In accordance with their desire for less rapid growth in monetary aggregates than in the third quarter, the Committee specified an RPD range of 6 to 11 percent for the October-November period "while continuing to avoid marked changes in money market conditions."[11]

The directive issued at the November meeting was essentially the same as a month earlier, with the major difference being that the changes in Regulations D and J that had been pending for several months had been implemented on November 9. The RPD range specified for the following two-month period was 6 to 10 percent, and the proviso "to avoid marked changes in money market conditions" was repeated.

At the time of this meeting it appeared that RPD growth would be at only a 5.5 percent rate in the October-November period, compared with the revised target range of 9 to 14 percent specified at the October meeting. Regarding this slower growth, the "Record" states:

> To a considerable extent, the short-fall in RPD's occurred because the relationship between reserves and monetary aggregates that evolved after the implementation of the amendment to the Board's Regulation D differed from the relationship that had been expected.

At the final meeting of the year the outlook was for a continued strong economic expansion through the first half of 1973. The members of the Committee indicated a continued desire to curb further monetary growth as they issued a directive to achieve "slower rates than those that appeared likely to be recorded for *the second half of 1972.*" [emphasis added] The "Record" for this meeting stated that since the prior meeting, operations had been conducted so as to "support more moderate monetary growth than the annual rates of about 8.5 per cent for M_1 and 9.5 per cent for M_2 recorded over the third quarter."

The target range for RPDs had been 6 to 10 percent, but during much of the intermeeting period

> . . . the rate of growth in RPD's had appeared to be substantially above the specified range, and the System had acted to restrain expansion in nonborrowed reserves.

The directive for the December-January period specified a wider range for RPD growth than had been indicated previously. The Committee sought RPD growth in the range of 4 to 11 percent, and the reason given for this wider band was to allow the Committee to take account of

> . . . a staff analysis of prospective reserve-deposit relationships which suggested that the Committee's objectives for the aggregates might be served by fostering growth in RPD's during the December-January period at an annual rate within a range of 7 to 11 per cent. However, in view of the rapid expansion in monetary aggregates since the preceding meeting, the members concluded that reserve-supplying operations that would result in an easing of money market conditions should be avoided unless the annual rate of RPD growth appeared to be dropping below 4 per cent.

And it was decided that in so doing they would continue "to avoid marked changes in money market conditions."

SUMMARY

At year's end the policy consensus was essentially the same as a year earlier, but the direction of emphasis in monetary actions was reversed. The desire to achieve greater growth in monetary aggregates at the December 1971 and January 1972 meetings of the Committee would indicate that relatively greater weight was being given to promoting real economic growth. In contrast, late in 1972 the Committee instructed the Desk to achieve slower growth in the monetary aggregates in view of the economic situation and the rapid rates of growth in money that had occurred.

[11]It was noted at this meeting that the amendments to Regulations D and J, initially scheduled to become effective on September 21, 1972 but postponed as a result of court proceedings, might be implemented during the October-November period. Following the Board's decision on October 24 to implement the amendments as of November 9, 1972, the range of tolerance for the RPD growth rate was modified to 9 to 14 percent in a technical adjustment to take account of the effects of those regulatory actions on the relationship between reserves and the monetary aggregates.

Other FOMC Actions in 1972

During 1972 the Federal Open Market Committee revised its rules with regard to the pricing of "repurchase agreements" (RPs) arranged by the Federal Reserve Bank of New York with nonbank dealers, and the limits on Federal Reserve holdings of the security issues of various Federal agencies.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Pricing of Repurchase Agreements

At a meeting on April 17, 1972 the FOMC amended its "continuing authority directive" with respect to open market operations. The change involved the method of determining the interest rates that would apply in arrangements between the Federal Reserve Bank of New York (the Desk) and nonbank security dealers, in which the Desk acquires short-term securities from the dealers under an advance agreement that the dealers would repurchase the securities in a fixed number of days. The use of these repurchase agreements has increased considerably in recent years.

Such an arrangement is a method available to the Desk for supplying reserves to the banking system; it is used as an alternative to outright purchases on the open market. A repurchase agreement is, in effect, a loan by the Federal Reserve Bank to private security dealers.

Until December 1971, the interest rate charged by the Desk on funds loaned to the dealers under such agreements was "not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower."[1] The dealers would not be willing to enter into such arrangements if the costs of funds in the market were lower than the cost of additional funds available from the New York Reserve Bank. On December 23, 1971, a majority of the Committee voted to suspend this lower limit through January 11, 1972, the date of the subsequent FOMC meeting.

Mr. Treiber voted on this action as alternate for Mr. Hayes; Chairman Burns was absent and not voting.

> Mr. Robertson dissented from this action because he believed that the desired injection of funds into the market by the Federal Reserve should be through the outright purchase of U. S. Government securities rather than through repurchase transactions which, in his judgment, actually constituted low-rate loans to securities dealers. He indicated that he was reluctant to increase the profits of dealers by providing them with low-cost Federal Reserve funds merely to avoid temporarily raising the price (lowering the yield) of Treasury securities by purchasing them outright.

At the meeting on January 11, 1972 the Committee ratified the earlier action to suspend the minimum interest charge on RPs. Mr. Robertson dissented from ratification for the same reason he dissented from the action itself. On two subsequent occasions the Committee suspended the lower limits on interest rates charged on repurchase agreements. The dates were January 26 through February 15, 1972, and March 7 through March 21, 1972. Mr. Robertson dissented on both occasions, emphasizing that "in his judgment, such agreements actually constituted subsidized loans to dealers, and he saw no justification for increasing the subsidy by making them at lower and lower rates of interest."[2] On the latter occasion Chairman Burns and Mr. Maisel were absent and not voting, and Mr. Brimmer joined Mr. Robertson in dissenting from the action

> . . . because he felt that excessive reliance was being placed on RP's in open market operations. He was also disturbed about the frequency with which RP's had been made recently at rates below the lower limit that would obtain in the absence of Committee action to suspend the relevant provision of the continuing authority directive. He thought that since such RP rates were typically below yields on 3-month Treasury bills, their continued use might give the market a misleading impression of the Committee's policy objectives.

On the recommendation of a staff committee appointed to study repurchase agreements, the FOMC amended its continuing authority directive to provide that in the future the interest rate charged on RPs should be determined by competitive bidding unless otherwise expressly authorized by the Committee. Previously there had been a lower limit on the interest rate on RPs, and, although no upper limit had been specified, in practice the rate charged had not been greater than the Federal Reserve discount rate. The staff committee felt a competitive bidding procedure would minimize any unintended announcement effects sometimes associated with changes in the RP rate, and it would insure that the costs to dealers of funds obtained through System repurchase agreements were closely related to the costs of funds from alternative sources.

Lending of Government Securities

At the March 21 meeting the FOMC reviewed all of its continuing authorizations and directives. This is the customary practice following election of new members from the Federal Reserve Banks to serve on the Committee. In connection with the review, special note was made of the authorization of Reserve Banks to lend U.S. Government Securities held in the System Open Market Account.

This authorization had been added on October 7, 1969, with the understanding it would be reviewed periodically. At that time,

> . . . the Manager had advised that the problem of delivery failures in the Government securities market had worsened significantly over the past year, partly because private facilities for lending such securities had become inadequate; that delivery failures were markedly impairing the performance of the market; and that the functioning of the market would be improved if securities held in the System Open Market Account could be lent, for the express purpose of avoiding delivery failures, to Government securities dealers

[1]Federal Reserve *Bulletin* (February 1972), p. 148.

[2]Federal Reserve *Bulletin* (May 1972), p. 462.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

doing business with the Federal Reserve Bank of New York and to banks participating in securities clearing arrangements conducted through a Reserve Bank.

Operations in Federal Agency Issues

On two occasions last year the FOMC revised its guidelines for the conduct of operations in securities issued by Federal agencies. The Committee had first authorized outright purchases and sales in agency issues on August 24, 1971. At its meeting on February 15, 1972, the FOMC revised the guideline regarding maturities of eligible issues so that the maturity of an obligation should be taken as of the time of issuance rather than as of the time of purchase.

The second revision of guidelines on operations in agency issues consisted of an increase in the limit of the holdings of any one issue from 10 percent to 20 percent of the amount outstanding, with the additional provision that System holdings of the issues of any one agency could not exceed 10 percent of the total outstanding issues of that agency. This action was taken at the Committee meeting on April 17, 1972.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis