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December 18, 1981

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# MONETARY POLICY ALTERNATIVES

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Prepared for the Federal Open Market Committee

By the staff Board of Governors of the Federal Reserve System

December 18, 1981

MONETARY POLICY ALTERNATIVES

Recent developments

(1) M1-B growth, adjusted for shifts into NOW accounts, rose to an 8½ percent annual rate in November, and continued rapid in early December. The strength in M1-B reflected a marked pickup in other checkable deposits, while demand deposits also rose a little (in contrast to marked declines over the first three quarters of the year). The exceptional strength in OCDs growth may be associated with the public's desire to accumulate passbook savings type assets in light of uncertainty about the near-term course of economic activity and interest rates. Growth in M1-B over the October to December period probably will be at about a 7½ percent annual rate (assuming an appreciable decline in the level of M1-B over the last half of December). Despite the recent pickup, QIV '80 to QIV '81 growth in adjusted M1-B will be only about 2 percent, well below the Committee's 3½ to 6 percent longer-run range. (Recent monetary and reserves data are shown in the table on the next page.)

(2) M2 expansion surged to a 16½ percent annual rate in November, and is estimated at a 14½ percent annual rate over the two-month October to December period--considerably more than expected at the time of the last meeting. M2 growth was buoyed by continued brisk inflows to money market funds and by a turnaround in savings deposit flows to a modest increase following a steady decline for more than a year. For the QIV '80 to QIV '81 period, M2 is expected to grow at a 9½ percent rate, above the Committee's 6 to 9 percent longer-run range. Reflecting the strength in M2, M3 growth

Key Monetary Policy Aggregates  
(Seasonally adjusted annual rates of growth)

	Oct.	Nov.	Dec. <sup>1/</sup>	Dec. '81 over Oct. '81	Dec. '81 over Sept. '81	QIV '81 over QIV '80 <sup>1/</sup>
<b>Money and Credit Aggregates</b>						
M1-B (shift adjusted)	3.1	8.8	6.8	7.8	6.3	1.9
M2	8.1	16.5	12.6	14.6	12.5	9.5
M2 plus retail RPs <sup>2/</sup>	7.9	16.0	12.8	14.5	12.4	10.2
M3	5.7	12.3	12.2	12.3	10.1	11.2
Bank Credit	8.5	3.2	n.a.	n.a.	n.a.	n.a.
<b>Reserve Measures<sup>3/</sup></b>						
Nonborrowed Reserves <sup>4/</sup>	1.9	7.5	14.1	10.9	7.9	7.0
Total Reserves	-10.3	0.1	11.7	5.9	0.5	4.4
Monetary Base	-0.6	5.8	9.0	7.4	4.8	4.8
<b>Memo: (Millions of dollars)</b>						
Adjustment Borrowing	743	498	424	--	--	--
Excess Reserves	189	265	165	--	--	--

<sup>1/</sup> December 1981 estimated on the basis of partial data.

<sup>2/</sup> Retail RPs have been estimated based on an August 31, 1981, universe survey and subsequent partial FRB and FHLBB samples.

<sup>3/</sup> Growth rates for reserve measures are adjusted to remove the effects of discontinuities resulting from phased changes in reserve ratios under the Monetary Control Act. In addition, reserve data for QIV '80 have been adjusted to remove the distorting effects of the reduction in weekend reserve avoidance activities that occurred in late 1980.

<sup>4/</sup> Nonborrowed reserves include special borrowing and other extended credit from the Federal Reserve.

MEMO: FOMC long-run targets (Percent increase)	QIV '81 over QIV '80
M1-B (shift adjusted)	3½ to 6
M2	6 to 9
M3	6½ to 9½
Bank Credit	6 to 9

also has accelerated recently, and remains well above the upper end of the Committee's longer-run range.

(3) Bank credit expansion slowed in November to a 3 percent annual rate, due mainly to a continued reduction in holdings of U.S. government securities and a further moderation in the growth of business loans. The weak loan growth, coupled with stronger inflows to core deposits, allowed commercial banks to run off large time deposits for the second consecutive month in November. S&Ls, however, continued to issue such deposits at the appreciable pace of other recent months, with the premium over offering rates of commercial banks reduced from the unusually high spread of last summer.

(4) Total reserves are expected to grow at a 6 percent annual rate over the last two months of the ~~year~~, reflecting the increase in required reserves associated with the strength in the aggregates. Non-borrowed reserves are likely to expand at about an 11 percent rate over this interval as adjustment borrowing in December will be down from its October level. In the first two weeks of the intermeeting period, adjustment borrowing averaged only about \$200 million. As M1 and M2 strengthened, the increase in required reserves was accompanied by a rise in adjustment borrowings. During the past two statement weeks, borrowing averaged \$380 million; this was less than the \$450-500 million implied by the reserve path, as banks economized on excess reserves.<sup>1/</sup> The reduced level of borrowing early in the period, and the one percentage point decline in the discount rate to 12 percent on December 3, contributed to a further easing

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<sup>1/</sup> Reserve paths and adjustments made since the last Committee meeting are shown in appendix.

in the federal funds rate to the 11½ to 12 percent area in early December from 13 to 13½ percent at the time of the November meeting. Most recently federal funds have been trading in a 12 to 12½ percent range.

(5) Both short- and long-term interest rates continued to decline early in the intermeeting period, responding to the further easing in money market conditions and the weakness of economic activity. Rates subsequently backed up, however, owing to strength in the monetary aggregates, reports of Administration estimates of a greatly enlarged budget deficit, and a rise in the funds rate to levels above the discount rate. At present, market rates are generally above levels prevailing at the time of the previous Committee meeting, but the prime loan rate is down one percentage point and primary mortgage rates have dropped about ½ of a point.

(6) After declining through late November, the dollar rebounded with the recent rise in U.S. short-term interest rates to post a small net advance on a weighted average basis since the last Committee meeting. Political developments abroad and more favorable inflation expectations for the United States also contributed to the strength of the dollar.

Background for preliminary consideration of target ranges for 1982

(7) The growth ranges for the aggregates in 1982 tentatively set by the FOMC in July are 2-1/2 to 5-1/2 percent for M1, 6 to 9 percent for M2, 6-1/2 to 9-1/2 percent for M3, and 6 to 9 percent for bank credit. With the exception of M1, these are the same ranges that were set for 1981. The M1 range is a reduction from the 1981 range of 3-1/2 to 6 percent for M1-B, shift adjusted.<sup>1/</sup>

(8) As statistical background for consideration of the annual targets for 1982, the table on the next page shows actual growth of money supply measures for the years 1977 through 1981. Annual growth in M1-B measured from QIV to QIV decelerated gradually over the last few years, followed by a sharper drop-off in 1981, particularly on a shift-adjusted basis. But whether the marked deceleration in shift-adjusted M1-B this year accurately measures the degree of greater restraint depends in part on whether there was a downward shift in money demand (relative to nominal income and interest rates). In the degree that there was such a shift, slower growth

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<sup>1/</sup> The nomenclature "M1" represents the same measure as M1-B. It is assumed that, consistent with earlier FOMC discussion, the distinction between M1-A and M1-B will be dropped and that M1-A will not be published (though its components will be). Moreover, it has also been assumed that the FOMC will not wish to continue with the "shift-adjusted" concept. It has been a year since NOW accounts were introduced nationwide and the great bulk of the conversion of outstanding savings and other interest-bearing deposits into newly established NOW accounts has apparently already taken place. It is likely that the public learned about nationwide NOW accounts more rapidly than they did when these accounts were first introduced in New England, when significant conversions of accounts continued over several years. This is supported by reports from a sampling of banks in mid-November that suggest the stock adjustment is about over. In addition, growth in the number of NOW accounts has tailed off considerably since summer. Nonetheless, it should be recognized that further structural shifts of funds into NOW accounts might develop, and need to be adjusted for, should, say, regulatory changes by DIDC change the nature of the account.

Annual Growth in Monetary Aggregates

1977 - 1981

[(1) = measured QIV over QIV; (2) = measured year over year]

		<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
M1-B	(1)	8.2	8.2	7.5	7.3 (6.7) <sup>1/</sup>	4.7 (1.9)
	(2)	7.7	8.2	7.8	6.3 (6.0)	6.9 (4.5)
M2	(1)	11.5	8.3	8.9	9.6	9.5
	(2)	13.0	8.9	8.9	8.9	9.7
M3	(1)	12.6	11.2	9.8	10.2	11.2
	(2)	12.3	11.7	10.4	9.5	11.6

<sup>1/</sup> Figures in parentheses are shift-adjusted.

would not indicate more restraint but would represent an accommodation to the shift in public preference away from narrow money assets to other assets. It is difficult to judge the extent of such shifts in practice. Econometric results, supported by more direct evidence of changing cash management practices, suggest a fairly substantial downward shift in desired M1 balances this year. This would indicate that the "effective" deceleration in money could be considerably less than measured.

(9) With regard to the broader aggregates, there has been no measured deceleration over recent years.<sup>1/</sup> And this year, their growth has been above the upper limits of the ranges set for them, markedly so in the case of M3. However, the broader aggregates, like M1, have also been subject to demand shifts. If, for instance, allowance were made for shifts from market assets to money market funds, the growth in the broader Ms would

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<sup>1/</sup> Growth rates were higher in 1977 than over the 1978-81 period, but growth in the earlier year was still being influenced by the low level of market rates relative to deposit ceiling rates.



be reduced, particularly in the past two years.<sup>1/</sup> In addition, broader Ms have been subject to other structural changes this year, such as the further deregulation of time deposit accounts by removing the cap on the SSC ceiling rate effective at the beginning of August, a more active use of retail RPs by depository institutions, and the introduction of ASCs at the beginning of October.

(10) Among the considerations entering into the Committee's decision about ranges for the aggregates in 1982 would be the need to continue to show determination to slow money growth over time. In that context, the Committee's intention to continue a policy of gradually reducing growth over time would be signalled by a lower target range for 1982 than for 1981, even if actual growth in M1 next year were to be more rapid than the relatively low rate of this year (on a QIV to QIV basis). Following past Committee practice, the range for M1 next year would take off from its level in the fourth quarter of 1981, which is given by the actual level of M1-B, not shift adjusted.<sup>2/</sup> Another approach would be to take off from the targeted level for 1981 (say, either the bottom or the midpoint of the

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<sup>1/</sup> Estimates based on responses from Michigan surveys and on assumptions about institutional behavior in the absence of money market funds suggest that M2 growth could be reduced by a percentage point or so in the past two years, more in 1981 and less in 1980.

<sup>2/</sup> The series does not link onto shift-adjusted M1-B because the latter series excludes that portion of NOW accounts which represents funds that would, in the absence of nationwide NOW accounts have been in other interest-bearing assets in 1981. Those accounts, totaling about \$12 billion in the fourth quarter of 1981, are of course included in M1.

1981 range).<sup>1/</sup> However, to the extent that there was in fact a downward shift in money demand in 1981, such an approach would lead to a higher level of money in 1982 than was warranted by the Committee's basic policy intentions.

(11) From another viewpoint, though, a higher range for M1 (taking off from the actual QIV '81 level) or perhaps a further widening by raising the upper end, might be considered on the grounds that it may be needed to encourage satisfactory economic recovery, especially if the view is also taken that there may be no, or only a minor, downward shift in money demand relative to income and interest rates next year. An increase in the upper end of the range might also be considered to allow for the possibility that either significantly lower market interest rates (a possibility, for example, if inflation improves more than anticipated) or actions by DIDC to make NOW accounts significantly more attractive would occasion a surge in such deposits and substantial upward pressures on M1. The offsetting risk to such an approach, however, is the possibility that

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<sup>1/</sup> The relevant range for this purpose would be the 6 to 8-1/2 percent growth in measured M1-B that was indicated by the Committee in early 1981 to be consistent with the basic shift-adjusted target of 3-1/2 to 6 percent. The 2-1/2 point difference between the two reflects the estimate made then of shifts into NOW accounts from interest-bearing assets. In the event it appears that such an estimate was approximately correct. The shift appears to have been equivalent to about a 2-3/4 percent differential. The increase in NOW accounts outside the Northeast (net of transfers from ATS accounts) in 1981 (QIV '80 to QIV '81) was about \$45 billion, with the fraction coming from interest-bearing assets estimated at just over 1/4 for the year on the basis of reports from depository institutions. At mid-year, the staff had estimated an increase of \$50 billion, with about the same fractional shift from interest-bearing assets. Thus, the behavior of NOW accounts on balance has been about as expected. M1-B growth was weaker than targeted--whether shift-adjusted or not--because of shortfalls in currency and demand deposits that presumably at least in part reflected a downward shift in money demand.

public would construe an increase in the tentative range as reflecting a diminution in the Federal Reserve's determination to curb money growth, given the need to finance large budgetary deficits.

(12) Reductions, rather than increases, in the tentative M1 range, or at least in the lower end of it, might be considered if a continued sizable downward shift in money demand (given income and interest rates) is anticipated next year. The staff's GNP projection, based on 4 percent M1 growth, assumes a shift on the order of 2-1/2 percentage points on the basis of our conventional quarterly money demand equation. The low end of the tentative range provides scope for a larger shift. If market interest rates remain high next year--and we are projecting that rates will, on average, exceed current levels--there will be continued incentive for financial innovations, such as the proposed sweeps of NOW and demand deposit accounts into money market funds, that may work to reduce M1 balances considerably.

(13) Attainment of the tentative 1982 ranges for the broader Ms would represent a deceleration in their measured growth. From that viewpoint, there may be little need to consider a further lowering of those ranges at this time. While some little lowering might not be inconsistent with a view that price increases will be lower in 1982 and that real income growth will be weak (particularly if one held the view that such a combination would lead to weaker nominal income growth than the 8-1/2 percent projected by the staff), the credibility of a reduced range might be in doubt given this year's results. Moreover, with more deregulation possibly in prospect for next year, a case might also be made for adjusting the ranges upward, at least for M2, to accommodate a more favorable competitive position for depository institutions relative to market instruments. A

more particular question may also be raised about the interpretation for purposes of monetary policy of a possible increase in M2 from a liberalization of tax and deposit ceiling rate regulations on IRAs; indeed, whether these accounts should be included in M2 is uncertain given their role as a vehicle for long-term savings. The staff currently projects in 1982 M2 would grow by 8-1/2 percent, and M3 just a shade faster, given M1 growth of 4 percent (the midpoint of the tentative 2-1/2 to 5-1/2 percent range) and our nominal GNP projection.

(14) Uncertainties about the impact of ongoing changes in financial technology on the public's holdings of deposits and closely related assets argue for retaining long-run target ranges for money as wide as 3 percentage points. Indeed, given the particular uncertainties about M1 at this juncture in the development of financial services and markets, one might even argue that its range should be somewhat wider. In addition to the issues noted in paragraphs (11) and (12), the interpretation of M1, and its proper setting as a target, could be affected by its changing composition. With relatively more of the aggregate held by consumers in NOW accounts, which behave in part like savings accounts, the sensitivity of M1 demand to both interest rates and income--and in turn the impact of M1 supply on income--could be affected. However, we estimate that no more than roughly 5 percent of M1 represents NOW accounts that have been shifted from saving balances.

Near-term Targets

(15) The upper panel of the table below presents three alternative specifications for the monetary aggregates during the first quarter of 1982. Growth rates are measured from a QIV '81 average base--in part because of the very preliminary nature of the December estimates of the aggregates--with the alternatives designed to achieve growth of M1 by March consistent with the upper, middle, and lower ends, respectively, of the FOMC's tentative long-run range for that aggregate in 1982. Implied growth rates over the three month December-to-March period, based on the staff's current December estimates, are shown in the second panel. Possible ranges for the inter-meeting federal funds rate are indicated in the last line of the table. (More detailed and longer-run data for the monetary aggregates may be found on the following page, and charts indicating the relationships of the alternative targets to the Committee's tentative longer-run ranges for 1982 may be found on the next three pages.)

	<u>Alt. A</u>	<u>Alt. B</u>	<u>Alt. C</u>
Growth from QIV '81 <sup>p/</sup> to March '82			
M1	5½	4	2½
M2	10½	9½	8½
Implied growth from December '81 <sup>p/</sup> to March '82			
M1	4½	2½	½
M2	8½	7½	6½
Federal funds rate range	10 to 14	11 to 15	12 to 16

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<sup>p/</sup> preliminary

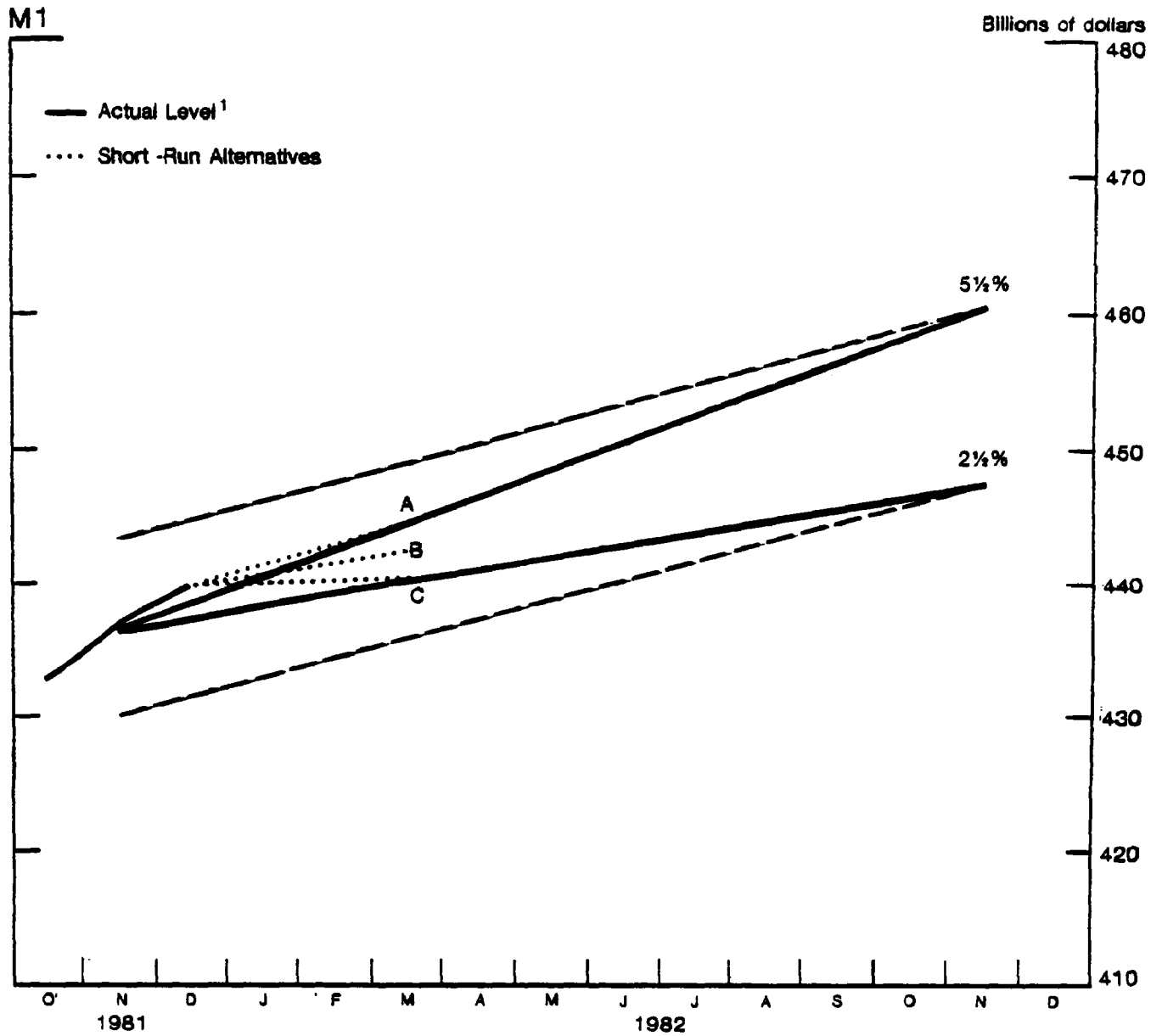
Alternative Levels and Growth Rates for Key Monetary Aggregates

	M1			M2			M3		
	<u>Alt. A</u>	<u>Alt. B</u>	<u>Alt. C</u>	<u>Alt. A</u>	<u>Alt. B</u>	<u>Alt. C</u>	<u>Alt. A</u>	<u>Alt. B</u>	<u>Alt. C</u>
1981--October	433.0	433.0	433.0	1798.8	1798.8	1798.8	2143.8	2143.8	2143.8
November	437.0	437.0	437.0	1823.6	1823.6	1823.6	2165.8	2165.8	2165.8
December	439.9	439.9	439.9	1842.7	1842.7	1842.7	2187.8	2187.8	2187.8
1982--January	441.3	440.7	440.1	1855.4	1853.9	1852.6	2203.2	2201.7	2200.4
February	442.9	441.6	440.2	1869.0	1866.9	1863.1	2220.0	2217.9	2214.1
March	444.6	442.4	440.2	1883.4	1877.6	1872.6	2237.7	2231.9	2226.9
<u>Growth Rates</u>									
<u>Monthly</u>									
1981--October	3.3	3.3	3.3	8.1	8.1	8.1	5.7	5.7	5.7
November	11.1	11.1	11.1	16.5	16.5	16.5	12.3	12.3	12.3
December	8.0	8.0	8.0	12.6	12.6	12.6	12.2	12.2	12.2
1982--January	3.8	2.2	0.6	8.2	7.3	6.4	8.4	7.6	6.9
February	4.3	2.2	0.3	8.8	7.8	6.8	9.2	8.3	7.5
March	4.6	2.2	0.0	9.2	7.5	6.1	9.6	8.1	6.9
December 1981 - March 1981	4.3	2.3	0.3	8.8	7.6	6.5	9.1	8.1	7.1
<u>Quarterly Average</u>									
1981--QIII	0.5	0.5	0.5	10.3	10.3	10.3	10.3	10.3	10.3
QIV	4.6	4.6	4.6	9.6	9.6	9.6	9.6	9.6	9.6
1982--QI	5.8	4.6	3.3	10.5	9.7	9.0	10.0	9.4	8.9
1980 QIV - 1981 QIV	1.9 <sup>1/</sup>	1.9 <sup>1/</sup>	1.9 <sup>1/</sup>	9.5	9.5	9.5	11.1	11.1	11.1
1981 QIV - March 1982	5.5	4.0	2.5	10.2	9.2	8.4	10.0	9.2	8.5
<u>Annual Average</u>									
1981 over 1980	4.5 <sup>1/</sup>	4.5 <sup>1/</sup>	4.5 <sup>1/</sup>	9.7	9.7	9.7	11.6	11.6	11.6

<sup>1/</sup> Based on M1-B adjusted for shifts to nationwide NOW accounts in 1981.

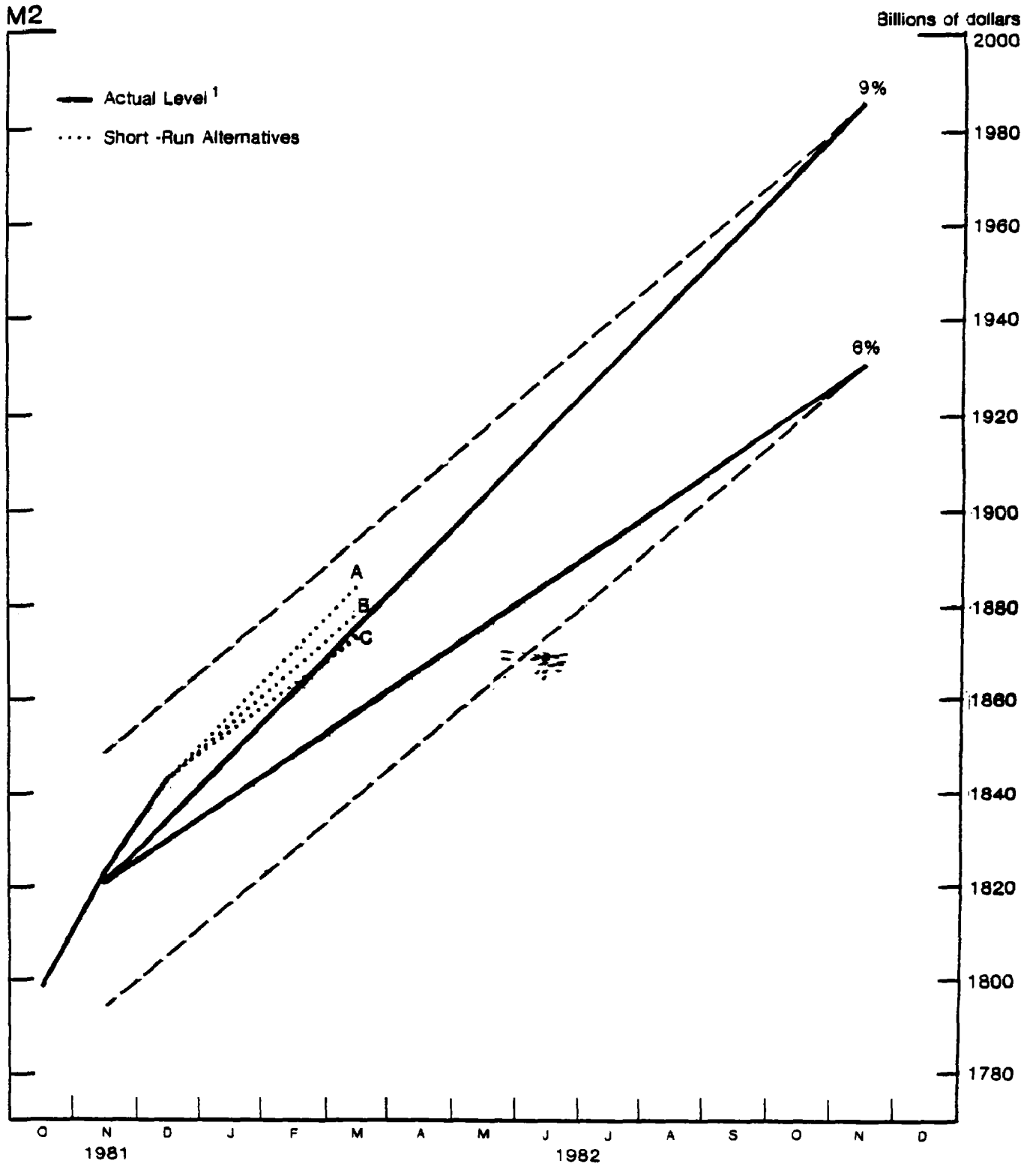
Chart 1  
**Actual and Targeted M1**

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<sup>1</sup> December level is projected.

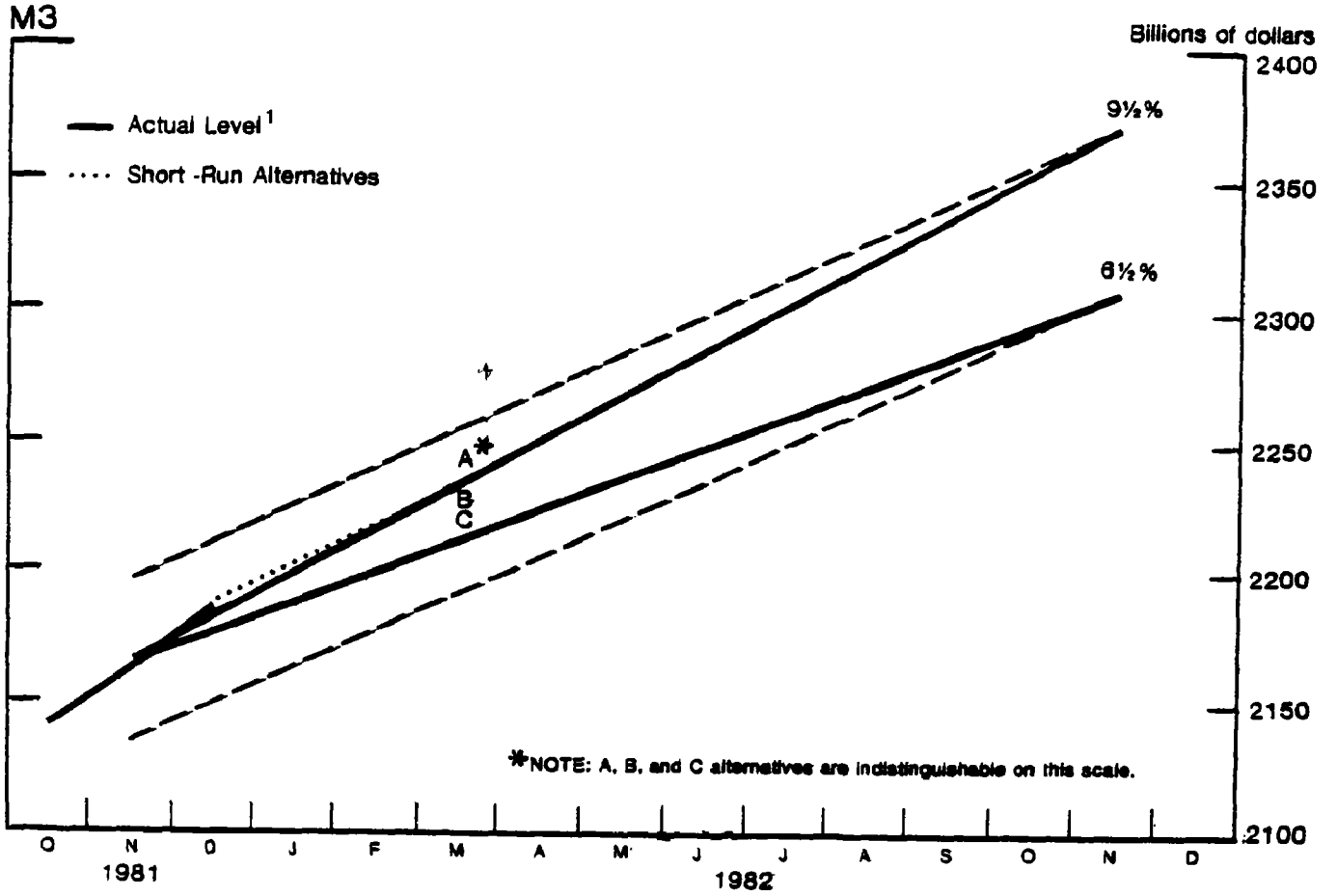
### Actual and Targeted M2



<sup>1</sup> December level is projected.



### Actual and Targeted M3



1 December level is projected.

(16) Alternative B calls for M1 growth from QIV '81 to March at a 4 percent annual rate, but probably involves M2 growth slightly above the upper end of its range. Growth of M1 from the estimated December level to March would be at a slower  $2\frac{1}{2}$  percent rate since the level of December is high relative to the fourth quarter average. Growth of M2 over that period would also be relatively moderate--at a  $7\frac{1}{2}$  percent annual rate--for the same reason.

(17) Assuming a continued downward shift in M1 demand, though at a slower pace than last year, and a small increase in nominal GNP in the first quarter, such a slowing in M1 growth from the recent pace may be accompanied by little net change in short-term interest rates over the next several weeks. However, both the economic outlook and the state of money demand (given income and interest rates) are highly uncertain at this juncture, so that an even wider range than usual should be placed around interest rate projections. For instance, strong downward pressures could develop--more consistent with a normal cyclical pattern of short-term rates--if the economic recession does not tend to abate early next year as assumed in the GNP projection. On the other hand, upward pressures could emerge, even with a weak GNP, if the demand for money were relatively strong either because of a return to historical relationships or because economic uncertainties caused the public to continue to save more than earlier in the year and to hold part of this saving in NOW accounts.

(18) The alternative B specifications would require expansion in total reserves at a 2 percent pace from December to March.<sup>1/</sup> Assuming adjustment borrowing in the \$450 million area, nonborrowed reserves would increase at a  $1\frac{1}{2}$  percent rate and, at the present discount rate, the

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<sup>1/</sup> Abstracting from any impact on required reserves from shifts from reservable deposits to nonreservable IBF liabilities.

federal funds rate in the intermeeting period would likely fluctuate up in a 12 to 13 percent range. The 3-month Treasury bill could be expected to trade in the 11 to 11-1/2 percent area, as sizable first quarter Treasury financing demands make themselves felt in an environment in which the money market shows no sign of easing.

(19) Private short-term credit demands are likely to remain weak, partly as borrowing is fairly strong in bond markets and partly in connection with projected inventory liquidation. Corporate borrowers who had postponed bond issues in December because of the rebound in long-term rates, may come back into the market early next year if they come to believe that the cost of staying out will be higher than expected—especially with enlarged Treasury offerings in prospect later in the year. Should corporate bond yields remain near current levels, there may be some scope for a further drop in interest rates on home mortgage commitments given the relatively wide spread existing between bond and mortgage rates. Even though thrift operating losses can be expected to moderate further at the projected short-term interest rate level as high cost deposits are rolled over, their deposit growth is not expected to be robust; this, together with continuing uncertainties about future rate developments, is likely to discourage them from aggressively offering mortgages.

(20) Alternative A calls for a 5-1/2 percent growth target for M1 from the fourth quarter to March and 4-1/4 percent from the estimated December level to March, and involves a greater risk that the level of M2 in the first quarter will be above the upper limit of its tentative long-run range. This alternative would entail growth in total reserves at a 4 percent annual rate over the first three months of the year. Assuming a level of adjustment borrowing of around \$250 million, nonborrowed

reserves would grow at a 6 percent rate. Such a pace of reserve provision would likely be associated with a federal funds rate near or a little below the current 12 percent discount rate. That probably would be accompanied by a decline in short-term rates from recent levels, with the 3-month bill perhaps around 10 to 10-1/2 percent. Bond yields are likely to decline some, but declines might be limited by a sizable pickup in bond offerings as the market viewed the decline as opening another "window". With an indication of lower borrowing costs, thrift institutions would be somewhat more willing to cut mortgage rates further and increase commitment activity.

(21) The contemplated modest decline in short-term interest rates under alternative A might be accompanied by a tendency for the dollar to decline on exchange markets. However, any decline could be short-lived, or limited, as foreign central banks take advantage of any strengthening in their currencies to lower their own interest rates further in light of continued weak performance of their economies.

(22) Alternative C--which calls for virtually no growth in M1 between December and March--may be expected to bring M2 into the upper part of its tentative long-run range by March. Essentially no growth in total reserves would be involved, and assuming adjustment borrowing of \$650 million, nonborrowed reserves would decline at about a 2-1/2 percent rate in the first quarter. A federal funds rate of perhaps 13 to 14 percent in the inter-meeting period would be implied. Such a move in the funds rate would surprise market participants, and a fairly substantial rise in other market interest rates, at least temporarily, would tend to develop. The 3-month bill rate would probably move to near 12-1/2 percent, the corporate bond rate might approach 16 percent, and new issue volume would probably drop significantly

as firms return to short-term credit markets. Residential mortgage rates would retrace part of their recent decline. The higher than expected level of interest rates would tend to strengthen the dollar further in foreign exchange markets and limit reductions in foreign interest rates.

(23) As 1982 progresses, short-term interest rates likely will rise to levels above those currently prevailing, assuming M1 grows at the midpoint of the FOMC's tentative range. The table below shows interest rate forecasts for the year, assuming alternative B for the first quarter and midpoint growth of M1 thereafter. These assumptions lie behind the Greenbook GNP projection. Selection of alternative A might involve a larger rise in rates later in the year to compensate for the greater near-term monetary stimulus associated with this approach if the Committee desires to slow money growth later in an effort to achieve midpoint growth for the year. Alternative C, on the other hand, by exerting near-term restraint would probably be associated with lower rate levels later in the year, reflecting not only the greater scope for faster money growth at that time but also possibly weaker economic activity.

	<u>Federal Funds</u>	<u>3-month Treasury Bill</u>	<u>Recently Offered Aaa Corporate Bond</u>	<u>Fixed Rate Mortgage Commitments</u>
1981 IV	13½	11½	16	17½
1982 I	12½	11½	15	16½
II	14	12	15	16
III	15	13	15½	16½
IV	15½	13½	15½	16½

Directive language

(24) Given below is a suggested operational paragraph for the directive. The specifications adopted at the meeting on November 17 are shown in strike-through form.

IN THE SHORT RUN, THE COMMITTEE, ~~after noting a moderate shortfall in growth of M1-B in October from the target path set at the last meeting,~~ seeks behavior of reserve aggregates consistent with growth of M1-B M1 AND M2 ~~from October to December~~ FROM THE FOURTH QUARTER OF 1981 TO MARCH at an annual rate RATES of about 7 \_\_\_ percent ~~(after allowance for the impact of flows into NOW accounts)~~ and with growth of M2 at an annual rate around ~~11~~ \_\_\_ percent RESPECTIVELY. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of ~~11 to 15~~ \_\_\_ TO \_\_\_ percent.

Appendix I

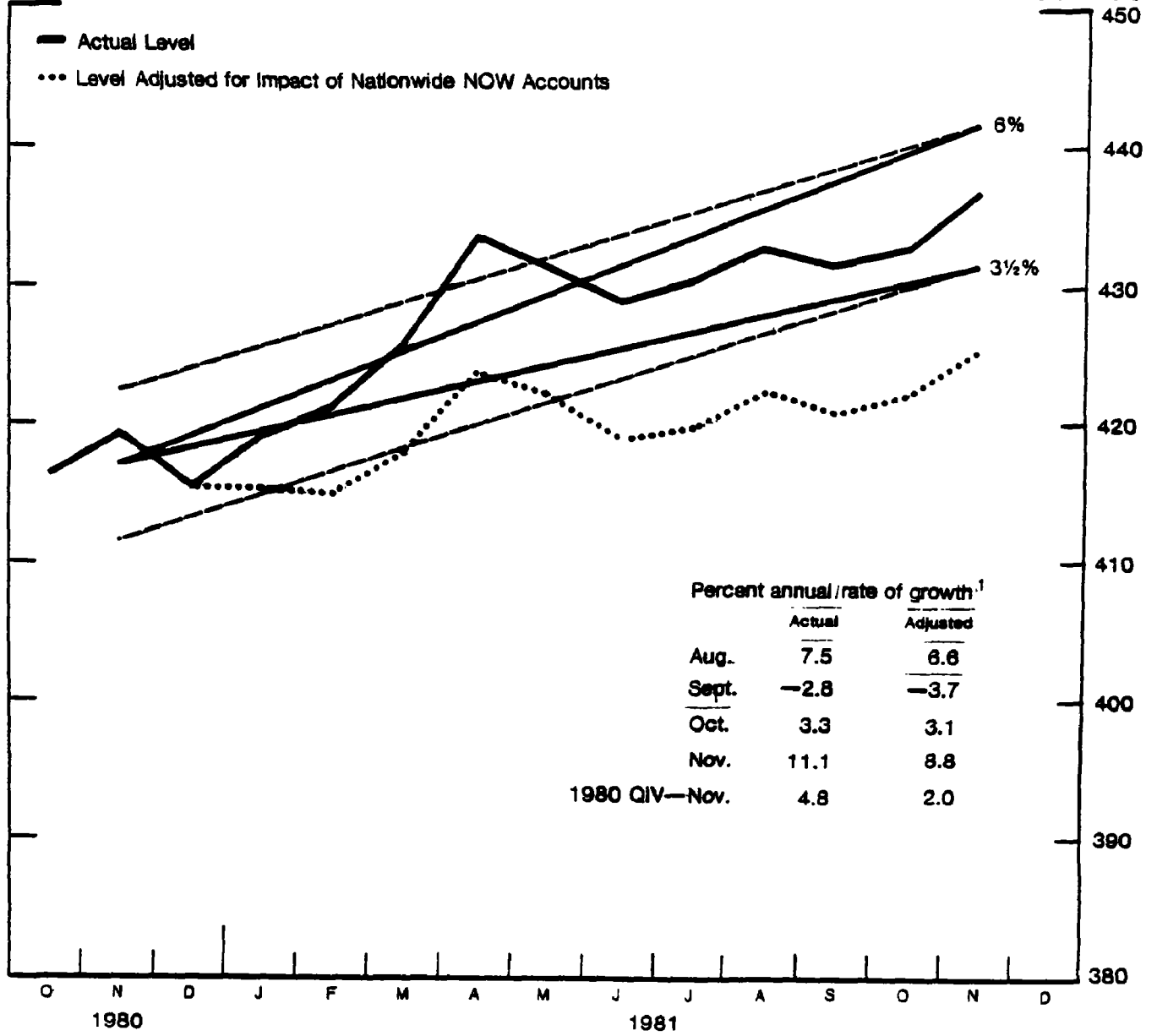
RESERVE TARGETS AND RELATED MEASURES  
INTERMEETING PERIOD  
(millions of dollars; not seasonally adjusted)

Date Reserves Path Constructed	Reserves Targets for 5-week Average (5-week Average Basis)		Projection of Reserves Demanded (5-week Average Basis)			Implied Adjustment Borrowing	
	November 25 to December 23		November 25 to December 23			On a 5-week Avg. Basis	For Remaining Statement Week of Intermeeting Period <sup>1/</sup>
	Total Reserves	Nonborrowed Reserves	Total Reserves	Required Reserves	Excess Reserves		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
November 17 (FOMC Meeting)	41,209	40,809	41,209	40,984	225	400	
20	41,209 <sub>2/</sub>	40,809 <sub>2/3/</sub>	41,209	40,984	225	400	400
30	41,252 <sub>2/</sub>	40,894 <sub>2/3/4/</sub>	41,277	41,085	192	383	425
December 4	41,252 <sub>5/</sub>	40,952 <sub>4/5/6/</sub>	41,305	41,081	224	353	453
11	41,526 <sub>7/</sub>	41,243 <sub>5/6/7/8/</sub>	41,621	41,379	242	378	496
18	41,389 <sub>7/</sub>	41,154 <sub>7/8/</sub>	41,488	41,289	199	334	500

- <sup>1/</sup> Represents borrowing in remaining statement weeks (as intermeeting period progresses) implied by each weekly updating of the 5-week average nonborrowed path. The movement in implied borrowing represents deviations in total reserves from target as well as the implications of compensating to whatever extent, for misses in nonborrowed reserves from target in the earlier weeks of the reserve period.
- <sup>2/</sup> Total and nonborrowed reserves paths adjusted upward by \$43 million due to changes affecting the reserves multiplier.
- <sup>3/</sup> To prevent unexpectedly low borrowings in the week of November 25 from distorting the nonborrowed reserves path, the 5-week average nonborrowed reserves path was adjusted upward by an additional \$42 million.
- <sup>4/</sup> To prevent the unexpectedly low borrowings in the weeks of November 25 and December 2 from distorting the nonborrowed reserves path, the upward adjustment to the 5-week average nonborrowed reserves path noted in footnote 3 was raised to \$100 million.
- <sup>5/</sup> Total and nonborrowed reserves paths adjusted upward by \$274 million due to changes affecting the reserves multiplier.
- <sup>6/</sup> To prevent the unexpectedly low borrowings in the week of November 25 and December 2 from distorting the nonborrowed reserves path, the upward adjustment to the 5-week average nonborrowed reserves path noted in footnotes 3 and 4 was raised to \$117 million.
- <sup>7/</sup> Total and nonborrowed reserves paths adjusted downward by \$137 million due to changes affecting the reserves multiplier.
- <sup>8/</sup> To prevent the unexpectedly low borrowings in the week of November 25 and December 2 from distorting the nonborrowed reserves path and to avoid a sharp change in bank reserves positions just prior to the Committee meeting, the upward adjustment to the 5-week average nonborrowed reserves path noted in footnotes 3, 4, and 6 was raised to \$165 million.

M1-B

M1-B



<sup>1</sup> Based on mid-points of the following assumed ranges for the proportion of QCD growth (apart from trend) coming from demand deposits: 75-80 percent in January and 70-75 percent in subsequent months.



**M2**

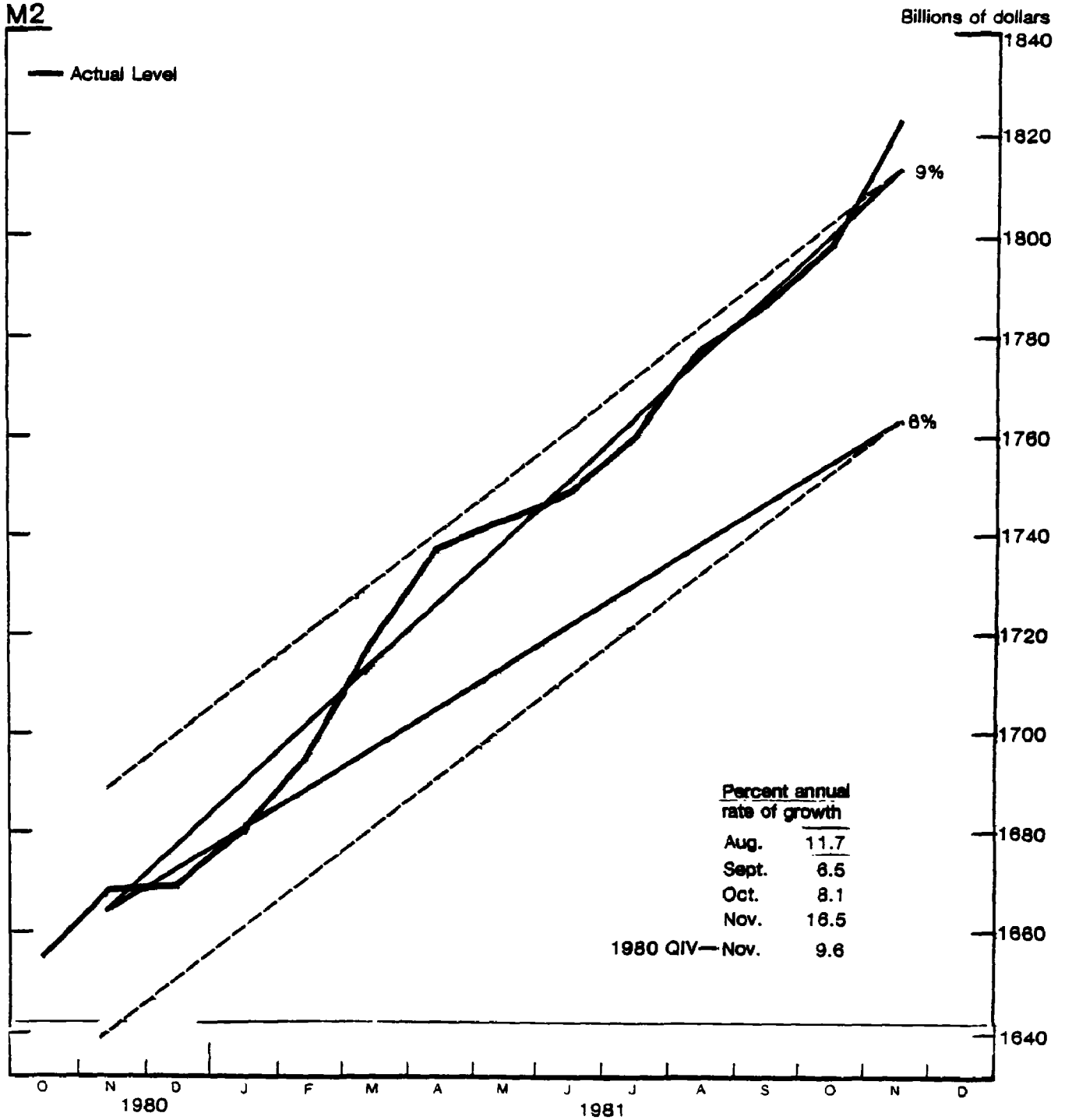
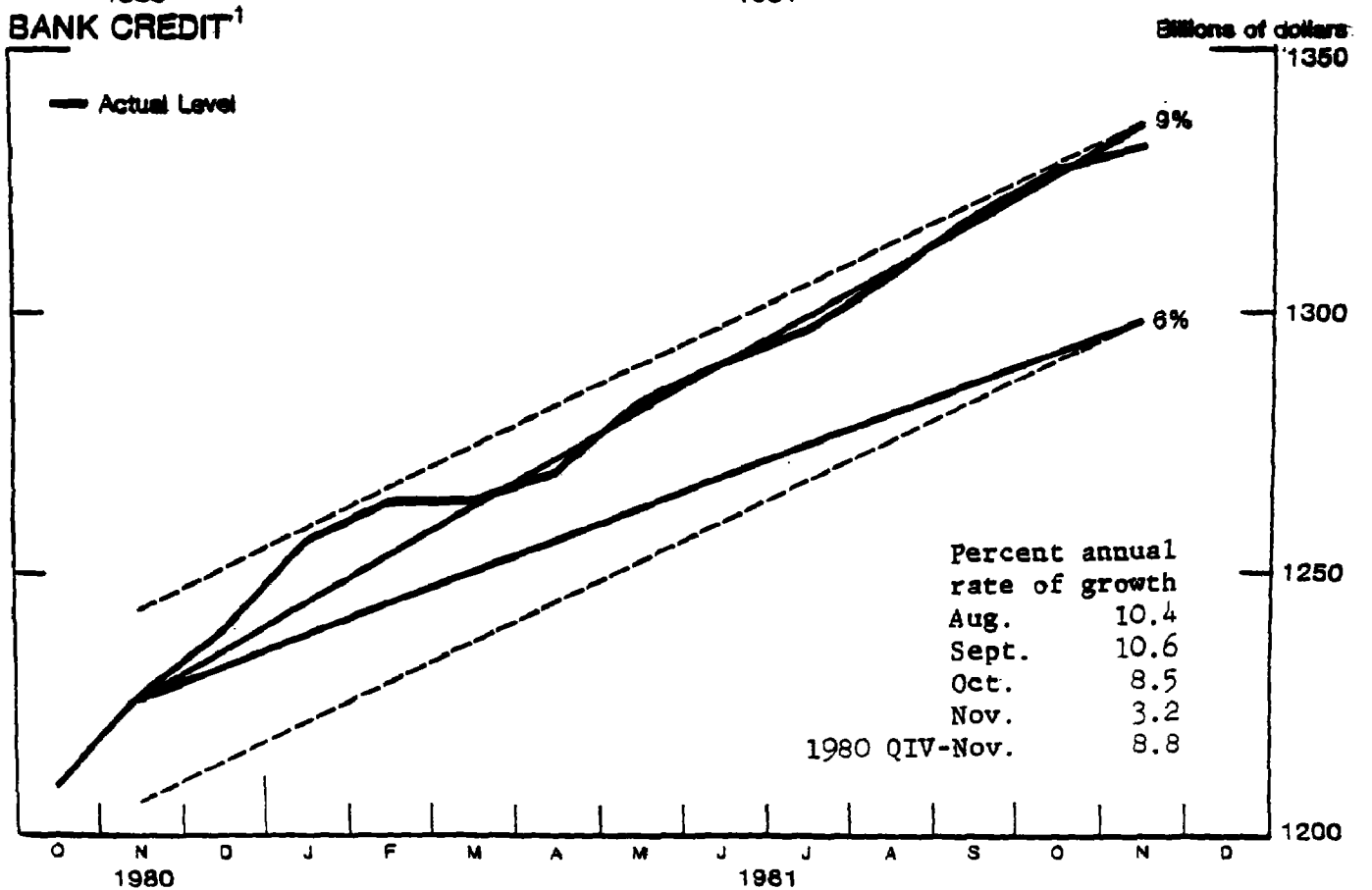
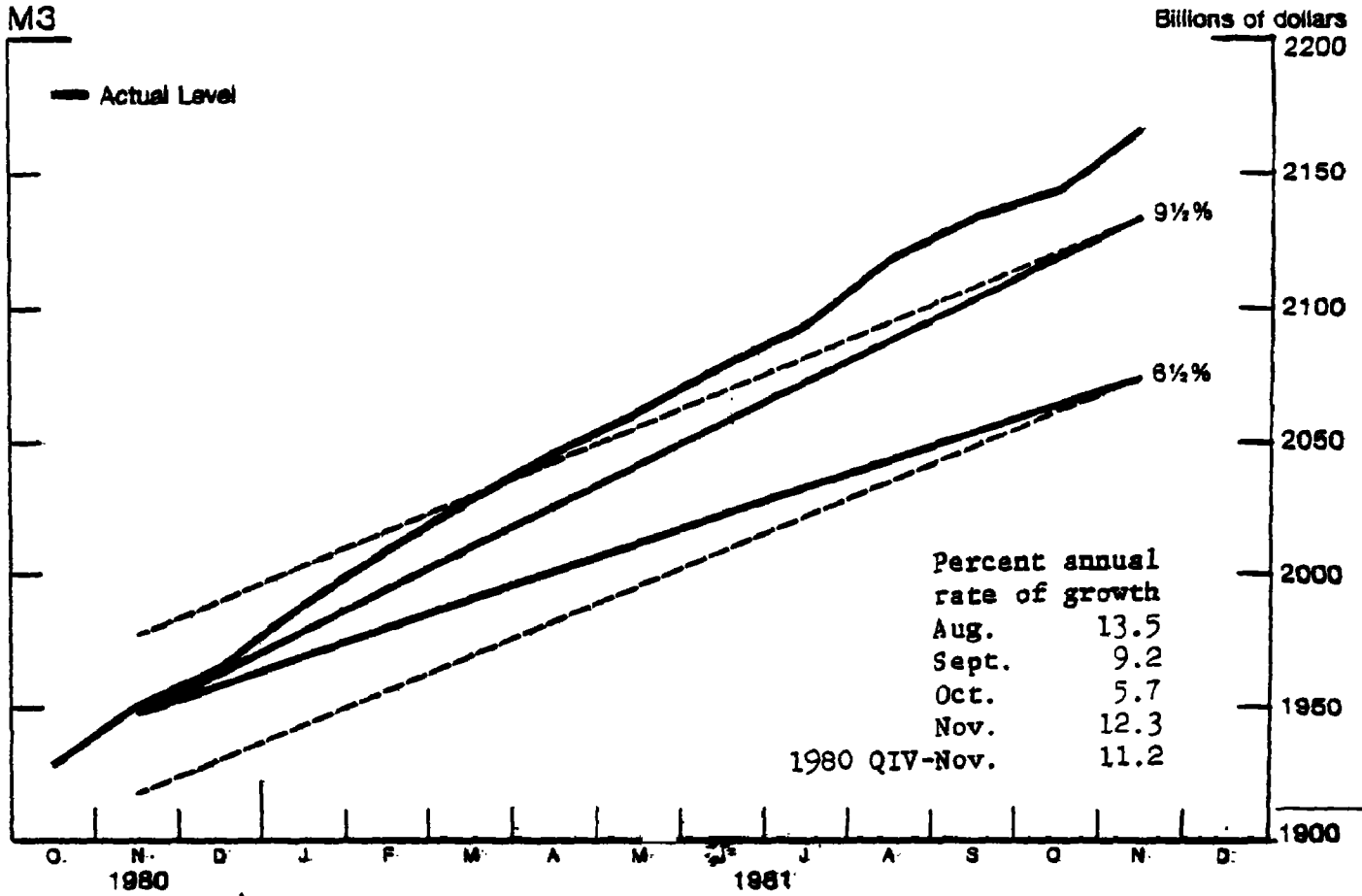


Chart 4

STRICTLY CONFIDENTIAL (FR)  
Class II - FOMC



<sup>1</sup> Level adjusted beginning in February to remove discontinuity due to absorption by one bank of a nonbank affiliate.

Table 1  
Selected Interest Rates  
Percent

December 21, 1981

Period	Short-Term							Long-Term								
	Federal funds	Treasury bills			CDs secondary market 3-month	comm. paper 3-month	bank prime rate	U.S. government constant maturity yields			corporate Aaa utility		municipal Bond Buyer	home mortgages		
		market		auction				3-year	10-year	30-year	new issue	recently offered		primary conv.	secondary market	
		3-month	1-year	6-month											FNMA auction	GNMA security
1	2	3	4	5	6	7	8	9	10	11	12	13	14		15	16
1980--High	19.83	16.73	14.39	15.70	20.50	19.74	21.50	14.29	13.36	12.91	14.51	15.03	10.56	16.35	15.93	14.17
Low	8.68	6.49	7.18	6.66	8.17	7.97	11.00	8.61	9.51	9.54	10.53	10.79	7.11	12.18	12.28	10.73
1981--High	20.06	16.72	15.05	15.85	18.70	18.04	20.64	16.54	15.65	15.03	17.62	17.72	13.21	18.63	19.23	17.46
Low	12.04	10.20	10.64	10.70	11.51	11.26	15.75	12.55	12.27	11.81	14.05	13.98	9.49	14.80	14.84	13.18
1981--Nov.	15.85	13.73	12.66	13.61	15.68	15.18	16.06	13.31	12.68	12.37	13.85	13.91	9.56	14.21	15.53	13.55
Dec.	18.90	15.49	13.23	14.77	18.65	18.07	20.35	13.65	12.84	12.40	14.51	14.38	10.11	14.79	15.21	13.62
1981--Jan.	19.08	15.02	12.62	13.88	17.19	16.58	20.16	13.01	12.57	12.14	14.12	14.17	9.66	14.90	14.87	13.55
Feb.	15.93	14.79	12.99	14.13	16.14	15.49	19.43	13.65	13.19	12.80	14.90	14.58	10.10	15.13	15.24	14.13
Mar.	14.70	13.36	12.28	12.98	14.43	13.94	18.05	13.51	13.12	12.69	14.71	14.41	10.16	15.40	15.74	14.18
Apr.	15.72	13.69	12.79	13.43	15.08	14.56	17.15	14.09	13.68	13.20	15.68	15.48	10.62	15.58	16.54	14.59
May	18.52	16.30	14.29	15.33	18.27	17.56	19.61	15.08	14.10	13.60	15.81	15.48	10.79	16.40	16.93	15.31
June	19.10	14.73	13.22	13.95	16.90	16.32	20.03	14.29	13.47	12.96	14.76	14.81	10.67	16.70	16.17	15.02
July	19.04	14.95	13.91	14.40	17.76	17.00	20.39	15.15	14.28	13.59	16.30	15.73	11.14	16.83	16.65	15.76
Aug.	17.82	15.51	14.70	15.55	17.96	17.23	20.50	16.00	14.94	14.17	--	16.82	12.26	17.29	17.63	16.67
Sept.	15.87	14.70	14.53	15.06	16.84	16.09	20.08	16.22	15.32	14.67	17.21	17.33	12.92	18.16	18.99	17.06
Oct.	15.08	13.54	13.62	14.01	15.39	14.85	18.45	15.50	15.15	14.68	16.94	17.24	12.83	18.45	18.13	16.61
Nov.	13.31	10.86	11.20	11.53	12.48	12.16	16.84	13.11	13.39	13.35	15.56	15.49	11.89	17.83	16.64	15.10
Oct. 7	15.46	14.25	14.11	14.22	16.04	15.44	19.29	15.94	15.31	14.74	16.94	16.96	12.73	18.63	--	16.80
14	14.93	13.44	13.44	13.50	15.21	14.67	18.71	15.29	14.86	14.39	--	17.21	12.53	18.53	17.74	16.30
21	15.32	13.43	13.55	13.80	15.16	14.65	18.00	15.37	15.04	14.61	--	17.38	12.99	18.39	--	16.36
28	14.87	13.29	13.60	13.62	15.30	14.74	18.00	15.61	15.45	15.01	--	17.16	12.99	18.44	18.51	16.97
Nov. 4	14.79	12.70	12.74	12.72	14.67	14.21	17.86	14.58	14.61	14.35	17.20	16.88	12.44	18.37	--	16.08
11	14.01	11.55	11.83	11.51	13.43	13.05	17.29	13.65	13.73	13.76	--	15.89	11.43	18.02	16.82	15.15
18	13.17	10.54	10.97	10.97	12.29	12.04	16.93	12.81	13.12	13.18	14.62	14.65	11.71	17.70	--	14.62
25	12.42	10.20	10.64	10.92	11.64	11.26	16.39	12.69	13.15	13.08	14.85	14.52	11.98	17.21	16.45	14.68
Dec. 2	12.48	10.41	10.84	10.70	11.51	11.26	15.93	12.96	13.23	12.99	14.96	14.77	12.18	16.90	--	14.96
9	12.04	10.26	10.82	10.77	11.67	11.39	15.75	13.17	13.45	13.19	15.44	15.18	12.89	16.94	16.76	15.36
16	12.26	10.84	11.50	11.60	12.54	12.20	15.75	13.60	13.67	13.42	--	15.28p	13.00	n.a.	--	15.49
23																
30																
Daily--Dec. 11	12.22	10.82	11.65	--	12.62	12.25	15.75	13.70	13.84	13.55	--	--	--	--	--	--
17	12.38	11.14	11.68	--	12.61	12.23	15.75	13.68	13.71	13.48	--	--	--	--	--	--
18	12.27p	10.87	11.50	--	12.85	12.42	15.75	13.58p	13.49p	13.30p	--	--	--	--	--	--

NOTE: Weekly data for columns 1, 2, 3, and 5 through 10 are statement week averages of daily data. Weekly data in column 4 are average rates set in the auction of 6-month bills that will be issued on the Thursday following the end of the statement week. For column 11, the weekly data is the mid-point of the calendar week over which data are averaged. Columns 12 and 13 are 1-day quotes for Friday and Thursday, respectively, following the end of the statement week. Column 14 is an average of contract interest rates on commitments for conventional first mortgages with 80 percent loan-to-value

ratios made by a sample of insured savings and loan associations on the Friday following the end of the statement week. The FNMA auction yield is the average yield in a bi-weekly auction for short-term forward commitments for government underwritten mortgages; figures exclude graduated payment mortgages. GNMA yields are average net yields to investors on mortgage-backed securities for immediate delivery, assuming prepayment in 12 years on pools of 30-year FHA/VA mortgages carrying the coupon rate 50 basis points below the current FHA/VA ceiling.

Table 2

Net Changes in System Holdings of Securities<sup>1</sup>

December 31, 1981

Millions of dollars, not seasonally adjusted

Period	Treasury bills net change <sup>2</sup>	Treasury coupons net purchases <sup>3</sup>					Federal agencies net purchases <sup>4</sup>					Net change outright holdings total <sup>5</sup>	Net RPs <sup>6</sup>
		within 1-year	1-5	5-10	over 10	total	within 1-year	1-5	5-10	over 10	total		
1976	863	472	3,025	1,048	642	5,187	105	469	203	114	891	6,227	3,507
1977	4,361	517	2,833	758	553	4,660	—	792	428	213	1,433	10,035	-2,892
1978	870	1,184	4,188	1,326	1,063	7,962	-47	45	104	24	127	8,724	-1,774
1979	6,243	603	3,456	523	454	5,035	131	317	5	—	454	10,290	-2,597
1980	-3,052	912	2,138	703	811	4,564	217	398	29	24	668	2,035	2,462
1980--Qtr. III	-3,298	137	541	236	320	1,234	--	--	--	--	--	-2,157	-1,381
IV	-58	100	--	--	--	100	--	--	--	--	--	-1	1,107
1981--Qtr. I	-2,514	-23	--	--	--	-23	--	--	--	--	--	-2,555	-1,694
II	2,135	115	469	164	89	836	--	--	--	--	--	2,944	-1,352
III	2,912	122	607	64	182	976	--	--	--	--	--	3,855	425
1981--June	204	--	--	--	--	--	--	--	--	--	--	179	1,502
July	1,225	122	607	64	182	976	--	--	--	--	--	2,200	1,768
Aug.	1,379	--	--	--	--	--	--	--	--	--	--	1,379	-843
Sept.	308	--	--	--	--	--	--	--	--	--	--	275	-500
Oct.	-1,116	--	--	--	--	--	--	--	--	--	--	-1,131	-209
Nov.	1,750	--	100	--	--	100	133	360	--	--	494	2,333	2,747
1981--Oct. 7	-169	--	--	--	--	--	--	--	--	--	--	-169	-7,855
14	-414	--	--	--	--	--	--	--	--	--	--	-429	8,095
21	131	--	--	--	--	--	--	--	--	--	--	131	5,064
28	-454	--	--	--	--	--	--	--	--	--	--	-454	-7,234
Nov. 4	-211	--	--	--	--	--	--	--	--	--	--	-211	4,634
11	116	--	--	--	--	--	--	--	--	--	--	116	-2,451
18	1,383	--	--	--	--	--	--	--	--	--	--	1,383	1,975
25	276	--	--	--	--	--	133	360	--	--	494	770	-216
Dec. 2	1,273	--	--	--	--	--	--	--	--	--	--	1,263	439
9	150	--	--	--	--	--	--	--	--	--	--	150	-1,685
16	822	--	456	165	108	729	--	--	--	--	--	1,547	-160
23													
30													
LEVEL--Dec. 16	52.3	13.8	36.1	11.8	16.6	78.2	2.3	5.3	1.0	0.6	9.1	139.7	-2.0

1 Change from end-of-period to end-of-period.

2 Outright transactions in market and with foreign accounts, and redemptions (-) in bill auctions.

3 Outright transactions in market and with foreign accounts, and short-term notes acquired in exchange for maturing bills. Excludes redemptions, maturity shifts, rollovers of maturing coupon issues, and direct Treasury borrowing from the System.

4 Outright transactions in market and with foreign accounts only. Excludes redemptions and maturity shifts.

5 In addition to the net purchases of securities, also reflects changes in System holdings of bankers' acceptances, direct Treasury borrowing from the System and redemptions (-) of agency and Treasury coupon issues.

6 Includes changes in RPs (+), matched sale-purchase transactions (-), and matched purchase sale transactions (+).

Table 3  
**Security Dealer Positions and Bank Positions**  
 Millions of dollars

STRICTLY CONFIDENTIAL (FR)  
 CLASS II-FOMC

December 21, 1981

Period	U.S. government securities dealer positions				Underwriting syndicate positions		Member bank reserve positions				
	cash		futures and forwards		corporate bonds	municipal bonds	excess** reserves	borrowing at FRB**			
	bills	coupons	bills	coupons				adjustment	seasonal	Extended (includes special)	total
1980--High	8,838	2,263			299	466	881	3,298	174	816	3,438
Low	1,972	-1,482			0	22	19	12	5	0	215
1981--High	15,668	4,633	-12,865	-4,676**	595	268	508	2,597	309	464	2,912
Low	1,273	965	-5,930	-2,514	0	19	-95	334	99	*	561
1980--Nov.	3,047	149	-7,068	-2,663	17	57	521	1,963	97	*	2,059
Dec.	4,287	20	-9,812	-2,751	6	70	468	1,571	116	3	1,690
1981--Jan.	9,985	1,584	-11,976	-2,884	8	68	310	1,204	120	22	1,395
Feb.	13,317	1,812	-12,203	-2,798	8	95	276	1,135	148	21	1,303
Mar.	13,597	3,415	-11,561	-3,251	46	124	248	789	196	15	1,000
Apr.	8,518	3,149	-7,277	-3,050	15	194	127	1,168	162	8	1,338
May	1,676	2,745	-6,486	-2,822	2	110	175	1,154	269	5	2,228
June	5,547	3,278	-9,934	-2,925	42	192	249	1,139	291	7	2,037
July	2,950	3,314	-8,340	-3,012	5	153	250	1,429	247	3	1,679
Aug.	4,324	2,242	-10,071	-2,972	6	65	202	1,105	235	80	1,420
Sept.	5,611	1,614	-9,830	-2,856	8	55	324	933	222	301	1,456
Oct.	4,781	1,629	-8,575	-3,655	29	59	189r	591	152	438	1,181
Nov.	5,037**	3,821**	-7,120**	-4,307**	195	107	265p	403p	95p	165p	663p
Oct. 7	5,640	1,280	-8,110	-3,438	0	53	122	577	156	413	1,146
14	5,577	2,133	-8,919	-3,953	139	40	267	529	158	423	1,110
21	4,247	1,071	-8,419	-3,789	0	98	198r	656	155	444	1,255
28	4,056	1,889	-8,001	-3,351	0	46	127	576	147	464	1,187
Nov. 4	5,108	2,494	-10,242	-3,884	0	49	287	651	134	452	1,237
11	5,908	3,713	-8,530	-4,427	70	11	432	268	130	111	1,009
18	4,705	3,259	-6,299	-4,338	595	214	71	334	101	126	561
25	4,349**	4,727**	-5,986**	-4,302**	113	153	152p	145p	69p	123p	337p
Dec. 2	4,484**	3,691**	-6,444**	-4,632**	40	194	446p	151p	41p	125p	317p
9	3,200**	2,779**	-6,383**	-4,676**	105	252	171p	463p	30p	125p	618p
16	1,070p**	574p**	-4,782p**	-4,206p**	0	132	-49	198p	63p	135p	398p
23											
30											

NOTE: Government securities dealer cash positions consist of securities already delivered, commitments to buy (sell) securities on an outright basis for immediate delivery (5 business days or less), and certain "when-issued" securities for delayed delivery (more than 5 business days). Futures and forward positions include all other commitments involving delayed delivery; futures contracts are arranged on organized exchanges. Underwriting syndicate positions consists of issues in syndicate, excluding trading positions.

Weekly data are daily averages for statement weeks, except for corporate and municipal issues in syndicate, which are Friday figures. Monthly averages for excess reserves and borrowing are weighted averages of statement week figures. Monthly data for dealer futures and forwards are end-of-month figures for 1980.

\*\* Strictly confidential