Authorized for public release by the FOMC Secretariat on 4/17/2020

RECORDS SECTION
MAR 20 1964

To Members of the Federal Open Market Committee and Presidents of the Federal Reserve Banks not presently serving on the Committee

March 18, 1964

From Robert W. Stone

Subject: The Second Paragraph of the Committee's Economic Policy Directive

At the Committee's March 3 meeting, President Wayne asked that I prepare a memorandum for the Committee on the extent to which problems have been introduced in the conduct of open market operations by a conflict between the "money market conditions" and the "bank reserves" clauses of the second paragraph of the Committee's current economic policy directive. For the past year or so, the general form of the second paragraph has been similar to that of the current directive:

> "To implement this policy, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves."

I have not encountered any significant difficulty in conducting open market operations because of conflicts within the directive. I have understood the "money market conditions" clause to encompass a number of indicators of marginal reserve availability and use that are frequently cited by members of the Committee in commenting on policy--for example, the Federal funds rate, a range of average free reserves and of average member bank borrowing, and Treasury bill rates. I have also understood it to be the Committee's view that, given the economic background against which policy has been formulated over the last year or two, achievement of the money market conditions called for in the second paragraph would result in "accommodating a moderate expansion in aggregate bank reserves". In the event, bank reserves have expanded

Authorized for public release by the FOMC Secretariat on 4/17/2020



over the year, even though views may differ as to whether this expansion has been moderate, or more or less than moderate.

While I have not encountered any significant conflict between the money market conditions and bank reserve clauses, it may be useful to discuss what responses might have been available to the Desk had it seemed that such a conflict was emerging. The Desk could, of course, have sought to modify money market conditions, including short rates, free reserves and borrowings, in a way which might be expected to affect the pace, or perhaps even the direction, of change in one of the measures of aggregate reserves--such as total reserves, nonborrowed reserves or required reserves. Such action, however, would produce effects that have hitherto been regarded by the Committee, the market, and indeed nearly all observers as constituting a shift in monetary policy. I have not considered it within the Manager's province to undertake action to bring about such a change in market conditions.

Another possible response available to the Desk in the event of apparent conflict between the two clauses in question is that the Desk might lean a little in the direction indicated by the behavior of aggregate reserve measures within the context of the money market conditions specified by the Committee. While such an approach might be worth trying experimentally, one should probably not expect more than modest results from it at best. As noted below, the aggregate reserve measures often move widely within the interval between Committee meetings, making it extremely difficult to sort out temporary movements from the trend in that brief time span. In addition, even in the absence of wide fluctuations, it is difficult to interpret the significance of sustained departures of aggregate reserve measures from the reference lines or standards calculated by the staff of the Board of Governors. To keep the Committee informed of the week-by-week performance of the aggregate reserve

XERO COPY XERO COPY XERO COPY

Authorized for public release by the FOMC Secretariat on 4/17/2020



measures, we have included a paragraph in our regular weekly reports since January 1962 on reserve behavior in relation to these reference lines or standards.

The Desk has found the Board staff's aggregate reserve data continuously useful in providing greater insight into the rate at which reserves have been demanded and utilized under given money market conditions in the recent past. The Board staff has done excellent work in this area. There are, however, as the staff itself is fully aware, some difficult problems involved in using the data. In following closely the day-to-day and week-to-week performance of aggregate reserve measures, for example, we have at times noted that against the background of the broad trend in reserves there has occurred what turned out to be temporary shifts between Government and private deposits--shifts that led to large deviations, also temporary, between reserves required against private deposits and the reference line. There is also the problem that shifts in the relative growth rates of time and demand deposits can lead to a greater or smaller volume of reserves being required to support a given rate of bank credit expansion. Beyond these important conceptual problems, there are the more mundane ones arising from the usual difficulties of seasonally adjusting data that are subject to as many special influences and random movements as bank reserve data. All these factors, of course, limit the usefulness of the data as a basis for significant action within such short periods as the three-week intervals between meetings. To put the matter another way, the short-run behavior (i.e., within a three-week period) of aggregate reserve measures would be a rather fragile basis for action by the Desk to effect counteracting changes in the array of market indicators that are generally

XERO COPY XERO COPY XERO COPY

Authorized for public release by the FOMC Secretariat on 4/17/2020



regarded as the proximate objectives of policy. (I might add here that the difficulties involved in the short-run use of aggregate reserve data militate against resort by the Desk to another possible response to apparent conflict between the two clauses in question--requesting a special FOMC meeting and new instructions.)

XERO COPY XERO COPY XERO COPY