

Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,¹ and then making the scanned versions text-searchable.² Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

¹ In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

² A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

CONFIDENTIAL (FR)

ALTERNATIVE OPERATING PARAGRAPHS
FOR THE DIRECTIVE,
AND BACKGROUND INFORMATION

January 7, 1972

Recent developments

(1) Since the last meeting of the Committee money market conditions have been eased substantially as growth in M_1 continued to fall below desired rates, as shown in the attached Table 1. Meanwhile growth of M_2 and the bank credit proxy was somewhat more rapid than anticipated as banks obtained more time and savings and U.S. Government deposits than expected.

(2) In the two weeks immediately after the mid-December meeting, given preliminary evidence of weakness in M_1 , reserves were provided through open market operations to reduce the funds rate to around 3-7/8--4 per cent from the 4-1/4--4-5/8 per cent range of the previous two weeks. In recent days open market operations have become more aggressive, and the System Account Manager has been aiming at a Federal funds rate around 3-5/8 per cent, the minimum level discussed by the Committee at its last meeting. Since mid-December, the 3-month Treasury bill rate has dropped about 70 basis points, most recently trading around 3.35 per cent; and other short-term rates, as well as bank prime rates, have also been reduced. With the general lowering of the short-term rate structure, System repurchase agreements have been made at 3-5/8 and 3-3/4 per cent, following suspension on December 23 of previous operating rules constraining the rate on these instruments.

(3) Over the three weeks ending January 5 nonborrowed reserves of member banks (not seasonally adjusted) rose \$1.7 billion, as shown in the last column of the table below, reflecting about \$2 billion of System reserve supplying operations. About half of the provision of nonborrowed reserves represented normal seasonal needs. In addition, more reserves

than earlier anticipated were absorbed by U.S. Government deposits, interbank deposits, and large CD's. Thus, despite a December seasonally adjusted increase in total reserves of 6 per cent--only slightly below expectations at the time of the last Committee meeting--achievement of the Committee's M_1 target would have required a still greater provision of reserves.

Member Bank Reserves
(Not seasonally adjusted, in million of dollars)

	Averages for weeks of Dec. 22, 29 and January 5 combined			Actual Cumulative changes for 3 weeks ending January 5
	Actuals	Bluebook targets ^{1/}	Difference: actual less target	
<u>Reserves supplied:</u>				
Nonborrowed reserves	31,866	31,900	-34	1,706
Borrowing	139	50	89	30
Total reserves	32,005	31,950	55	1,736
<u>Reserves absorbed by:</u>				
Excess reserves	260	275	-15	219
Required--related to deposits 2 weeks earlier	<u>31,745</u>	<u>31,675</u>	<u>70</u>	<u>1,517</u>
U. S. Gov't deposits	761	694	68	707
Interbank deposits	1,283	1,275	8	71
Large CD's	1,350	1,329	20	-2
M_2 - type deposits	28,351	28,377	-26	741
M_1 - type deposits	21,368	21,412	-51	641

^{1/} December 10, Bluebook estimates that were considered to be consistent with 5 per cent M_1 growth rate in December.

(4) The following table shows changes in major financial aggregates for selected recent periods.

	4th Qtr. '70 1st Qtr. '71 (March over Sept.)	2nd & 3rd Qtrs. '71 combined (Sept. over March)	Fourth Quarter (Dec. over Sept.)
Total Reserves	8.9	8.6	-0.8
Nonborrowed Reserves	10.3	8.1	3.1
<u>Concepts of Money</u>			
M ₁ (Currency plus demand deposits <u>1/</u>)	6.5	7.2	1.1
M ₂ (M ₁ plus time deposits at commercial banks other than large CD's)	13.6	8.5	7.9
M ₃ (M ₂ plus deposits at thrift institutions)	14.5	11.2	9.5
<u>Bank Credit</u>			
Total member bank deposits (Bank credit proxy adj.)	9.4	8.1	9.5
Loans and investments of Commercial banks <u>2/</u>	10.7	10.2	8.7
Short-term market paper (Actual \$ change in billions)			
Large CD's	\$ 6.8	\$ 3.6	\$ 2.3
Nonbank commercial paper	- 0.4	- 1.0	n.a.

1/ Other than interbank and U.S. Government.

2/ Based on month-end figures. Includes loans sold to affiliates and branches.

N.A. - Not available.

NOTE: All items are based on averages of daily figures, except for data on total loans and investments of commercial banks, commercial paper, and thrift institutions--which are either end-of-month or last Wednesday of month figures.

Proposed directives

(5) Possible targets for the aggregates are shown in the table on the following page. These targets include a 6 per cent annual rate of growth for M_1 in both January and February (target I) and an 8 per cent rate in both months (target II). The first of these, if realized, would produce M_1 growth for the three-month interval December-February of about 5 per cent, and the second would raise the average rate for that period to about 6 per cent. It has to be recognized that month-to-month M_1 figures are variable and not subject to tight control, so that fluctuations around an average rate of growth are a reasonable expectation.

(6) Presented below for Committee consideration are two alternatives for the second paragraph of the directive which differ with respect to the kinds of operating procedures they imply but not necessarily with respect to the monetary aggregate targets (whether I or II) the Committee may wish to adopt. As noted below, the language of alternative A is quite similar to that adopted by the Committee on December 14. Alternative B, on the other hand, places primary stress on bank reserves as the operating target variable, with a money market conditions constraint in a proviso clause. The choice of operating procedure depends in part on the Committee's relative confidence in reserves or money market conditions as bearing a more dependable relationship to bank deposit behavior.

(7) The language proposed for alternative A is as follows:

"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; -while-taking-account-of-international-developments."

Possible Targets For Monetary Aggregates

		<u>M₁</u>		<u>M₂</u>	
		<u>I</u>	<u>II</u>	<u>I</u>	<u>II</u>
1971	December	228.2	228.2	464.6	464.4
1972	January	229.3	229.7	468.3	468.8
	February	230.4	231.2	470.8	472.1

Per Cent Annual Rates of Growth

1971	December	2.6	2.6	9.9	9.9
1972	January	6.0	8.0	9.5	11.0
	February	6.0	8.0	6.5	8.5

Credit Proxy

Total Reserves

		<u>I</u>	<u>II</u>	<u>I</u>	<u>II</u>
1971	December	361.7	361.7	32.0	32.0
1972	January	363.8	364.2	32.7	32.7
	February	361.1	362.4	32.3	32.3

Per Cent Annual Rates of Growth

1971	December	12.4	12.4	6.0	6.0
1972	January	7.0	8.5	26.5	27.0
	February	-9.0	-6.0	-13.0	-11.5

This language differs from that adopted at the last meeting (as amended on December 20) by omitting references to the "months ahead" and to international developments, and it would be associated with different money market specifications. Omission of the reference to "months ahead" is suggested if the Committee wishes to emphasize prompt attainment of a desired rate of growth for M_1 the aggregate hitherto lagging. The reference to international developments is omitted because reflows of funds from abroad have not been showing signs of becoming a disturbing influence on monetary policy. To the extent that pressures from this source do in fact develop, it is thought that past Committee discussion gives the Manager sufficient flexibility to cope with them.

(8) If the Committee were to adopt the language of alternative A, it may wish to consider instructing the Manager to ease the Federal funds rate from the prevailing 3-5/8 per cent to the neighborhood of 3-1/4 per cent in the first week following the meeting and to the neighborhood of 3 per cent in the second week, unless a sudden surge of M_1 growth were to appear. The purpose of such an instruction would be to stimulate more growth in M_1 than has been apparent in the data thus far available. If such an approach were successful in moving M_1 onto the path specified by the Committee as desired, the staff believes that the odds are that the funds rate would need to be raised in the ensuing weeks in order to keep growth in M_1 around the target rate, particularly if a 6 per cent target path for M_1 is adopted but also perhaps under an 8 per cent target.

(9) The proposed language for alternative B follows:

~~"To implement this policy, the Committee seeks to promote the degree of ease in bank reserve and money market conditions essential to~~ SYSTEM OPEN MARKET OPERATIONS UNTIL THE NEXT MEETING OF THE COMMITTEE SHALL BE CONDUCTED WITH A VIEW TO SUPPLYING THE BANK RESERVES NEEDED TO SUPPORT greater growth in monetary aggregates; ~~over the months ahead, while taking account of international developments~~ PROVIDED THAT MONEY MARKET CONDITIONS DO NOT FLUCTUATE OVER AN UNDULY WIDE RANGE."

If the Committee were to take this course in its operating instructions, the Manager would be guided initially in his reserve supplying operations by a target path for reserves thought to be consistent with whatever aggregate targets the Committee adopts. The estimates for total reserves, seasonally adjusted and rounded, consistent with the proposed targets I and II are shown in the table; and detailed weekly and monthly seasonally unadjusted figures have been prepared for use if this alternative procedure is adopted.

(10) Operating on an aggregate reserve target would represent a departure from past Committee practice. With primary emphasis on a reserve target, the Manager would be guided in the amount of reserves he supplies during a week by the difference between the reserve target and the sum of other factors affecting reserves, and not primarily by the behavior of the Federal funds rate. The reserve target would, however,

have to be adjusted week by week to take account of changes in the deposit mix--such as unexpected developments with respect to Treasury deposits, interbank deposits, and perhaps CD's--and also shifts in the demand for excess reserves. Such adjustments would tend to reduce the potential for day-to-day money market fluctuations, but money market conditions would still likely be more volatile than under present procedures. Since it will take time for the market and banks to adjust to the new procedures, with transitional uncertainties reflected in, for example, greater bank demand for excess reserves, reserve targets for the period immediately ahead would have to be flexible enough to allow for a potential enlargement of excess reserves.

(11) Since effects on money market conditions would be a secondary consideration in the Manager's operations under alternative B, the Committee need not prejudge the direction of the funds rate, as would be the case under alternative A. Depending on developments affecting the demand for money, the funds rate under this procedure might rise or fall from currently prevailing levels, and the rate movements could be substantial. Therefore, the Committee might wish to place a lower and upper limit on the funds rate, perhaps 2 and 5 per cent. These limits could apply to the weekly average, with somewhat more intra-weekly volatility permitted. In the period ahead--given past shortfalls in M_1 and the announcement by the Treasury in late January of its mid-February refunding --the Committee might wish to instruct the Manager within the context of this directive to err on the side of ease, that is, to show greater resistance to interest rate increases than to declines.

Table 1
PATHS OF KEY MONETARY AGGREGATES

STRICTLY CONFIDENTIAL (

January 7, 1972

Period	Narrow Money Supply (M ₁) 1/		Broad Money Supply (M ₂) 2/		Adjusted Credit Proxy		Total Reserves	
	1 Path as of Dec. 14	2 Actuals & Current Proj.	3 Path as of Dec. 14	4 Actuals & Current Proj.	5 Path as of Dec. 14	6 Actuals & Current Proj.	7 Path as of Dec. 14	8 Actuals & Current Proj.
Monthly Pattern in Billions of Dollars								
1971: Sept.		227.6		455.6		353.3		32.1
Oct.		227.7		458.3		354.7		31.6
Nov.		227.7		460.8		358.0		31.8
Dec.	228.8	228.2	464.3	464.6	360.9	361.7	32.0	32.0
1972: Jan.	229.8	(229.3)	467.6	(468.4)	363.0	(364.0)	32.6	(32.7)
Annual Percentage Rates of Change--Quarterly and Monthly								
1971: 1st Qtr.		9.1		18.1		10.9		11.0
2nd Qtr.		10.6		12.4		8.4		6.6
3rd Qtr.		3.7		4.4		7.6		10.4
4th Qtr.	2.0	1.1	7.5	7.9	8.5	9.5	0.5	-0.8
1971: Sept.		-2.1		2.9		7.9		15.8
Oct.		0.5		7.1		4.8		-15.9
Nov.		--		6.5		11.2		7.7
Dec.	5.0	2.6	8.5	9.9	9.0	12.4	6.5	6.0
1972: Jan.	5.0	(6.0)	8.5	(10.0)	7.0	(7.5)	20.5	(26.0)
Weekly Pattern in Billions of Dollars								
1971: Nov. 17		227.4		460.5		358.3		32.1
24		227.6		461.7		358.7		31.1
Dec. 1		227.6		462.1		359.6		32.2
8		228.6		463.3		360.4		31.8
15	228.4	227.6	463.4	463.6	360.8	360.6	31.9	31.9
22	228.6	227.7	464.1	464.2	361.5	362.1	32.1	31.8
29	229.7	228.7	466.0	467.0	360.8	363.0	32.1	32.2
1972: Jan. 5 pe	228.5	228.4	465.8	466.4	361.4	362.9	32.4	32.8
12	229.1	(228.7)	466.7	(467.6)	363.7	(364.6)	32.0	(32.3)

NOTES: Annual rates of change other than those for the past are rounded to the nearest half per cent. pe - Partially estimated.
Data shown in parentheses are current projections.
1/ Currency plus primary demand deposits.
2/ M₂ plus time deposits other than large CDs.

FR 716
Rev 2/10/

Table 1-A
PATHS OF KEY MONETARY AGGREGATES

STRICTLY CONFIDENTIAL (F)

January 7, 1972

Period	U.S. Gov't. Deposits		Total Time & Savings Deposits		Time Deposits other than large CD's		Large Negotiable CD's		Nondeposit Sources of Funds	
	1 Path as of Dec. 14	2 Actuals & Current Proj.	3 Path as of Dec. 14	4 Actuals & Current Proj.	5 Path as of Dec. 14	6 Actuals & Current Proj.	7 Path as of Dec. 14	8 Actuals & Current Proj.	9 Path as of Dec. 14	10 Actuals & Current Proj.
Monthly Pattern in Billions of Dollars										
1971: Sept.		6.6		259.6		228.0		31.6		4.1
Oct.		4.7		263.3		230.6		32.7		4.8
Nov.		5.4		265.3		233.1		32.2		5.4
Dec.	5.4	5.8	268.4	269.9	235.5	236.4	32.9	33.5	4.7	4.0
1972: Jan.	5.8	(6.0)	271.1	(273.5)	237.9	(239.1)	33.2	(34.4)	4.7	(3)
Annual Percentage Rates of Change--Quarterly and Monthly										
1971: 1st Qtr.				28.8		27.5				
2nd Qtr.				14.7		14.0				
3rd Qtr.				8.2		5.3				
4th Qtr.			13.5	15.9	13.0	14.7				
1971: Sept.				10.7		7.9				
Oct.				17.1		13.7				
Nov.				9.1		13.0				
Dec.			13.5	20.8	12.0	17.0				
1972: Jan.			12.0	(16.0)	12.0	(13.5)				
Weekly Pattern in Billions of Dollars										
1971: Nov. 17		5.5		265.2		233.1		32.1		5.
24		5.0		266.3		234.0		32.3		5.7
Dec. 1		5.1		267.1		234.5		32.6		5.4
8		5.7		267.9		234.7		33.2		4.7
15	5.5	5.3	267.9	269.1	235.0	236.1	32.9	33.0	4.7	3.8
22	5.9	6.4	268.5	270.1	235.5	236.4	33.0	33.6	4.7	3.9
29	4.5	5.7	269.3	272.3	236.3	238.2	33.0	34.0	4.7	3.8
1972: Jan. 5 pe	7.4	7.3	270.4	272.1	237.3	238.0	33.1	34.1	4.7	3.5
12	6.7	(7.1)	270.7	(273.1)	237.6	(238.9)	33.1	(34.2)	4.7	(3.5)

NOTES: pe - Partially estimated.
Annual rates of change other than those for the past are rounded to the nearest half per cent.
Data shown in parentheses are current projections.

FR 712-K
Rev 2/16/71

Table 2
AGGREGATE RESERVES AND MONETARY VARIABLES
 RETROSPECTIVE CHANGES, SEASONALLY ADJUSTED
 (Annual rates in per cent)

CONFIDENTIAL (FR
 January 7, 1972

Period	Reserve Aggregates ¹		Monetary Variables					Addenda		
	1 Total Reserves	2 Nonborrowed Reserves	3 Total Member Bank Deposits	4 Adjusted Credit Proxy	Money Supply			8 Time Deposits Adjusted	9 Thrift Instit. Deposits	10 Nonbank Commercial Paper
					5 Total	6 Currency	7 Private Demand Deposits			
Annually										
1968	+ 7.8	+ 6.0	+ 8.9	+ 9.7	+ 7.8	+ 7.4	+ 7.9	+11.3	+ 6.3	n.a.
1969	- 1.6	- 3.0	- 4.0	+ 0.4	+ 3.2	+ 6.0	+ 2.4	- 4.9	+ 3.4	n.a.
1970	+ 6.4	+ 9.5	+11.8	+ 8.3	+ 5.4	+ 6.5	+ 5.1	+17.9	+ 7.8	+ 7.3
Semi-annually										
1st Half 1970	- 0.2	+ 1.9	+ 4.7	+ 4.8	+ 5.6	+ 7.4	+ 5.1	+ 8.4	+ 4.7	+12.8
2nd Half 1970	+13.0	+17.1	+18.4	+11.4	+ 5.2	+ 5.5	+ 5.1	+26.3	+10.6	+ 1.7
1st Half 1971	+ 8.9	+ 8.2	+14.6	+ 9.7	+10.0	+ 8.6	+10.5	+22.3	+20.9	-18.2
Quarterly										
3rd Qtr. 1970	+19.1	+24.4	+21.5	+14.7	+ 6.5	+ 5.0	+ 6.9	+30.4	+ 9.3	-16.2
4th Qtr. 1970	+ 6.6	+ 9.4	+14.6	+ 7.8	+ 3.8	+ 5.8	+ 3.2	+20.6	+11.6	+20.4
1st Qtr. 1971	+11.0	+11.0	+16.9	+10.9	+ 9.1	+ 8.2	+ 9.4	+28.8	+23.3	-24.7
2nd Qtr. 1971	+ 6.6	+ 5.3	+11.8	+ 8.4	+10.6	+ 8.8	+11.3	+14.7	+17.4	-12.5
3rd Qtr. 1971	+10.4	+10.8	+ 8.1	+ 7.6	+ 3.7	+ 6.3	+ 2.8	+ 8.2	+12.8	- 1.0
1970--Oct.	- 1.9	--	+10.9	+ 1.8	+ 1.7	+ 5.0	+ 0.7	+20.9	+10.6	+32.4
Nov.	+ 3.6	+ 4.4	+12.4	+ 6.3	+ 2.8	+ 4.9	+ 2.2	+14.6	+ 9.4	-28.7
Dec.	+18.4	+22.8	+19.9	+15.1	+ 6.7	+ 7.4	+ 6.5	+25.2	+14.5	+58.1
1971--Jan.	+12.2	+ 8.8	+16.2	+10.2	+ 2.8	+ 7.3	+ 1.4	+28.8	+25.1	- 9.0
Feb.	+11.4	+15.1	+17.8	+11.9	+13.4	+ 9.7	+14.5	+29.7	+18.5	-10.9
Mar.	+ 9.2	+ 8.8	+16.1	+10.3	+11.0	+ 7.2	+12.1	+26.0	+24.9	-55.2
Apr.	+ 2.7	+ 9.7	+15.9	+ 8.5	+ 8.2	+12.0	+ 7.1	+13.2	+21.8	+ 4.4
May	+17.0	+12.4	+12.5	+ 8.8	+14.1	+ 7.1	+16.2	+15.5	+14.2	-15.8
June	+ 0.2	- 6.2	+ 6.7	+ 7.7	+ 9.1	+ 7.1	+10.4	+14.8	+15.4	-26.3
July	+ 0.3	-13.1	+11.2	+10.7	+10.1	+11.7	+ 8.9	+ 9.4	+15.9	-32.1
Aug.	+14.7	+16.1	+ 5.6	+ 4.1	+ 3.2	+ 2.3	+ 3.4	+ 4.2	+ 8.5	- 1.7
Sept.	+15.8	+29.6	+ 7.3	+ 7.9	- 2.1	+ 4.6	- 4.1	+10.7	+13.8	+31.6
Oct.	-15.9	-13.0	+ 2.1	+ 4.8	+ 0.5	+ 6.9	- 1.4	+17.1	+11.8	+30.1
Nov.	+ 7.7	+ 5.6	+ 9.9	+11.2	--	--	--	+ 9.1	+10.0	-38.6

NOTE: Aggregate reserve series have been adjusted to eliminate changes in percentage reserve requirements against deposits, but reserve requirements for FR 712-E on Eurodollar borrowings are included beginning October 16, 1969, and requirements on bank-related commercial paper are included beginning October 1, 1970.