MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, August 15, 1972, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Bucher
Mr. Coldwell
Mr. Daane
Mr. Eastburn
Mr. MacLaury
Mr. Mitchell
Mr. Robertson
Mr. Sheehan
Mr. Winn

Messrs. Francis, Heflin, and Mayo, Alternate Members of the Federal Open Market Committee

Messrs. Morris, Kimbrel, and Clay, Presidents of the Federal Reserve Banks of Boston, Atlanta, and Kansas City, respectively

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Altmann and Bernard, Assistant Secretaries
Mr. Hackley, General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Partee, Senior Economist
Messrs. Boehne, Bryant, Gramley, Green, Hocter, Kareken, and Link, Associate Economists
Mr. Coombs, Special Manager, System Open Market Account

Mr. Melnicoff, Deputy Executive Director, Board of Governors
Mr. Cardon, Assistant to the Board of Governors

Mr. O'Brien, Special Assistant to the Board of Governors
Mr. Reynolds, Associate Director, Division of International Finance, Board of Governors
Mr. Chase, Associate Director, Division of Research and Statistics, Board of Governors
Messrs. Keir, Pierce, and Wernick, Advisers, Division of Research and Statistics, Board of Governors
Mr. Pizer, Adviser, Division of International Finance, Board of Governors
Mr. Wendel, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mrs. Rehanek, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors
Mrs. Sherman, Secretary, Legal Division, Board of Governors

Mr. Merritt, First Vice President, Federal Reserve Bank of San Francisco
Messrs. Eisenmenger, Taylor, Scheld, Tow, and Craven, Senior Vice Presidents, Federal Reserve Banks of Boston, Atlanta, Chicago, Kansas City, and San Francisco, respectively
Messrs. Sternlight, Snellings, and Jordan, Vice Presidents, Federal Reserve Banks of New York, Richmond, and St. Louis, respectively
Mr. Meek, Assistant Vice President, Federal Reserve Bank of New York

Chairman Burns noted that Senator Proxmire, Chairman of the Joint Economic Committee, had recently sent him a letter raising a question about the lag in publishing the record of policy actions following each meeting of the Federal Open Market Committee. Copies of the Senator's letter and of a draft reply prepared by the staff had been distributed to the members of the Committee. While he had not yet had an opportunity to review the draft reply thoroughly, he thought it was generally satisfactory. He would want to add a reference, however, to the large number of monetary and credit statistics which the System regularly published on a weekly or other periodic basis. Indeed, it was his impression that the System released more such statistics than any other central bank in the world. He also thought it might be desirable to indicate more explicitly that in the spring of 1971 the Committee had made a thorough review of its publication schedule. Finally, he believed the Committee should review the schedule from time to time and the letter could be given a constructive tone if it were to indicate that the Committee would undertake another such review.

Chairman Burns added that he felt somewhat unhappy about the present practice of employing a lag of 90 days for 11 months of the year and then shortening it to between 45 and 60 days for the December meeting. While he understood that the lag for the December meeting was shortened in order to make the Committee's policy record for an entire year available to the Joint Economic Committee at the time of the Chairman's testimony during February of each year, he thought the Committee should adopt and adhere to a consistent schedule based on what was judged to be an appropriate lag, whether it be 45, 60, or 90 days.

Chairman Burns added that he would appreciate having the comments of the Reserve Bank Presidents and Board members regarding the response to Senator Proxmire's letter. Such views should be communicated promptly since he wanted to send the reply within a few days.[1/]

> By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee on June 19-20, 1972, were approved.
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> The memorandum of discussion for the meeting of the Federal Open Market Committee on June 19-20, 1972, was accepted.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period July 18 through August 9, 1972, and a supplemental report covering the period August 10 through 14, 1972. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs observed that since the last meeting of the Committee, the atmosphere in the exchange markets had improved considerably. The System's intervention in German marks on July 19, the day after the last

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1/ The text of the letter from Chairman Burns to Senator Proxmire, dated August 17, 1972, is appended to this memorandum as Attachment C.

meeting, and the forceful policy statement given to the press by Chairman Burns had strengthened confidence in the Smithsonian Agreement and had led to a general relaxation of market tensions.

Since the System's outright holdings of foreign currencies were so small, Mr. Coombs continued, he had originally planned to defer market intervention until the System had its swap lines freely available for use. The availability of those lines involved more than just the problem of lifting the suspension from the American side. As the Committee members would recall, the Common Market central banks had taken the position in June that the revaluation clause in the swap line agreements would have to be renegotiated before the System could make any drawings. However, the German mark situation on the day following the July meeting had seemed to be so favorable that, with Chairman Burns' agreement, he had decided to intervene immediately on the basis of System mark balances of slightly less than $10 million, plus whatever the System might be able to borrow from Treasury balances. The System operated fairly aggressively, offering roughly $50 million equivalent of marks over a 2-day stretch, but was called upon to sell no more than $12 million as the market tended to back away. In subsequent weeks, as the mark rate retreated to a full one per cent below the ceiling, the System was able to buy back enough marks through the market to repay the Treasury as well as to reconstitute its original balances. It remained a matter of urgency to reopen the German swap facility, however, and on July 21, the Friday following the July meeting, the head of the Foreign Department of the German Federal Bank came to New York for discussions over the weekend. On the following Tuesday (July 25) those discussions had finally resulted in approval by the Subcommittee--consisting of Messrs. Burns, Hayes, and Robertson--of an acceptable revision of the revaluation clause.[1/] Since then, the German line had been fully available for use, but as the mark had shown a certain degree of weakness and had created no market problems, there had been no need for the System to intervene in the market or to call the swap line into play.

Following the negotiations on the revaluation clause, Mr. Coombs noted, the Germans had requested that they be allowed as a matter of courtesy to inform their Common Market partners of the revised arrangement and the System's market operations. For various reasons, however, the German report to their Common Market associates apparently left a lot of questions unanswered, and so he had made a quick trip last week to Switzerland, Belgium, and France to make sure that both the objectives and the limitations

1/ Copies of a memorandum from Mr. Broida, dated July 27, 1972, and entitled, "Subcommittee actions relating to German swap line," were distributed to the members of the Committee and placed in its files.

of the System's new approach were fully understood. On the day he was returning to New York--Wednesday, August 9--the National Bank of Belgium had to take in a further $29 million on top of roughly $50 million over the preceding 10 days. The Belgians called the Trading Desk that day to ask if the System could give them some help by intervening in New York on the following day, and it was agreed to do so. Since the System was facing a net demand for Belgian francs of uncertain dimensions, the Desk naturally operated cautiously. However, over a 3-day period the Desk managed to move the Belgian franc rate down significantly below its ceiling at a cost of no more than $10 million and in the process may have damped down some of the earlier speculative pressure on the Belgian franc. The System's operations seemed to have had a useful effect in that there was now some feeling in the market for Belgian francs, and perhaps in the market for German marks as well, that exchange rate developments were no longer a one-way street. The System's intervention in Belgian francs seemed also to have had the sympathetic effect of pulling the French franc down slightly from its ceiling, just as the System's earlier intervention in marks brought about a sympathetic weakening of the Dutch guilder and Swiss franc.

Finally, Mr. Coombs said, he was glad to report to the Committee that the System had completed yesterday the final repayment on its swap debt to the Bank of England which, as the members would recall, originally stood at $750 million. The System's over-all swap debt had now been reduced from a peak of $3,045 million to $1,780 million, a reduction of $1,265 million during the past year.

Chairman Burns remarked that Mr. Coombs' report was most encouraging. He asked Mr. Coombs, with reference to his recent trip, to review the objectives and limitations of the System's new intervention policy as he had explained them to the Europeans.

Mr. Coombs said he had stressed that under no circumstances would the System draw on a swap line to absorb dollars which the foreign country already held on an uncovered basis or which a country might take in under the Smithsonian agreement, and that the System would undertake operations in the market only on its own initiative. As for the possibilities of intervention to deal with market disturbances, there had been a great deal of exploratory conversation about technical matters.

Mr. Coombs added that European officials had greatly appreciated his visit to review the System's operations. Moreover, they had appeared to be relieved that the United States had taken a decision which at least temporarily had defused a situation that had been reaching an explosive point. He came away with the belief that they were now in a highly cooperative mood for working out any new arrangements to keep the situation under control.

In response to a question by Chairman Burns, Mr. Coombs said he had not consulted with Japanese officials, that they had not sought to initiate any consultations, and that he did not think they would. He believed that Japanese officials, particularly those at the Bank of Japan, understood that the Federal Reserve would not be inclined to make commitments in Japanese yen at this time.

In reply to a further question by Chairman Burns, Mr. Coombs said the bulk of the sterling used to repay the debt to the Bank of England had been acquired in direct dealings with the Bank of England; about $250 million equivalent had been purchased from the U.S. Treasury; and in response to a Treasury request, about £2 million a day had been purchased in the market over recent weeks. The British had not been altogether happy with the market purchases, which had reduced their reserves.

Chairman Burns observed that the System's position with respect to its swap lines and debts looked much improved.

Responding to a question by Mr. Mayo, Mr. Coombs reported that when he had undertaken to intervene in the market for German marks on the day after the July meeting of the Committee, he had obtained a tentative commitment from the Treasury to make $25 million of marks available for the purpose. On the second day of those operations the Treasury had informed him that they could not continue to make marks available, and he had had to rely on the System's holdings of no more than $10 million. When those had been used up the dollar had slumped quite sharply. Fortunately, however, the rate had leveled out later in the day.

Mr. Daane remarked, and other members of the Committee agreed, that the Special Manager deserved special commendation for his conduct of recent operations.

Mr. MacLaury asked Mr. Coombs to comment on recent newspaper accounts of discussions between the French and the Italians concerning an increase in the price of gold for official transactions within the framework of the European Community monetary agreement.

Mr. Coombs replied that the issue arose out of the breakdown of the financing arrangements that had accompanied the European Community's agreement to maintain narrower margins of fluctuations among their own currencies than between their currencies and the dollar. Under those arrangements, countries had committed themselves to settle debts to their partners with gold, SDR's, and dollars in proportion to their holdings of those reserve assets. However, after the British had decided to allow sterling to float and the lira had come under pressure, the Italians balked at making payments in gold and SDR's at existing prices in relation to the dollar. The Italians indicated that they would be willing to use dollars in settlement of the debts incurred in the process of defending the narrow exchange rates against other EC currencies or, alternatively, that they would abandon the narrow margins for exchange rates and intervene only with dollars. In the event, they followed the latter course. Consequently, the functioning of the whole European Community monetary agreement reached an impasse, and continued uncertainty about the terms of settlement would tend to maintain the London gold price in a range around $70 an ounce. So far those developments had not produced a reaction in exchange markets, but there was the threat that official suggestions for a new international conference to consider the price of gold and exchange parities would provoke a new crisis in exchange markets.

Mr. Brimmer noted that one newspaper story attributed to the French a proposal that the EC countries make settlement among themselves in gold at the market price rather than at the official price of $38 an ounce. He asked Mr. Coombs whether the French had indeed made such a proposal.

Mr. Coombs said he thought the French had not formally made the proposal but might have hinted at it.

Mr. Morris observed that the constraints on Euro-dollar borrowings by U.S. banks had been imposed in 1969 in the context of a very different balance of payments situation. In light of the current situation and of the developing interest rate relationships that would again encourage U.S. banks to borrow abroad, he questioned whether the present reserve requirement on such borrowings should be maintained. Although he thought the flow needed to be controlled, he questioned whether it was appropriate at this time for it to be shut off altogether. He thought the reserve requirement ought to be used flexibly, and he asked Mr. Coombs how European central bankers might react to Board action in that area at this time.

Mr. Coombs replied that he thought their reaction would be favorable.

Chairman Burns commented that the Board intended to consider the question in the near future. Personally, he understood the arguments for change that Mr. Morris had mentioned, but at the same time he would not like to see a repetition of the 1969-71 pattern that involved first heavy borrowing abroad and then heavy repayment of those borrowings. If the door to those borrowings were to be opened once again, he thought the System should be careful not to open it widely, or else be prepared to act promptly to close it again in the event of very large inflows.

Mr. Brimmer said he had gained the impression from the weekly statistics that some banks borrowed Euro-dollars even when their borrowings were subject to the reserve requirement of

20 per cent. It appeared, therefore, that the flow had not been cut off completely but rather had been inhibited--as had been intended. He, like Chairman Burns, was concerned about a repetition of the 1969-71 pattern of flows. Some banks had been willing to rely heavily on Euro-dollar borrowings as an alternative source of funds to adjust their reserve positions, and they would be prepared to do so again in a period of tight money. He was concerned that once again problems of reserve management would be posed for the System.

Mr. Hayes remarked that in the immediate situation it would be desirable to have larger inflows of funds from abroad. Although it would be important to be prepared to check inflows if they became too large, he thought that problem could be faced when it arose.

> By unanimous vote, the System open market transactions in foreign currencies during the period July 18 through August 14, 1972, were approved, ratified, and confirmed.

Mr. Coombs then referred to a letter, dated August 9, 1972, from Dr. Fritz Leutwiler, the General Manager of the Swiss National Bank, which had been distributed to the Committee. As Governor Daane was aware, some time ago he (Mr. Coombs) had become intrigued by the fact that the Swiss National Bank had locked up roughly $1 billion of commercial bank funds through 100 per cent reserve requirements on certain categories of nonresident foreign deposits in Swiss francs. The Swiss banks had been earning nothing on those frozen funds, and it therefore seemed to him that they might very well welcome any possibility of investing them in the dollar market, even at minimal rates of return.

Mr. Coombs noted that an outflow of those presently frozen Swiss franc funds into dollar investments could, of course, supply the System with some of the Swiss francs needed to pay down the swap debt. The key to such an operation, however, lay in providing the Swiss commercial banks with somewhat less expensive forward cover; currently that cover was running at about 4-1/2 per cent, which would offset the interest on CD's. However, less expensive forward cover might induce the outflow. Quite clearly, the Swiss commercial banks, like most commercial banks, would not be prepared to move the money out on an uncovered basis. However, the Swiss National Bank had recently secured new authority to operate in the forward market. In his trip to Zurich last week, he had raised with Dr. Leutwiler the possibility that the Swiss National Bank might employ this new authority to operate in the forward market to provide exchange rate cover at a premium of 3 to 3-1/2 per cent, which would leave a net return of 1 to 1-1/2 per cent on new placements by Swiss commercial banks in the New York CD market. Dr. Leutwiler expressed interest in the idea but felt that it would have to include Federal Reserve sharing in the forward operation if it was to have any chance of getting his associates' approval. His letter, which arrived yesterday, outlined a possible proposal which would enable the System to reduce its swap debt in Swiss francs by as much as $300 million. In view of the fact that the System did not yet have a firm official proposal from the Swiss but might have one before the next meeting of the Committee, he recommended that this matter be referred to the Subcommittee, consisting of the Chairman, Vice Chairman, and Mr. Robertson, for possible action between now and the next meeting.

Mr. Coombs added that about $200 million equivalent of funds was similarly tied up in Belgium. If the operation with Switzerland worked effectively, the System might be able to arrange a similar one with the Belgians. The two operations together could result in a reduction of roughly $400 million in the System's swap debt. He was inclined to make a very strong, favorable recommendation to the Subcommittee. Assuming that the Swiss were willing to proceed with this proposal--and they might not be--he thought it was a good means of enabling the System to show a further sizable reduction in the swap debt--a development which would have a useful psychological effect on the market.

In response to questions by Mr. Daane and Mr. Hayes, Mr. Coombs said that, over the longer run, repayment of the System debts would require reflows of funds from abroad. However, this operation with the Swiss would reduce by 50 per cent the System's exposure to a change in the exchange rate; in terms of Swiss francs, the System would reduce the swap debt by $300 million equivalent while taking on forward liabilities of $150 million equivalent. As long as there was no outflow from Switzerland, the funds would remain locked up--except for the amounts channeled out by this operation--and there would be no problem of rolling over the forward contracts. Should the situation improve and funds flow back to the United States, the Swiss commercial banks would be able to obtain forward cover at a premium under the 3-1/2 per cent likely to be required in this operation, and they would then be likely to ask that they be allowed to substitute cover obtained in the market for the cover they had obtained from the System and the Swiss National Bank.

In reply to a question by Mr. Brimmer, Mr. Coombs noted that the Swiss commercial banks became involved through the speculation against the dollar that caused an inflow of funds into Switzerland. The projected operation would channel those private funds back into dollar investments at a minimal rate of return, and the Swiss commercial banks would not gain much from it. In effect, the proposed procedure was similar to that used in the past whereby a European central bank acquiring unwanted dollars engaged in swap operations in order to induce an outflow of funds, generally into the Euro-dollar market. As that market no longer was a desirable outlet, the New York CD market was suggested. The United States would gain from the operation in terms of the reduction in its swap debt and the favorable impact such reduction would have on attitudes in the market. The Swiss National Bank would lose in the sense that it would reduce its covered position in dollars by $300 million and would incur a forward liability of the equivalent of $150 million in Swiss francs. Its willingness to consider this operation was an indication of the improved atmosphere for cooperation.

In reply to a question by Mr. Coldwell, Mr. Coombs said the timing of the operation was related to the report on the System's foreign currency operations that would be made public around September 10. If this operation were to be implemented prior to that date, the report would show that the System's swap debt had been cut in half from its peak in August 1971, and that could have a very constructive effect on the market.

It was agreed that a Subcommittee, consisting of the Chairman and Vice Chairman of the Committee and the Vice Chairman of the Board of Governors, or designated alternates, should be authorized to act on behalf of the Committee with respect to a proposal for reducing the System's swap debt in Swiss francs.

Chairman Burns said that any Committee members having further thoughts about the proposed operations should communicate them to him promptly for consideration by the Subcommittee.

The Chairman then called for the staff report on the domestic economic and financial situation, supplementing the written reports that had been distributed prior to the meeting. Copies of the written reports have been placed in the files of the Committee.

Mr. Partee made the following statement:

> Today marks the first anniversary of the new economic initiatives launched by the Administration last August 15. The extent to which the existence of that program has contributed to subsequent economic developments is now being subjected to a barrage of claims and counter-claims in the press and elsewhere. Without attempting a definitive answer on that question, I think it important to note the progress that the economy has made, at least in its domestic ramifications. Comparing the results of the past three quarters with those of the preceding year, real economic output is shown to have accelerated from a 2.3 per cent growth to an annual rate averaging 7.4 per cent; nonfarm employment has spurted at a 2-1/2 million annual rate, compared with a net gain of only 100,000 in the year before; and moderate but convincing progress has finally been made in reducing the unemployment rate below the 6 per cent level that had prevailed for close to 2 years. At the same time, the rate of inflation, as measured by the fixed-weight deflator for private GNP, has moderated from a 4.8 per cent advance in the year ended last fall to 3.1 per cent, annual rate, since then.
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> For the most part, of course, these figures are the reflection of a vigorous, if belated, economic recovery. Since last fall, consumer spending has advanced markedly, business investment has turned sharply upward, residential construction outlays have shown further gains, and Federal, State and local purchases combined have risen at a substantially faster rate than in the previous year. The strength of demand has stimulated rising production and employment, and the output resurgence has created conditions conducive to accelerated productivity growth and a leveling off in unit labor costs. Would these favorable results have taken place in the absence of the new economic program? Perhaps so. But in mid-1971 the Board staff was projecting a rise in real GNP over these past three

quarters at an annual rate averaging 4.6 per cent, rather than the 7.4 per cent realized; a gain in nonfarm employment at a 1.6 million rate rather than 2-1/2 million; and a rate of inflation averaging 4.3 per cent rather than 3.1 per cent. These differences are very substantial--far more than our usual orders of error--and they made a substantial difference in the unemployment rate too; we had projected unemployment still to be at 6.3 per cent as of the second quarter of this year.

I do not believe that our mid-1971 projection was greatly out of line with those current at that time in the business and financial community. And the main factor that the forecasts of last summer did not take into account, of course, was the introduction of the new economic program. It does seem clear that the wage-price freeze and the subsequent controls program curbed the advance in wages, and to a lesser extent in prices, below the rates that had been anticipated. And it does appear that the termination of the automobile excise tax, the reintroduction of the investment tax credit, and the other fiscal measures taken had the effect of buoying private spending plans. With market prospects looking up and inflation at least partially under wraps, the effect was to raise business and consumer confidence, and to buttress the forces that already were pointing toward economic recovery.

Now that the recovery is well established, it has gathered an upward momentum that should carry through for a considerable time to come. As I noted a month ago, the most recent statistics are showing less vigor than before, perhaps due in large part to the effects of the late-June floods in the East. Thus, the revised industrial production index changed little from May to June and will show only a very modest increase in July, so that the advance over the 2-month period is at an annual rate of only 2 per cent. Similarly, nonfarm employment remained virtually unchanged in July, with a sizable decline reported in manufacturing. Yet retail sales showed a sharp, 2 per cent gain last month, according to the advance report, with new car sales at an 11-1/2 million annual rate--the highest of the year. Manufacturers' new orders also continued strong through mid-year, with orders for business capital equipment especially buoyant. And the recent data on business inventories suggest that a move toward more rapid accumulation finally is in progress.

Despite some weaker aspects in the business news, therefore, I remain confident that the economy will continue in its vigorous recovery trend. A more buoyant spending behavior on the part of consumers will be buttressed by the 20 per cent increase in social security benefits commencing in October, by a probable increase of size in the Federal minimum wage, and later on, by the income tax refunds that will be paid out early next year. State and local government purchases, which have been lagging a little recently, will be supported by Federal payments on general revenue sharing beginning this fall, probably on a retroactive basis, and apparently also by increases in other grants-in-aid. Business expenditures for plant and equipment seem certain to continue upward--perhaps by more than we have projected--and increasing rates of inventory accumulation appear highly likely as well. And although housing starts have been moving downward, the data on building permits, mortgage commitments, and vacancy rates suggest that the downtrend over the near-term will be gradual, as expected.

The evidence on wages and prices also seems generally favorable. Wage rate advances clearly have slowed this year, with average hourly earnings in the private nonfarm sector up at only a 4-1/2 per cent annual rate from January to July, and productivity gains have accelerated to an annual rate of close to 5 per cent. The pace of price increase also clearly has moderated, although food prices at retail will continue to be a problem for at least the next few months. Odds are that we are at close to the most favorable point of the cycle in terms of unit labor costs. Pressures for larger wage gains may grow as labor markets continue to strengthen, and productivity growth is likely to slow. Nevertheless, the immediate outlook is more favorable than had been anticipated.

In sum, although our economic projection for the remainder of this year and 1973 is little changed from that of 4 weeks ago, I find myself a shade more optimistic about the outlook. Good growth in real terms seems assured, but the timing of probable sources of additional demand suggests that the rate of expansion will tend to moderate to a more sustainable pace as 1973 progresses. Moreover, the recent behavior of costs and prices suggests that there may be a basis for a more moderate behavior into the future than we have predicted, although some deterioration in the cost and productivity picture seems inevitable. To realize this potential may require the continuation of some form of incomes policy, but it now seems possible that such a program--if there is one--may not come under unbearable upward pressures that would lead to its collapse.

What does this outlook imply for monetary policy? The period since last August has been one in which the problems of balancing the objectives of policy in the domestic sphere have not been difficult. Expansion in the monetary aggregates--particularly the money supply--has been moderate, and yet upward interest rate pressures have been slight. Net, both long- and short-term rates remain significantly below the levels reached a year ago. We on the staff have been surprised by this outcome. Given the growth that has occurred in both real and nominal GNP, we would have expected appreciably stronger money demands and considerably higher interest rates in at least the short-term area long before now. The unexpected lull in Treasury financing has been a major help in this respect, and it seems likely also that precautionary money balances may have been drawn down as confidence returned and the outlook for jobs and incomes improved.

It may well be that we are now coming to the end of that comfortable period. The surge in money supply in July, though exaggerated and partially reversed, was disquieting. Past and projected rates of economic growth lead us to believe that money demands will be stronger in the future than has been the case in recent months. And Treasury financing requirements are about to reverse and will then remain exceptionally large through at least the spring of next year.

Under the circumstances, the policy alternatives presented to you in the blue book[1] this time all show appreciably larger increases in the monetary aggregates for the third quarter than they did last time. Rates of expansion subsequently are expected to moderate, and can be brought back within the Committee's target range either by late 1972 or early 1973, depending on the option chosen. Mr. Keir will discuss questions of operating strategy in more detail later on this morning. At this point, I would simply like to point out that somewhat faster money growth, if it is limited in dimension and duration, should not prove harmful to the economy. Resource utilization rates are still relatively

1/ The report, "Monetary Aggregates and Money Market Conditions," prepared for the Committee by the Board's staff.

low, and they are projected to remain comfortable throughout 1973, while the wage-price problem seems somewhat more susceptible of control than was the case a few months ago. Given the uncomfortable choice, I would prefer at this point to see only a gradual firming in interest rates, even at the cost of some excess growth in money supply, rather than risk an abrupt upward escalation in interest rate levels. I therefore find myself in accord with the rate and quantity implications of alternative B.[1/]

Mr. Winn asked Mr. Partee what assumptions the staff had made concerning the impact on the reserve aggregates in the third and fourth quarters of the forthcoming changes in Regulations D and J.

In reply, Mr. Partee said that the reserve levels shown in the blue book were not adjusted for the regulatory changes scheduled to take effect in the statement week ended September 27--apart from the effect on RPD's of a small increase in the level of excess reserves, assumed to occur when the regulatory changes first became effective during the final week of the August-September period. In the next blue book, appropriate adjustments would be made to the new levels of the reserve aggregates, taking account of more complete data on the volume of waivers resulting from the changed regulations.

Chairman Burns remarked that it was not too early to develop plans for the large volume of transactions that the Desk

1/ The alternative draft directives submitted by the staff for Committee consideration are appended to this memorandum as Attachment A.

would need to make in order to absorb reserves released by the combined changes in Regulations D and J. Ordinarily the Desk sold Treasury bills to absorb reserves, but in this case he thought that the Desk should carefully consider the possibilities of selling longer-term Treasury and Federal agency issues as well. It might be desirable to demonstrate in the market that the System was ready at times not only to buy but also to sell longer-term securities.

Mr. Hayes said he agreed with the Chairman's observation. With respect to the possible monetary effects of the changes in Regulations D and J, he was concerned that many banks believed they would gain a significant amount of reserves regardless of the Desk's operations. There was a risk that that expectation would lead them to excessively exuberant behavior during the next 6 weeks.

Mr. Mitchell remarked that the large banks--the sector one would classify as aggressive--would not be much affected by the changes in the Regulations; the effect would be primarily on the smaller, less aggressive banks. Although a sizable amount of reserves would be released, the System had announced that it did not intend the changes to have any monetary effects.

Mr. Hayes observed that there would be difficulty in determining the appropriate volume of offsetting open market operations since the amount of reserves actually released would not be known until after the event.

Mr. MacLaury added that it would seem to matter little whether the reserves released by the regulatory changes were acquired initially by large or small banks, since the large banks could count on gaining access to them through the Federal funds market.

Mr. Heflin said the high rate of growth in GNP in the second quarter and the sharp increase in M_1 in July along with the other statistics that had become available since the July meeting had made the Committee's problem somewhat more difficult. He believed there was a danger of over-reacting to prosperity. After the board of the Richmond Bank was briefed on the economic situation last week, one director expressed the view that an increase in the discount rate would be appropriate. He was reminded by another director that a year ago everyone would have been happy to see real GNP growing at the rate that it had been lately.

Mr. Heflin added that in view of the recent record of growth in real GNP and in the money supply, he was a little surprised that the staff projections for real growth in the second half of the year had been reduced somewhat from those of a month ago, but he recognized that one had to take a longer view of such relationships. In his opinion, the Committee should be careful not to take any action that would raise interest rates unnecessarily.

Mr. Morris remarked that the prospects for interest rates discussed in the current blue book suggested to him that the structure of Regulation Q ceilings urgently needed to be reconsidered. The existing structure had been established in early 1970, and another structure might be appropriate to conditions of 1973 when the economy would be moving into a period of higher interest rates.

Mr. Daane noted that the blue book discussed the consequences for interest rates of a policy to dampen down the rates of expansion in the monetary aggregates. However, he was troubled by the lack in either the blue book or the green book[1/] of any appraisal of the impact that rising interest rates would have on economic activity. He was troubled also by the lack of analysis of the present state of financial markets and of expectations with respect to Federal Reserve policy. A significant volume of the recently issued Treasury securities had not yet been digested, and the market was very sensitive to any signs of a shift in System policy. Therefore, he questioned whether it was possible to have a gradual upward movement of interest rates, as Mr. Partee had suggested; he wondered whether the movement might not be so precipitate as to have adverse consequences for economic activity. He shared Mr. Heflin's concern about actions that might raise

1/ The report, "Current Economic and Financial Conditions," prepared for the Committee by the Board's staff.

interest rates. In particular, he was concerned that a vulnerable market might over-react to a System action designed to produce only small differences in the rates of change in the monetary aggregates.

In response, Mr. Partee noted that the staff's projections of economic activity through the fourth quarter of 1973 were based on monetary assumptions that included rising interest rates. Specifically, the staff had thought that by the end of this year long-term rates would rise by about 50 basis points and short-term rates by about 150 basis points. Although interest rates generally had moved up somewhat since early spring, on balance they had not moved very far. This suggested that economic activity could expand along the lines of the staff projections with considerably higher interest rates than those prevailing at this time. Actually, the rise in interest rates might be somewhat less than projected earlier because the rates of monetary growth under alternative B were somewhat higher than the rates projected a month ago.

Concerning the psychological elements in the situation, Mr. Partee continued, market participants no doubt anticipated that money market conditions would tighten as economic activity continued to strengthen, and they would tend to act on indications that the expected was in fact happening. It was difficult to judge how much effect that might have on interest rates. However, it seemed to him that in recent weeks market participants--ordinarily a mercurial group--had become more complacent about the outlook for interest rates, and they might not be as sensitive to some firming in money market conditions as they would have been a month earlier. Any move in interest rates might well be erratic, but generally speaking, he thought the rise could be gradual.

Mr. Sternlight said he agreed that market participants were a mercurial group. He agreed also that they might be more complacent about the outlook for interest rates, as evidenced by their willingness to take a sizable stake in the recent Treasury refunding, making it very successful. However, that also created a degree of vulnerability that suggested caution in moving toward firmer money market conditions.

Mr. Hayes remarked that from his talks with various market participants over the past month he was convinced that there was a general expectation of an upward trend in short-term interest rates during the rest of this year.

Chairman Burns noted that in a recent meeting of the Committee on Interest and Dividends, representatives of commercial banks, savings banks, savings and loan associations, and life insurance companies had expressed expectations for increases in short-term rates. With respect to long-term rates, however, the expectations for increases that had been widespread just a few months ago had given way in some cases to expectations for little change.

Mr. MacLaury said that the Minneapolis Bank, like the Richmond Bank, had recently held a board meeting at which a director had suggested that circumstances were appropriate for an increase in the discount rate. He (Mr. MacLaury) and a number of others had disagreed, but nevertheless he had been instructed to send a telegram to the Board of Governors expressing his board's belief that monetary policy needed to counter the excessive stimulation from fiscal policy that was in prospect.

Mr. MacLaury then noted that the GNP projections contained in the latest green book still were based on an assumption of growth in the monetary aggregates consistent with expansion in M_1 at an annual rate of around 6 per cent. He believed that it would have been useful to have included GNP projections for the third and fourth quarters based on higher--and, in his view, more realistic--rates of monetary expansion.

In reply, Mr. Partee said the staff had not wished to prejudge a change in the Committee's targets for the monetary aggregates and therefore had continued to assume rates of monetary growth in the second half of the year consistent with a rate of 6 per cent in M_1 even though those rates no longer appeared realistic. However, the staff had used the econometric model to gauge roughly the impact that higher rates of growth in the aggregates would have on GNP projections. The results, which had not been refined in any way by judgmental assessment, suggested that nominal GNP in the final quarter of next year would be roughly $5 billion higher under the most restrictive alternative in the blue book, about $15 billion higher under the middle alternative, and $25 billion higher under the least restrictive alternative. Should the Committee's decision today imply rates of monetary growth higher than those consistent with 6 per cent in M_1, those higher rates would be taken into account in the projections prepared for the next green book.

Mr. MacLaury commented that he recognized that the staff could not present GNP projections based on a single set of assumptions for the monetary aggregates which differed from the Committee's targets. However, it would be useful if the green book contained alternative projections based on more than one set of monetary assumptions.

Mr. Keir made the following statement on the monetary relationships discussed in the blue book:

> Mr. Partee has provided the analytical reasons for believing that the stronger-than-anticipated performance of M_1 in July may represent a catch-up to a more normal growth relationship with expanding GNP. On this basis the staff now believes that--given current interest rates--M_1 might be expected to grow at annual rates of 9 per cent in the third quarter and 8-1/2 per cent in the fourth. Recent and projected rates of growth in M_2 and the adjusted credit proxy are also fairly rapid, but less so in relation to past experience than M_1.
>
> With growth in the demand for money thus expected to remain strong, the key question facing the Committee

today is whether the Desk should be directed to hold back on the provision of RPD's as a means of moderating growth in the aggregates, and if so, by how much. The blue book presents three possible policy approaches for Committee consideration which can be characterized most easily in terms of their expected impact on M_1.

Alternative C--the most stringent of the three--specifies an RPD path designed to achieve a 6-1/2 per cent annual growth rate for M_1 in the fourth quarter, rather than in the third as contemplated by the directive adopted at the last Committee meeting.

Alternative B specifies an RPD path designed to achieve about the same 6-1/2 per cent annual growth rate, but over the fourth and first quarters taken together, rather than in the fourth alone. By the first quarter this approach would be expected to slow M_1 growth down to the 6 per cent annual rate assumed in the June chart show.

Alternative A would focus on the same fourth and first quarter time interval as alternative B, but for the two quarters combined it would seek to slow growth of M_1 only to about a 7-1/2 per cent annual rate rather than 6-1/2 per cent. In the last blue book, the specifications for alternative A also contemplated an M_1 growth rate of 7-1/2 per cent, but for the third quarter taken by itself.

All the new blue book alternatives thus involve some lengthening of the time horizon over which the Committee would seek to achieve moderation in growth of the aggregates. The logic of this shift is two-fold. First, given the revised outlook for the aggregates, any effort to set new, more stringent RPD paths that would achieve the old M_1 growth specification within the third quarter could be expected to trigger abrupt and rather drastic interest rate advances. A large part of these advances would probably then have to be reversed, if their lagged impact on the aggregates were not to produce an overly sharp subsequent deceleration. Secondly, since there is still a substantial volume of under-employment in the economy, attainment of a slowing in growth of the aggregates to desired rates over a somewhat longer period would not be likely to create any distortions of importance in the Committee's longer-run economic objectives.

It may seem puzzling that even under alternative C, for which markedly higher Federal funds rate and member bank borrowing ranges are shown, the August-September RPD growth rate is not much slower than under the other two alternatives. This relationship reflects the lags involved in the adjustment process whenever the volume of reserves supplied or the level of interest rates changes.

At any given point, bank demands for reserves depend on the volume of deposits outstanding and the consequent need for required reserves. Under present operating procedures, if the growth in private deposits and associated RPD's appears to be more rapid than desired, the Desk holds back on the provision of nonborrowed reserves. This forces banks to seek other sources of reserves and, on the margin, to turn to the System discount window. In the first instance, except for a slight reduction in banks' excess reserves, the Desk's action does not reduce the flow of RPD's; it only changes the mix between nonborrowed and borrowed reserves. However, if the constraint on RPD's persists, increased member bank borrowing is partly offset by smaller increases--or reductions--in nonborrowed reserves, and as banks seek alternative sources of funds, they bid up money market rates. In time, higher interest rates encourage the public to economize on deposits; and growth in the monetary aggregates slows down.

The sequence of relationships in this process is clear. The Desk holds back on the provision of nonborrowed reserves, forcing banks into debt at the discount window. This raises money market rates. Higher interest rates lead the public to economize on deposits, and demands for RPD's are then lowered. In the last analysis, while the reserve tightening process starts with the Desk holding back on the provision of nonborrowed reserves, the actual attainment of slower growth in total RPD's and the aggregates reflects a lagged response to higher interest rates.

The RPD control process I have just been describing relates to Desk operating strategy when growth in RPD's and the aggregates tends to exceed rates desired by the Committee. Because of the importance of interest rate changes to longer-run growth paths for the aggregates, however, when the Committee wants to act to reduce such growth rates, as would be the case under alternatives B and C, similar control considerations may even arise when RPD's are remaining within the target range. For example, the three proposed policy approaches would seek to achieve quite different growth rates for M_1 over the fourth and first quarters, even though their August-September RPD targets ranges are not very different. Attainment of the more stringent M_1 growth rate for alternative C would be expected to be associated with substantially higher interest rates than the more modest M_1 objectives of alternatives B and A. This raises the question, whether the Desk should follow a more restrictive strategy in providing nonborrowed reserves under alternative C (and to a lesser extent B), even when RPD's are remaining within the target range. Fewer nonborrowed reserves and higher average levels of member bank borrowing would very likely be needed soon in order to reach the higher levels of interest rates that we think are required to encourage the public to follow through on the desired economizing of deposit balances.

Mr. Brimmer noted that the staff's latest review of GNP projections in the green book essentially reconfirmed the earlier expectation of continued strength in economic activity over the months ahead. However, he questioned the projections for Federal expenditures, which indicated an increase of only 2-1/2 per cent from calendar 1972 to calendar 1973 compared with an increase of 11 per cent from 1971 to 1972; he would have thought that the expansion in 1973 would have been more than in the year before rather than less. Consequently, he thought that pressures on resources might be greater than suggested by the staff projections. Nevertheless, he would stress that the volume of unemployed resources would still be substantial in mid-1973; while the level of activity would be high, the economy would not be in a boom.

Continuing, Mr. Brimmer said the question arose whether the Committee should attempt to sustain more rapid growth in the economy in order to reduce the volume of unemployed resources or whether it should attempt to moderate growth in order to contribute more to restraining the rise in prices. In his view, it would be premature for the Committee to attempt to retard the rate of economic expansion.

Mr. Partee observed, in response to Mr. Brimmer's comment on the projections, that Federal budget expenditures were expected to rise substantially but Federal purchases of goods and services in terms of the GNP accounts were not expected to rise much. The difference was accounted for by transfer programs and grants-in-aid, which were reflected in other expenditure categories in the national accounts rather than in Federal purchases of goods and services. The staff had raised its estimates of budget outlays--which now totaled $257 billion for fiscal 1973 compared with $250 billion at the time of the mid-year budget review--to reflect, among other things, retroactive revenue sharing and flood relief and purchases of goods and services associated with escalation of the Vietnam war. The Federal Government seemed to be exercising tight control over increases in purchases of other goods and services.

Mr. Brimmer remarked that nevertheless he was doubtful that Federal purchases of goods and services would be held to an increase in 1973 as small as that indicated by the projections in the green book. With respect to those projections, he inquired whether they reflected the latest assessment of the outlook for U.S. foreign trade.

Mr. Partee replied that they did.

Mr. Daane observed that in his view the analytical approach--as in Mr. Keir's statement--that put so much emphasis on slightly different rates of growth in M_1 in the first quarter of 1973 distorted the focus on the current problem. As he had observed, the Committee was confronted with a vulnerable market that might overreact to System actions designed to produce only small differences in the rates of change in the monetary aggregates.

Mr. Hayes commented that Mr. Keir's statement had given an accurate description of the way Desk operations work to implement the Committee's policy. At any time, the Desk could control the provision of nonborrowed reserves, and its operations were reflected in the funds rate and in money market conditions in general. In his view, that emphasized the importance of the funds rate; money market conditions were in fact the more immediate operating handle even though Committee members talked of RPD's as the major handle.

Chairman Burns remarked that however important money market conditions might be, the Committee had decided upon the experiment that used reserves against private nonbank deposits as its operating handle.

Mr. Coldwell said he agreed with Mr. Partee's assessment of the economic situation. Also, he thought that Mr. Keir's analytical approach to the monetary relationships was consistent with the Committee's policy framework, which was designed to achieve desired rates of growth in the monetary aggregates over a period of time rather than to achieve any immediate conditions in the market; the Committee adopted targets with respect to the monetary aggregates rather than with respect to interest rates. Given the lags in the system, the Committee ought to be looking ahead to the fourth quarter of this year and the first quarter of next year, and perhaps even to the second quarter of next year.

In addition, Mr. Coldwell observed that the rates of growth in the monetary aggregates specified in the blue book under alternative A represented a sharp departure from the growth rates the Committee had contemplated in recent months and that the staff had employed in making its GNP projections. Alternative B also specified relatively high rates of growth for the remainder of this year. The significant differences between alternatives B and C did not begin to show up until early next year. It was with that problem in mind that he had dissented from the Committee's decision at the last meeting.

Mr. Mitchell commented that the situation in which the Committee found itself reminded him of Paul Dukas' orchestral composition, "The Sorcerer's Apprentice." The Committee-sorcerer had directed the staff-apprentice to develop a model to use in guiding policy formation. The staff had done so to the best of its ability, but nevertheless it made many mistakes; in trying to accommodate the Committee, the staff went further than its techniques would permit. In consequence many misunderstandings and uncertainties arose and were compounded into a confusion which was more than the "apprentice" or even the "sorcerer" could dispel. Tranquility could not be restored in this real-life dilemma by faith in M_1 numbers subject to large fluctuation from month to month. Looking ahead, the Committee wished to reduce unemployment and achieve sustainable economic growth, but it had become convinced that it needed to moderate the rate of growth in M_1 mainly because of an unexplained surge in M_1 in July. However, the record of the past year showed that such an action based on a single month's performance was not justified. In this period the annual rate of growth in M_1 had fluctuated on a monthly basis between -2 and +13.5 per cent. Action based on so erratic a series should await a sustained trend or supplementary and supportive analysis or both.

In conclusion, Mr. Mitchell called the Committee's attention to the observation in the blue book that long-term interest rates probably would remain relatively stable until late in the year under the alternative A policy course, but not under alternatives B and C. To his mind that observation conveyed the most useful advice the staff could offer the Committee at this time.

Before this meeting there had been distributed to members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period July 18 through August 9, 1972, and a supplemental report covering the period August 10 through 14, 1972. Copies of both reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Sternlight made the following statement:

> Open market operations in the period since the last meeting of the Committee provided reserves to the banking system cautiously and with increasing reluctance as the period progressed. Within a few days after the period began, projections suggested that growth in reserves available against private deposits would be in the upper part of the 3 to 7 per cent range sought by the Committee. Subsequently, projections suggested a growth rate at or above the top of the range, while the latest estimates pointed to growth just within the upper end. Growth in the aggregates has also come in on the strong side, particularly M_1 and the adjusted credit proxy.
>
> The response of the Account Management to these indications of strength was limited somewhat by even keel considerations as the Treasury undertook a very large refunding operation, but with a constructive atmosphere prevailing in the credit markets it was possible, and appropriate, to achieve some modest firming of money market conditions without jeopardizing the success of the Treasury financing. Indicative of this firming, average Federal funds rates moved up from around 4-1/2 per cent in mid-July to around 4-3/4 per cent in recent days. While this may seem to be a very modest move, it does have some significance in that funds were encouraged to trade steadily at rates above the discount rate. At the same time, member banks have had to meet somewhat more of their reserve needs at the discount window.
>
> Thus far, the credit markets seem to have taken this modest firming well in stride. Investors and dealers took a large stake in the Treasury financing, making it a very successful operation from the standpoint of Treasury debt management, and the new issues have performed well in the market thus far. Dealers initially took a total of $1,115 million of the 3 new

issues into position at the time the subscription books closed on August 2. As of last Friday they still held $887 million. Of the $228 million decline, nearly $190 million reflected Desk buying for various foreign and domestic official accounts. Net redistribution to private investors has been quite modest so far. In addition to the holdings of reporting dealers, some of the new securities--how much we do not know--are held by so-called trading banks, which are relatively short-term holders and which bought the securities in the hope of taking out a profit, perhaps within the next month or so.

The dealer and trading bank supplies are not now being pressed on the market; for the time being, these holders are content to stay put. However, many of these holders believe that interest rates are likely to go higher rather than lower if one looks several months ahead. Thus these holdings represent a potential area of vulnerability, and it is possible that substantial selling pressure could emerge if credit market participants got the idea that higher rates were coming sooner rather than later.

Viewing the policy alternatives before the Committee against this background, it appears to me that a rapid firming of money market conditions could produce a considerable change in the atmosphere for intermediate- and longer-term issues. The Desk has on hand some sizable investment orders for Treasury and foreign accounts that could help to cushion market adjustments. With that help, my guess would be that the markets could accept without much trauma a further firming in the Federal funds rate to around 5 per cent over the next week or so. To push beyond that would pose greater risk for the stability of longer-term interest rates, although taking this risk may indeed be necessary in order to slow the aggregates.

The steady-to-constructive feeling in longer-term credit markets has not been confined to Treasury issues. Yields on tax-exempt issues and corporate bonds have tended to decline somewhat in recent weeks, as credit demands have been moderate and market participants seem to be impressed by signs of progress in moderating inflation. A firming in money markets would have an impact on these long-term sectors, but perhaps only after some delay.

Despite the firming that has recently occurred in day-to-day money market rates such as those on Federal funds and dealer loans, a number of key short-term market rates, including those on commercial paper and CD's, have come down a bit in the past few weeks. As much as anything, this seemed to reflect a scarcity of collateral, while short-term investment funds were ample. Treasury bill rates have backed and filled in a fairly narrow range over the interval, responding to divergent influences that included some foreign account selling early in the period, followed by buying by foreign accounts and by investors who sold rights eligible in the Treasury exchange. In yesterday's auction of 3- and 6-month bills, rates were about 3.96 and 4.46 per cent, respectively, virtually unchanged from the levels the day before the last meeting. Persistence of higher Federal funds and dealer financing rates in days ahead should tend to push bill rates somewhat higher, particularly as the time approaches when the Treasury must come to the market in size to raise new cash. Another factor that may work in this direction would be the forthcoming changes in Regulations D and J, the net effect of which will be to release a sizable volume of reserves, presumably calling for offsetting action to hold reserve growth within desired bounds. It may be a few more weeks before these latter factors are felt, however, and in the meantime it is possible that persistent foreign buying and general scarcity of collateral would tend to hold back a rise in bill rates even while day-to-day money rates move up.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period July 18 through August 14, 1972, were approved, ratified, and confirmed.

Mr. Sheehan then remarked that the telegram to the Board of Governors from the directors of the Minneapolis Bank, to which Mr. MacLaury had referred, helped to dramatize his view of the current situation. It seemed to him that the telegram and the tone of the description of developments in the Ninth District contained in the red book[1] were not consistent. On the one hand, the telegram emphasized the degree of fiscal stimulus; it urged the Chairman to continue his efforts to encourage a responsible fiscal policy; and it recommended some further move toward monetary restraint. On the other hand, the red book noted that District farmers' willingness to spend had declined, although their earnings had improved, and that the unemployment rate for the District averaged 6 per cent during the second quarter compared with 5.6 per cent a year earlier.

Continuing, Mr. Sheehan noted that staff projections suggested growth in real GNP of about 5.5 per cent from the second half of this year to the second half of 1973. Industrial production would expand perhaps 7.5 per cent, but it would then exceed the peak reached in 1969--4 years earlier--by little more than 10 per cent. The projections also suggested that the unemployment rate would fall only a half of one percentage point to 5 per cent in the second half of next year, and that capacity utilization in manufacturing would rise by only about 3 per cent to around 80.5 per cent. Therefore, he agreed with Mr. Brimmer's observation that the economic expansion was not developing into a boom.

1/ The report, "Current Economic Comment by District," prepared for the Committee by the staff.

Concerning fiscal policy, Mr. Sheehan commented that the Federal budget apparently would be stimulative for the next three quarters, but the record of misjudgments about Federal receipts and expenditures over the past 6 months raised doubts about the actual outcome. It was uncertain whether the Congress would legislate revenue sharing--as had been assumed in making the budget estimates--and whether the Treasury would take steps, as had been suggested by Chairman Burns, to divert some portion of next year's tax refunds into a special security. And there was doubt as well that the price and wage controls would end next April, as had been assumed by the staff in projecting price changes through the end of next year. In conclusion, Mr. Sheehan agreed with Paul Samuelson's remark, quoted in the red book, that despite three consecutive quarters with real growth at a rate in excess of 6 per cent, "We should not conclude we're having too much of a good thing."

Mr. Hayes commented that the New York Bank's analysis of the economic outlook was very much like that presented by the Board's staff. With respect to wage and price developments, he was encouraged by recent evidence of progress. However, he was concerned by the prospects of a large number of labor contract negotiations next year, of a shrinking of the margins of idle resources, and of a possible decline in the rate of productivity growth; he strongly hoped that the wage and price controls would be continued. Moreover, he was worried by the present fiscal policy; according to the New York Bank's measure, the fiscal stimulus in the current fiscal year would be the greatest since the period of the Korean war.

Mr. Hayes observed that the policy decision confronting the Committee was especially difficult because of a great sensitivity at this time about the whole subject of interest rates. However, he believed there was a clear case for some modest firming in view of the likelihood of excessively rapid growth of money and credit both in the current quarter and during the coming autumn and winter. The vigorous advance in the economy did not in itself warrant an effort to slow it, but recognition of the lags in the effects of monetary policy required that a start be made in trying to prevent undesirably rapid growth in the monetary aggregates at a time when fears of inflation were still lively and the whole international situation remained very delicate.

Continuing, Mr. Hayes said he favored the money market specifications associated with alternative B, with a central tendency around 5-1/4 per cent for the Federal funds rate. He would hope that the Desk would move the funds rate to 5 per cent fairly promptly--that is, over the next week or two--and then would move it up further toward 5-1/4 per cent in the remainder of the period, unless the figures on the aggregates seemed to be coming in substantially weaker than the blue book paths. An excessive growth rate for M_1 in the third quarter now seemed inevitable, and there was no point in any precipitate action with respect to the funds rate in an effort to affect the third-quarter growth rate, but he was worried about the following quarters. In order to underscore that concern, he would suggest aiming for RPD growth centering closer to 6 per cent for August and September combined--rather than the 7.3 per cent figure associated in the blue book with alternative B. As for the language of the directive, he would retain the reference to international developments in the final paragraph to emphasize that open market operations should be conducted in a way that would guard against downward pressure on short-term rates. With reference to the proposed revision of the statement of the Committee's general policy objectives in the preceding paragraph, he would prefer to retain the language the Committee had been using, even though it had been he who had initially suggested that the statement of objectives be reviewed. It seemed to him that the proposed new wording suggested a more accommodative monetary policy and would give the wrong impression at this time. Revision of that paragraph might be reconsidered when the problems facing the Committee or its response to them underwent some significant modification.

Mr. Hayes commented that it was desirable and feasible to defer any consideration of a discount rate increase; the funds rate could remain in the 5 to 5-1/4 per cent range for a considerable period without requiring an increase in the discount rate from 4-1/2 per cent. The directors of the New York Bank so far had not been impatient for action.

Finally, Mr. Hayes said, the recent substantial expansion in stock market credit, coupled with the relative exuberance of the market itself, suggested to him that it might be worthwhile for the Board to consider an increase in margin requirements.

Mr. Eastburn remarked that his experience on the morning call each day since the last meeting of the Committee had convinced him that holding growth in the aggregates to modest rates in the period ahead inevitably would entail higher short-term interest rates. Had it not been for the Treasury financing in the interim since the last meeting, he believed, the Federal funds rate would have moved close to or above 5 per cent in the process of trying to hold down the rates of increase in the aggregates. For the period ahead, he would prefer--other things equal--to pursue more moderate rates of growth in the aggregates along the lines of alternative C, which would slow growth in M_1 to a rate of 6.5 per cent in the fourth quarter. As the blue book suggested, however, reducing the rate of growth that quickly would lead to an undesirable stop-and-go policy. Therefore, the reasonable course appeared to be somewhere between alternatives B and C, aiming at average rates of growth in M_1 over the fourth quarter of this year and the first quarter of next year in line with the target the Committee had held for a considerable period. Some increase, and perhaps a substantial increase, in money market rates would be necessary; that would be consistent with the Committee's experiment with reserves as an operating handle.

Continuing, Mr. Eastburn said his experience on the morning call since the last meeting also had raised a question in his mind about the specifications for the funds rate. For that period, the Committee had specified a range of 4 to 5.5 per cent, but it became apparent that 5.5 per cent was unrealistically high, even apart from even keel considerations. For the period ahead, a range of 4-1/2 to 6 per cent was shown in the blue book under alternative B, and an increase up to 6 per cent might well be required if growth in the aggregates was to be slowed to the extent indicated under that alternative. On the basis of the discussion so far, however, he doubted that anyone was seriously contemplating a funds rate as high as 6 per cent. If that were the case, perhaps the Committee should not specify a range up to that level.

In conclusion, Mr. Eastburn remarked that the directors of his Bank were not restive about the discount rate at this time, but he thought they would become so if short-term interest rates continued upward. However, their thinking was based on the principle of a flexible rate. If the discount rate was in fact not to be flexible, it would be important to so inform the directors, so that they would not be acting on the basis of a mistaken assumption.

Mr. Mitchell asked Mr. Hayes whether he believed that an increase in the discount rate could be avoided if the Committee adopted either alternative B or C. He (Mr. Mitchell) believed that implementation of either of those alternatives would generate expectations of an increase in the rate and probably would lead some Reserve Bank directors to favor such action.

Mr. Hayes replied that, as he had said earlier, he thought a Federal funds rate between 5 and 5-1/4 per cent would not in itself require an increase in the discount rate.

Mr. Eastburn agreed with Mr. Mitchell that further advances in the funds rate would exert growing pressure for an increase in the discount rate. The pressure would be generated not only by excessive borrowing at the discount window but also by public discussion that would occur against the background of the emphasis the System itself had placed on the relationship between the discount rate and market rates in the past year and a half.

Mr. Daane said it seemed obvious that if the funds rate rose to 6 per cent, an increase in the discount rate would be unavoidable and the whole structure of interest rates would move up abruptly. Consequently, he did not think it made sense to contemplate ranges for the funds rate that extended that high. He noted that the blue book specifications for all three alternatives, including alternative A, envisaged increases in short-term rates, and he questioned whether long-term rates would remain stable even under alternative A. He believed that some further uptick in short-term rates was desirable, but he would not want to see large increases. Accordingly, he favored alternative A today. Since he thought Mr. Hayes was similarly opposed to sharp interest rate increases, he was surprised that the latter had not also expressed a preference for alternative A.

In response, Mr. Hayes said that he had not advocated a rise in the funds rate to 6 per cent; he had mentioned a range of 5 to 5-1/4 per cent. His main concern was with the outlook for the monetary aggregates, and he noted that under alternative A the staff expected M_1 to grow at rates of 8.5 per cent in the fourth quarter and 7 per cent in the first quarter of 1973, on top of a rate of 9 per cent in the current quarter. That would mean three consecutive quarters of growth at excessive rates. Moreover, the heavy financing needs of the Federal Government late this year raised the possibility of excessive expansion in both public and private borrowings. He believed that the probable course of credit demands over the next 6 months would force substantially higher interest rates. Although he would not want to anticipate that upward pull on interest rates to any degree, he also would not want to try deliberately to hold interest rates down. If the Committee failed to take some modest firming action now, there was the possibility that it would be confronted 3 or 4 months hence with a need for drastic increases in interest rates.

Mr. Daane remarked that in his judgment interest rates would not be held down under any of the three alternatives. As for the growth rates of the monetary aggregates, he thought the underlying linkages were too tenuous to warrant much confidence in projections through the first quarter of next year.

Mr. Coldwell commented that projections of the relationship between rates of growth in the aggregates and the Federal funds rate had not been very good. With the experience of the past 4 months in mind, he doubted that the funds rate would in fact rise to the upper limits of 6 and 6-3/4 per cent shown in the blue book for alternatives B and C respectively. In any event, he hoped that the funds rate would not rise as high as 6 per cent before the next meeting of the Committee, and he certainly would not favor a rate as high as 6-3/4 per cent.

Mr. Brimmer remarked that if alternative C was not realistic and if no member of the Committee was willing to contemplate a funds rate as high as 6-3/4 per cent in the interval before the next meeting, the record should not suggest that the Committee had seriously considered that alternative.

Mr. Robertson observed that in his view alternative C was not beyond consideration by the Committee.

Mr. Hayes commented that the Committee's adoption of reserves as an operating handle had been based on an assumption that the funds rate would be allowed to move through a wider range in the period from one meeting to the next. However, the Committee seemed to be reluctant to allow that wider range of fluctuation.

Mr. Morris observed that thus far in the experiment with the use of reserves as an operating handle, it had not been necessary to utilize ranges for the funds rate as wide as those that the Committee had assumed would be necessary. Believing in the utility of the projections, he would want the staff to continue presenting its best assessment of the relationships between the aggregates and the funds rate. Committee members would, of course, remain free to make their own judgments.

Mr. Mitchell responded that he would have no objections to the current procedure if the staff attached probabilities to each of its projections. However, they presented all of them as if they were equally likely. The recent record suggested that some of the projections had rather low probabilities.

Mr. Partee noted that in working through the projections, the staff attempted to judge the central tendency for the funds rate and the range through which it might fluctuate, if not constrained, in relation to growth in RPD's in the short run and to growth in the monetary aggregates over the longer term. Whether the funds rate was constrained to a narrower range of fluctuation was a policy issue for the Committee to decide. With respect to alternative C, the range specified for the funds rate--5-1/4 to 6-3/4 per cent--reflected the staff's expectation that the demand for money would be very strong in the fourth quarter, so that restraint on the rate of growth in money would raise the funds rate appreciably. If the Committee adopted that alternative, it could specify a range for the funds rate with an upper limit below 6-3/4 per cent.

Mr. Partee added that despite all the tools and judgments brought to bear, the staff would still make projection errors. Over the past 4 months, the funds rate had not risen as much as projected in relation to the paths for RPD's that the Committee had adopted. In the period ahead, projections might continue to err in the same direction. Alternatively, interest rate pressures might prove to be stronger than projected in relation to any given rate of growth in RPD's. It might be possible to use experience with projections to calculate probabilities of errors of various magnitudes, but they would be of limited value to the Committee in that they could not indicate in a given situation whether the deviations were more likely to be positive or negative.

Chairman Burns observed that members of the Committee needed to recognize the fallibility inherent in projections. Also, the kinds of projections given to them depended on the questions asked. For example, the members could ask what the consequences would be of raising the Federal funds rate over a period of one month and then holding it stable for the following 6 months. That actually was the nature of the assumptions made in working through the projections for the blue book. Alternatively, they could ask what the effect would be if the same change in the funds rate occurred over a period of 2 or 3 months. There were numerous possibilities.

Continuing, Chairman Burns remarked that he was not afraid of prosperity and that he did not see an economic boom developing; if the projections for economic activity made by the staff and other economists were anywhere near the mark--and he did not differ with them--extensive underutilization of resources would persist for at least another year. Over the past year, the Committee had pursued a very moderate monetary policy. In fact, the rate of growth in the narrowly defined money supply not only had been substantially lower than growth in the dollar value of the gross national product, it also had been lower than the rate of growth in real GNP.

As for fiscal policy, Chairman Burns observed, the President had firmly stated his intention to veto any Congressionally approved appropriations that exceeded the amounts he had recommended. Within the Congress itself and on both sides of the political aisle, sentiment was growing rapidly for some kind of ceiling on expenditures that would maintain them in a closer relationship with revenues, and chances were good that such legislation would be passed in 1973 if not this year. In his judgment, Federal expenditures next year would not rise as high as had been suggested by many projections.

Concerning incomes policy, Chairman Burns said he believed price and wage controls would be extended beyond next April, when the authorizing legislation was scheduled to expire. Moreover, the Pay Board had been examining the possibility of a downward revision in the guideline for wages. The Board had decided not to lower the guideline at this time, but at least the issue had been considered, and favorable action was likely early next year. It was significant also that in the House of Representatives a stiff battle was being fought against legislation to increase the minimum wage. Over the past few months, the behavior of the price indexes had been good. Although he doubted that the record would be equally good over the next few months, he had been informed that the Department of Agriculture expected food prices to level off or decline after rising further in August and Septemb

In conclusion, Chairman Burns reiterated that the remaining margins of unutilized resources were great enough to permit rapid expansion in real output and still leave extensive unemployment of labor and of machinery and equipment. At the same time, the blue book projections of even more liberal monetary growth suggested a rate of increase in M_1 that was no greater than the rate of growth in real output. At this stage of the expansion, he saw no need to be afraid of prosperity and to adopt a restrictive monetary policy.

Mr. Francis observed that staff projections indicated only slight differences among the three alternatives in the rates of growth in M_1 that would result for this calendar year--ranging from 7.4 to 8 per cent. However, they differed considerably in terms of the rate of monetary expansion at the beginning of the new year.

Reviewing the recent past, Mr. Francis noted that after the Committee had decided in late 1968 that restraint was in order, monetary expansion was reduced from high rates in 1967 and 1968 to a rate of about 3 per cent in 1969, and the pace of economic expansion slowed. Then, in 1970, the Committee acted to increase the rate of monetary expansion; M_1 grew at a rate of about 5.5 per cent in 1970 and a rate of 6.2 per cent in 1971, and that appeared to cushion the economic adjustment substantially as compared with earlier economic adjustments. During the whole period, he had expressed concern at times that the rate of monetary growth was too fast and at other times that it was too slow, but on balance since 1968 the record did not look bad.

At present, Mr. Francis continued, the economic expansion was proceeding rather well. However, he believed that a rate of growth in M_1 at 8 or 9 per cent continued into the new year, following a rate of 8.7 per cent during the first 7 months of this year, would produce a demand situation that somewhere along the line would require that the Committee pursue a policy of restraint. He was concerned that the slowing down then would proceed too far, once again reducing real output and raising unemployment. He would prefer that the rate of monetary expansion be restrained now in order to avoid sharper restraint later and an economic downturn once again. He believed that was the way to produce prosperity.

Mr. Robertson commented that the Committee was confronted with a vigorously expanding economy and a price performance that was still too strong for comfort, and also with an accompanying balance of payments performance that was far too weak. In that kind of environment, acceleration in monetary expansion significantly beyond the moderate growth the Committee had intended was a cause for real concern. Such acceleration, if allowed to continue unchecked, could sow the seeds of renewed inflation and undermine the hard-won gains of the economic stabilization program, and the Committee should not permit that to happen.

Too often in the past, Mr. Robertson continued, the Federal Reserve had been slow to apply needed monetary restraint. The Committee had talked itself into such delays, waiting for more confirming evidence, hoping for a snapback in the figures, yearning for more appropriate stabilization action elsewhere on the part of authorities better equipped to deal with the underlying problems. Typically, the result on those occasions was that by waiting longer the Committee had allowed the problems to grow larger, requiring harsher action from all responsible authorities, including the Federal Reserve, when action finally had been forthcoming.

With those thoughts in mind, Mr. Robertson believed that it was important for the Committee to move now to firm monetary policy as much as it responsibly could. He favored targets for the monetary aggregates no higher than those shown under alternative C. He granted that the money market changes projected for that alternative were more abrupt than the Committee should ordinarily inflict on markets, but he was frankly skeptical of those projections. He would rather tell the Manager to pursue the moderate monetary aggregates specified for alternative C, so long as he could do so without exceeding the reasonable money market constraints associated with alternative B. If those constraints were reached--for example, if the Federal funds rate rose to 5-1/2 per cent--it would be high time for the Committee to counsel again on its policy course.

He would submit that that was the best way to move today, on what might be the last occasion this year that was free of "even keel" restraints.

Mr. MacLaury said he might first explain the apparent disparity--on which Mr. Sheehan had commented earlier--between the review of developments in the Ninth District contained in the red book and the contents of the telegram sent to the Board on behalf of the directors of the Minneapolis Bank. The report in the red book was concerned with recent and current developments in the District and was not forward looking. The telegram, on the other hand, was forward looking; it pointed to the overly expansive effects of fiscal policy and suggested that a move toward monetary restraint should not be long delayed, particularly because of the long lags in the effects of monetary policy.

Turning to policy, Mr. MacLaury noted that the experiment with reserves as the operating handle was at issue in the discussion today. On a number of other occasions, Chairman Burns had warned that the Committee was in danger of abandoning the experiment embarked on early in the year, and now the challenge to the experiment seemed more serious. From the discussion, he concluded that Committee members were not prepared to see the funds rate move by a large amount in a single month. He believed that others had been viewing the funds rate in terms of the experiment in the same way that he had--not as a target on a par with RPD's and the monetary aggregates but rather as a constraint, in what might be described as a reversal of the old proviso clause. From that standpoint, he felt that the extension of the blue book projections by an additional quarter for today's meeting was a disservice, and that the first-quarter projection of growth in M_1 at a rate of 4-1/2 per cent under alternative C was a distraction. As he understood the procedure, the projection assumed that the funds rate moved up a specified amount within the next month and then remained there for some period of time. However, if short-term interest rates rose over the near term, the Committee could, in the light of the behavior of the aggregates, decide at its next meeting or the one after that whether or not it wished to see interest rates sustained at the higher levels.

Continuing, Mr. MacLaury said he would find it difficult to characterize the alternative C rates of growth in the monetary aggregates--as represented by growth in M_1 at an average rate of 7.5 per cent in the second half of this year--as a policy that would stifle growth and prosperity. He shared the view that the Committee should allow market forces to move interest rates up gradually. Like Mr. Robertson, he would adopt the specifications for the aggregates under alternative C--apart from those for the first quarter of next year, for the reasons he had indicated--but he would specify a narrower range for the funds rate than the Committee had been using. A range of 4-1/2 to 5-1/2 per cent for the funds rate until the next meeting would provide an appropriate constraint on the pursuit of the target for RPD's. Thus, he would like to see the Committee aim at the rates of growth in the aggregates specified under alternative C, if need be using the entire range specified for the funds rate.

In reply to a question by Mr. Mitchell, Mr. MacLaury said that while he could not speak for his directors, he personally would be prepared to see the discount rate get out of line in September and October. Of greater concern to him was the possibility that in order to avoid being faced with the issue of a change in the discount rate, the Committee would be unwilling to allow the tightening of money market conditions required in an effort to achieve the rates of growth in the aggregates it desired.

In response to a question by Mr. Brimmer, Mr. MacLaury said the telegram to the Board of Governors from his directors was not based on their view of developments in the Ninth District alone but rather on their concern about inflationary developments in the nation as a whole. Only one director had suggested an increase in the discount rate, and he doubted that there was much support for an increase among the others. The directors had agreed that a telegram reflecting their concerns should be sent to the Board, but they had not reviewed the specific language used in the wire.

Mr. Mayo remarked that he, like Chairman Burns, hoped that Federal expenditures would be held down, but the lags in the system were such that both expenditures and receipts for the current fiscal year were largely determined already. Given the fiscal outlook, and in view of the recent rates of growth in the monetary aggregates, he would favor a modest firming in policy. The projections of M_1 alone might suggest alternative C as the proper course. Considering the projections for M_2, however, he favored alternative B. He also favored the alternative B specifications for the funds rate and, unlike Mr. MacLaury, he would retain the wider range specified in the blue book; he was somewhat concerned that the Desk seemed to interpret the mid-point of the range more or less as the upper limit.

Continuing, Mr. Mayo observed that the staff had done an excellent job in providing the Committee with alternatives for policy, and he would not ask that an effort be made to attach probabilities to the projections. In his view, such an assessment was part of the process of arriving at a judgment on policy and therefore was the responsibility of Committee members.

Mr. Mayo added that the directors at the Chicago Bank had not been restive concerning the discount rate, partly because of an expectation that the Board of Governors would adopt a change with respect to Regulation A that would result in more frequent changes in the discount rate in line with developments in short-term markets. A great deal depended upon the principles that were decided upon with respect to changes in the discount rate.

Mr. Kimbrel said he wondered whether the Committee, having chosen to give primary emphasis to the monetary aggregates, should not decide now to accept the wider swings in short-term interest rates which it had been warned could occur. He noted also that the language proposed for the operational paragraph under alternative B was substantially the same as that adopted at the last meeting, although the rates of growth in the aggregates specified under that alternative were higher this time. Moreover, he was concerned about the consequences of the changes in Regulations D and J, which would be implemented shortly after the next meeting of the Committee, and about the prospects that even keel considerations would limit the Committee's opportunities in the months ahead. Accordingly, he favored a move toward restraint at this meeting. The rates of growth in M_1 specified under alternative C--8-1/2 and 6-1/2 per cent in the third and fourth quarters, respectively--were as high as he thought the Committee could countenance without risking accelerating inflationary developments.

Mr. Kimbrel noted that staff projections for the first quarter of next year suggested that growth in the aggregates under alternative C might fall to rates lower than the Committee would desire. However, he was more concerned that a funds rate as high as 6-3/4 per cent might be required in order to achieve the growth rates specified under alternative C. Nevertheless, he would give priority to the aggregates, and experience indicated that the funds rate might not need to rise to as high a level as 6-3/4 per cent. Some increase appeared necessary, and he favored a range of 4-1/2 to 5-1/2 per cent. Should the rate move too rapidly toward 5-1/2 per cent, or should the money and capital markets become disturbed, it might be desirable for the Committee to review its decision before the next scheduled meeting.

Mr. Kimbrel added that the directors of the Atlanta Bank had not grown restive with respect to the discount rate. However, they might regard an increase as desirable if short-term interest rates rose or if inflationary expectations intensified.

Mr. Winn remarked that he was disturbed by a number of credit developments. Specifically, he was concerned about stock market credit and about auto instalment loans involving excessive loan-to-value ratios and 48-month maturities, although he did not know whether the use of a 48-month term had spread significantly. The financing of leasing as well as sales through auto finance companies rather than directly through banks meant that borrowing was at the prime rate rather than at banks' traditional rates.

At banks, growth in long-term balloon paper and write-offs of some of their loans under the Small Business Administration suggested possible problems. As noted in the supplement to the green book, moreover, mortgage borrowing in the second quarter of the year included sizable financings against land and existing homes.

With reference to the July surge in M_1, Mr. Winn observed that there was danger of another bulge in September associated with adjustment to the changes in Regulations D and J. Despite the System's educational efforts, banks probably misunderstood the net effect of those changes on the availability of funds. The Committee would be fortunate if growth in the aggregates fell within a range encompassed by alternatives A and C. With the confusion and uncertainty that would exist, the System would need to pursue a kind of even keel policy in a broad sense, and its hands would be tied with respect to the discount rate.

Mr. Daane said he would not put much emphasis on small differences in rates of growth in M_1 at this time but rather would emphasize System posture toward conditions in financial markets. The markets presently were vulnerable, and he would avoid actions likely to prove disruptive. The Committee could, cautiously and gradually, probe toward a slightly higher pattern of interest rates without pushing; some rise in rates was bound to occur in any event, although he hoped a sharp increase in long-term rates could be avoided. Consequently, he favored the language of alternative B, with the reference to international developments restored, and the financial market conditions and interest rate pattern of alternative A. In his judgment, an increase in the discount rate would be unavoidable if the Committee moved toward restraint as aggressively as some members were suggesting.

Mr. Clay observed that he wanted prosperity, but prosperity without inflation. The Committee was facing a serious problem in its formulation of monetary policy. It had to limit the growth rates of the monetary aggregates in order to avoid excessive stimulation of the economy in the months ahead. The difficult issue revolved around what interest rate developments the Committee was willing to accept. It did not appear that the Committee could do what was necessary in limiting growth rates of the monetary aggregates without accepting increases in money market rates and possibly in capital market rates. The problem could not be alleviated by backing away from it and permitting excessive growth rates in the aggregates. Over time that would only intensify the interest rate problem.

The appropriate choice of policy, Mr. Clay continued, obviously was not found in alternative A. It lay between alternatives B and C. What was needed in terms of the monetary aggregates was most nearly represented by alternative C, although the probable interest rate developments in the money markets and possibly in the capital markets accompanying such a policy move were of some concern. However, there could be no certainty as to what those interest rate developments would be. Moreover, one had to recognize the upward pressure on capital market rates that would flow from evidence of a monetary policy of excessive stimulation. He would suggest the monetary aggregate patterns of alternative C within a money market conditions constraint represented by a Federal funds range of 4-3/4 to 6 per cent. It was important that no abrupt action be taken in the implementation of the Committee's policy; actions should be gradual.

Mr. Clay added that he believed the ensuing advance in interest rates would be acceptable. He would guess that such an advance in rates would lead his board of directors to propose an increase in the discount rate. The directors had been convinced that it was desirable for the discount rate to be flexible and to be adjusted closely to market rates.

Mr. Merritt said he would associate himself with the views expressed by Messrs. Robertson, MacLaury, and Kimbrel. He believed that if the Committee allowed this opportunity to pass, it might find it extremely difficult later on to apply the desired degree of restraint.

Mr. Bucher observed that in the short time he had been a member of the Committee he had fixed in his mind the concept of the Committee's experiment, and it would be his normal inclination to stay within the framework of that experiment. However, the staff materials prepared for this meeting and the discussion so far today had caused him to modify that position somewhat. Specifically, he shared the concern expressed by several others about the risks of an unduly rapid rise in interest rates. Therefore, while he favored the alternative B growth rates for the aggregates, he would like to see the Federal funds rate constrained within the 4 to 5-1/2 per cent range of alternative A.

At this point the meeting recessed for lunch. It reconvened at 2:30 p.m. with the same attendance as the morning session.

Chairman Burns remarked that during the luncheon recess he had asked the staff to check with the Treasury about its near-term financing plans, because it seemed likely that if the Treasury were going to raise a substantial volume of funds in late September it would probably do so primarily through a bill issue, and that would add to the upward pressures on bill rates. The check revealed that the need for a late-September financing would depend on whether Congress enacted the revenue sharing bill. A large financing probably would be required if that legislation were enacted, but not otherwise.

Continuing, Chairman Burns said he would like at this point to draw the attention of Committee members to a few arithmetical facts about the staff's projections. As shown in the blue book, the average rates of growth in M_1 projected for August and September combined were 5-3/4 per cent for alternative A, 5-1/2 per cent for alternative B, and 5-1/4 per cent for alternative C. The differences among those growth rates clearly were not large. With respect to RPD's, the differences between alternatives A and B were \$6 million in August and \$13 million in September in relation to an RPD level in excess of \$30 billion; the differences between alternatives B and C were \$6 million in August and \$28 million in September; and, of course, the differences between alternatives A and C were the sums of those differences.

The Chairman then proposed that the Committee hold a go-around on the subject of directive language and specifications. In view of the concerns expressed this morning about the outlook for interest rates, it would be desirable for each speaker to state specifically his preference with respect to the Federal funds rate constraint and to offer any other brief comments he had on the subject of interest rates.

Mr. Hayes observed that he preferred the language of alternative B, with the reference to international developments restored. He preferred the specifications of alternative C for the aggregates--including growth in RPD's at an average rate of about 6.5 per cent in August and September combined--but not for the funds rate. For the funds rate, he would prefer a range of 4-1/2 to 5-3/4 per cent, or perhaps 4-1/2 to 5-1/2 per cent, and he would hope that the rate would not get stuck at 5 per cent but would gradually move a little higher during the course of the period.

Mr. Francis said he also would choose the specifications of alternative C except for the funds rate. He thought that the funds rate specifications of alternative B would be consistent with the other specifications of alternative C.

Mr. Kimbrel remarked that he preferred the aggregate growth rates of alternative C with the funds rate in a range of 4-1/2 to 5-3/4 per cent.

Mr. Eastburn said he would prefer rates of growth for the aggregates mid-way between those of alternatives B and C--which would mean growth in M_1 at a rate of about 7 per cent in the fourth quarter. For the funds rate, he would specify a range of 4-3/4 to 5-1/2 per cent, with the expectation that a meeting would be called if the rate pressed against the upper limit.

Mr. Winn observed that he favored the language of alternative B. As to specifications, he preferred aggregate growth rates mid-way between those of alternatives B and C and a range of 4-1/2 to 5-1/2 per cent for the funds rate.

Mr. Bucher said he preferred the language of alternative B, and he would combine the aggregates specified under alternative B with the alternative A range for the funds rate.

Mr. Sheehan observed that he favored specifications for the aggregates mid-way between those of alternatives A and B, with a growth rate for RPD's of 7 to 7-1/2 per cent. He would specify a range of 4-1/4 to 5-1/2 per cent for the funds rate.

Mr. Brimmer said he favored the language of alternative A, a range of 4-1/2 to 5-1/2 per cent for the funds rate, and the growth rates for the aggregates specified under alternative B. Growth rates for the aggregates between those of alternatives A and B also would be acceptable to him. Like Mr. Hayes, he would retain the language the Committee had been using to describe its broad objectives in the third paragraph of the directive. With respect to the implementation of the changes in Regulations D and J, he thought it might be desirable for the staff to consider encouraging the Treasury to manage its balance in a way that might be helpful to System operations. Finally, he noted that several references had been made to constraints on interest rates, some of which might be interpreted as suggesting political constraints. He assumed such an interpretation was not intended.

Mr. Daane noted that he favored the language of alternative B with the reference to international developments restored. He had a slight preference for the monetary aggregate growth rates of alternative B, but he would not pursue them if that required cranking up interest rates. However, he would accept some rise in interest rates. In general, he would prefer to specify targets more in terms of money market conditions. He would accept a rise in the funds rate to around 5-1/4 or perhaps 5-3/8 per cent, if market forces carried it up; he would not aggressively move the rate up, and he would constrain the rise to a level under 5-1/2 per cent.

Mr. Mitchell observed that he preferred both the language and specifications of alternative A. His major concern was that the Committee avoid taking any action that would create market expectations of an increase in the discount rate and thereby generate cumulative speculation on an increase. It seemed to him that the inflationary component of long-term rates had been diminishing, and that it had been diminishing to the disadvantage of some market participants. Consequently, there was an element of indirect persuasion aimed at raising longer-term rates, which was not in the public interest. He felt that that particular movement in the private sector should not be given any ammunition, and that a Federal Reserve posture which implied a near-term change in the discount rate should be resisted.

Mr. Heflin remarked that he agreed with Mr. Mitchell. For the short run, he was more concerned about the pressure on interest rates than about movements in the aggregates, particularly in view of the pressures that might develop at this time for an increase in the discount rate. Therefore, he favored the specifications of alternative A. However, the language of alternative B was acceptable to him.

Mr. Clay said he preferred the language of alternative B with the specifications for the aggregates of alternative C and a range for the Federal funds rate of 4-3/4 to 6 per cent. He would instruct the Desk to avoid an abrupt rise in the funds rate if possible.

Mr. Mayo noted that the language and specifications of alternative B were acceptable to him, including the range of 4-1/2 to 6 per cent for the funds rate--on the understanding that the wide range was specified to allow flexibility and that there would be no intention of pushing toward the upper limit of 6 per cent. Expansion in M_1 at a rate of about 7 per cent in the fourth quarter and in RPD's at about 7 per cent in August and September combined was acceptable.

Mr. MacLaury said he favored the language of alternative B and the specifications for the aggregates of alternative C, but he would constrain the funds rate to a reduced range of 4-1/2 to 5-1/2 per cent. Like Mr. Clay, he would instruct the Desk to avoid an abrupt move in the rate. At the same time, he would be willing to use the full range if necessary. With reference to the concerns expressed by Messrs. Mitchell and Heflin, he noted that a substantial deviation between the discount rate and market rates was not unprecedented, and he thought that under Phase II guidelines there was more of a case for tolerating such a deviation now than there had been in the past.

Mr. Merritt observed that he favored the language of alternative C with the reference to international developments restored and the rates of growth for the aggregates specified under alternative C. For the funds rate, he would set a range of 4-1/2 to 5-1/2 per cent.

Mr. Coldwell said he favored the language of alternative C for the directive with the international reference restored, and he agreed with Messrs. Hayes and Brimmer that the paragraph which stated the Committee's broad objectives should not be changed at this time. He would accept a funds rate range of 4-1/2 to 5-3/4 per cent, with the understanding that the Desk move gradually toward the higher level. He preferred the specifications of growth in RPD's at a rate of 7 per cent in August and September combined and in M_1 at a rate of 6 to 7 per cent in the fourth quarter. He was skeptical about the money market relationships spelled out in the blue book, but he would aim for the lower end of the range set for RPD's if the funds rate did not rise as rapidly as expected. He would not consider the discount rate to be out of line even if the Federal funds rate rose to 5-1/4 per cent.

Mr. Morris said he preferred the specifications of alternative B but with a ceiling of 5-1/2 per cent on the Federal funds rate, which he thought would give the Manager sufficient flexibility. Following the Committee's usual practice, the target for RPD would be formulated in terms of a range, which might be set at 5-1/2 to 9-1/2 per cent. In the event the demand for money was not as strong in September as forecast by the staff--which he regarded as a real possibility--he would shade toward the lower end of the growth path for RPD's provided that did not push the funds rate above 5-1/2 per cent. In his view, the linkage between the long- and the short-term markets was being over-estimated. In that connection, he noted that since February the funds rate had risen 140 basis points but long-term rates had been stable on balance.

Mr. Robertson remarked that while he had no strong preferences with respect to the language of the operational paragraph, he thought alternative C best reflected his desire for restraint. Although he favored restraint, he did not favor an abrupt rise in interest rates, and he would want a stop-out point on the funds rate at 5-1/2 per cent. If that rate moved up into the range of 5-1/4 to 5-1/2 per cent, he would expect the Manager to notify the Chairman who would have the Committee review the situation.

Mr. Brimmer noted that at this point he wished to call attention to what was a dilemma for him and perhaps also for other Committee members. To him, alternative A appeared to represent no change in policy, although the language differed from that adopted at the last meeting. Alternative B, despite its description of monetary growth as "moderate," represented a modest tightening, and alternative C represented a more substantial tightening. He would prefer language that suggested a posture somewhere between A and B--language that would indicate a modest step toward less generous provision of reserves.

Mr. Partee commented that alternative B contained the words, "moderate growth in monetary aggregates over the months ahead," because growth in M_1 in the fourth and first quarters would average 6.7 per cent. That alternative would be characterized as tightening only in terms of money market conditions.

Mr. Holland remarked that the alternative B language was essentially the same as that adopted at the last meeting of the Committee. Whether the associated specifications would be described as involving no change in policy or a tightening depended upon whether one used monetary aggregates or interest rate to characterize policy. Thus, alternative A called for roughly the same pattern of interest rates as that contemplated at the last meeting but a higher rate of growth in the aggregates, whereas under alternative B growth in the aggregates would be worked down to about the rates anticipated last time.

Mr. Mitchell noted that no one had advocated a funds rate higher than 5-1/2 per cent, and some members of the Committee had suggested that the situation be reviewed before the next regular meeting if the rate rose to 5-1/4 per cent. The blue book suggested, and he would agree, that such funds rates were not consistent with the rates of growth in the aggregates specified in alternatives B and C. In his view, the Committee was in danger of voting for inconsistent specifications. It appeared that everyone would like to have more moderate rates of growth in the aggregates without paying the price in terms of interest rates.

Mr. Mitchell added that he was uncertain about the meaning of the suggestion that the Committee "review the situation" if the funds rate rose to certain levels. Was it expected that the members would hold a telephone consultation?

Chairman Burns observed that it might be necessary to hold a meeting of the Committee in advance of the next regularly scheduled meeting or at least to consult by telephone. With respect to Mr. Brimmer's earlier remarks concerning constraints on interest rates, he commented that there were no political constraints. Nevertheless, the Federal Reserve System was a part of the Government. At present the Government had an incomes policy that applied to prices, to wages, and to profits; and through the Committee on Interest and Dividends, it also applied--on a voluntary basis--to dividends and interest rates. That Committee had already announced that the guideline limiting increases in dividends to 4 per cent a year, which had been respected by virtually every corporate enterprise in the country, would be extended into 1973. Despite the existence of a national policy affecting prices, wages, profits, and dividends, he had considered it his duty to oppose the establishment of guidelines for interest rates.

Given the framework of the Government's incomes policy, Chairman Burns continued, there was widespread opposition to higher interest rates. Thus far the record on interest rates had been extraordinarily good, and while the System could claim only a small part of the credit for that record, it had made its contribution. Nevertheless, voices had been raised to advocate ceilings on interest rates. Fortunately, resistance to ceilings had come from the President and from the Secretary of the Treasury as well as from himself, and so far resistance had succeeded. In the circumstances, the Federal Reserve should not be eager to raise interest rates.

Chairman Burns then noted that the projections for rates of growth in the monetary aggregates in the fourth and first quarters specified under alternative B in the blue book were based on an assumption that the Federal funds rate would rise one-half of one per cent before the next meeting of the Committee and then remain at that level. In response to his inquiry, the staff had studied the issue and had concluded that it would alter the projections very little if the rise in the funds rate was assumed to occur over a period of 2 or 3 months rather than one month. He saw no reason for a deliberate move to raise the funds rate by a half of one per cent within the next month. Later, toward the end of September, the Desk would probably need to sell bills in the process of absorbing reserves released by the combined changes in Regulations D and J, and that operation might exert some upward pressure on short-term rates. Forthcoming

Treasury financings also might exert upward pressures on interest rates, and the relationship between the Treasury's needs for sizable amounts of funds and increases in interest rates would be widely understood. For the period immediately ahead, therefore, he would not specify a range for the funds rate that extended as high as 5-1/2 per cent--a range for which there seemed to be sentiment within the Committee. Should that range be adopted, he would find it necessary to consult with the Committee if the rate moved toward the higher end of the range.

Mr. Coldwell remarked that the effort to achieve the moderate rates of growth in the aggregates that he believed were desired by the Committee might require a rise in the funds rate. He was not convinced that the rate would have to rise into the range of 5-1/2 to 6 per cent, and he hoped that the rate would not rise above 5-1/2 per cent before the Committee's meeting in September. He thought the rate could rise gradually, rather than abruptly, and therefore he did not think his views differed much from those of Chairman Burns.

Mr. MacLaury observed that while forthcoming Treasury financing might put upward pressure on short-term interest rates, the timing of any such financing was highly uncertain at this juncture. At the last meeting of the Committee, it had already been apparent that a sharp expansion in M_1 was developing in July, and the Committee had chosen then not to move against it on the grounds that it would prove to be transitory. He would have preferred to have seen a gradual inching up in short-term rates since then, but even keel considerations had limited the opportunity to pursue such a policy. He would not wish to attempt to make up for lost time by taking actions that would result in an abrupt rise in rates, but neither would he wish to delay action further.

Chairman Burns noted that in fact the funds rate had been moving up gradually; it was somewhat higher than at the time of the last meeting and was up substantially from its low in March. As for the period immediately ahead, he would not describe a rise from the current level of 4-3/4 per cent up to 5-1/2 as a gradual inching up. He questioned whether the Committee would be happy to see the funds rate rise one-half of a percentage point or more within the next month.

Mr. Daane commented that he shared the Chairman's trepidation about the repercussions if the funds rate rose rapidly to a level as high as 5-1/2 per cent.

In response to a question by Mr. Eastburn, Chairman Burns remarked that it was not possible to say with assurance how the aggregates would be affected in the fourth quarter if the funds rate rose no higher than 5-1/8 or 5-1/4 per cent. He would like to cite a passage from a paper the staff had prepared for him in order to demonstrate the degree of uncertainty that the Committee was dealing with.

> "We have some reason to believe that the monthly model underestimates the impact of interest rates on the demand for money. To compensate for the possibility of the understatement, we conducted a sensitivity analysis in which the interest elasticity of money demand--both current and lagged--was increased by up to 20 per cent in the model. The greater the interest elasticity of money demand, the smaller the rise in interest rates required to induce the public to reduce the rate of growth in its money balances. Thus, as the interest elasticity is increased, the amount of upward drift in interest rates is reduced.
>
> "We found that if the interest elasticity of money demand is increased by a full 20 per cent in the model, then no upward drift in the funds rate would be required at all to achieve the average growth rate in the money stock for the fourth and first quarters combined. . . ."

Thus, it was possible to have a variety of results. For that reason, he had refrained from emphasizing the numbers and rather had raised the question in terms of whether the Committee wished to move in a restrictive direction. He would be delighted to see the aggregates grow at the rates specified in alternative C, or at even lower rates, if that occurred without a substantial rise in the Federal funds rate.

Mr. Mitchell remarked that in his view interest rates were a better guide to policy at this time than were the monetary aggregates. The record demonstrated that growth in the aggregates was lumpy; an effort at strict control in the short run would be too costly. He believed, as Mr. Sternlight had said, that 5 per cent was a critical area for the funds rate, and he would be very cautious about breaching it. In any case, he thought that Committee members did not differ greatly in terms of what they would like to accomplish.

Mr. Daane commented that, like Mr. Mitchell, he believed Committee members really were not very far apart. He also felt that a rise in the funds rate beyond 5 per cent would be interpreted in the market as a major policy move and would affect expectations materially. He did not believe that economic and financial conditions presented a clear case for positive steps that would raise interest rates and provoke an increase in the discount rate.

Chairman Burns, noting his agreement with Mr. Mitchell, commented that growth in M_1 had been high at times during the past year, but over the year as a whole monetary policy had been very moderate. He felt that the differences among Committee members today reflected in part the abnormally rapid growth in M_1 in July. The question now was whether the Committee wished to take positive steps to push the funds rate up by one-half of a percentage point or more, or whether it would allow market forces to bring about a more modest increase.

Chairman Burns added that he would take second place to no one in the fight against inflation. As the members would recall, he had argued for a wage and price policy long before the Administration had decided to adopt one, and recently he had advocated a reduction in the wage guidelines, provoking displeasure in some quarters.

Mr. Robertson said it was clear that all members of the Committee wished to have as much restraint as could be achieved responsibly. That fact could form the basis for agreement. He suggested that, whatever language the Committee adopted for the directive, the Manager be instructed to apply as much restraint as possible without driving up interest rates, although some rise in interest rates no doubt would occur. The upper end of the range for the Federal funds rate might be set at 5-1/4 per cent, on the understanding that if the rate pressed against that ceiling the Committee would review the situation.

Chairman Burns agreed that Mr. Robertson's suggestion might offer a basis for agreement. He then proposed that the Committee vote on a directive consisting of the staff's draft of the first two paragraphs, a third paragraph stating the Committee's broad policy objectives in its previous form, and alternative B for the operational paragraph with the reference to international developments retained. It would be understood that in implementing the directive the Manager would be guided by the following specifications within the five-point procedure the Committee had been following since the meeting of February 15, 1972: for August and September combined, an average annual rate of growth for RPD's in a range of 5 to 9 per cent and rates of growth for M_1, M_2, and the credit proxy of about 5.5, 7.5, and 7.5 per cent, respectively; and a range for the funds rate of 4.5 to 5.25 per cent.

A discussion ensued of the extent to which the Desk had felt free in the past to use the full range for the funds rate specified by the Committee. At the end of this discussion, Mr. Coldwell said he assumed that it would be satisfactory for the Desk to aim for a rate of growth in RPD's in the lower portion of the 5 to 9 per cent range provided that the funds rate was not raised beyond 5 per cent. However, should RPD's be growing at a rate of 8 or 9 per cent, the full range of the funds rate should be used in an effort to limit growth.

Chairman Burns remarked that he thought the Desk would operate in that direction. However, he advised that, under point 5 of the Committee's procedure, he might wish to consult with the members before the next scheduled meeting.

> By unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions for the System Account in accordance with the following current economic policy directive:

The information reviewed at this meeting indicates that real output of goods and services increased at a rapid rate in the second quarter, and continued though less rapid growth appears in prospect for the current quarter. The unemployment rate was lower in June and July, but it was still substantial. The pace of advance in wage rates has slowed on balance in recent months, and the rate of increase in average prices of all goods and services in the private economy moderated in the second quarter. In July, the rise in wholesale prices of industrial commodities slowed, but wholesale prices of farm and food products rose sharply further. Since mid-July foreign exchange market conditions have been quiet and the central bank reserves of most industrial countries have changed little. In June, the large excess of U.S. merchandise imports over exports persisted.

The narrowly defined money stock grew at an unusually rapid rate in July, following relatively slow growth in May and June. Growth in the broadly defined money stock remained substantial, although inflows of consumer-type time and savings deposits to banks slowed appreciably. The bank credit proxy expanded sharply in July, reflecting strength in both private demand deposits and large-denomination CD's. In recent weeks, interest rates on most market securities have declined somewhat on balance, and the Treasury completed a highly successful refunding.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee 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.

To implement this policy, 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.

Secretary's note: The specifications agreed upon by the Committee, in the form distributed following the meeting, are appended to this memorandum as Attachment B.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, September 19, 1972, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

CONFIDENTIAL (FR) August 14, 1972

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on August 15, 1972

GENERAL PARAGRAPHS

The information reviewed at this meeting indicates that real output of goods and services increased at a rapid rate in the second quarter, and continued though less rapid growth appears in prospect for the current quarter. The unemployment rate was lower in June and July, but it was still substantial. The pace of advance in wage rates has slowed on balance in recent months, and the rate of increase in average prices of all goods and services in the private economy moderated in the second quarter. In July, the rise in wholesale prices of industrial commodities slowed, but wholesale prices of farm and food products rose sharply further. Since mid-July foreign exchange market conditions have been quiet and the central bank reserves of most industrial countries have changed little. In June, the large excess of U.S. merchandise imports over exports persisted.

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In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to substainable growth in real output, further reduction in unemployment, continued resistance to inflationary pressures, and progress toward reasonable equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPHS

Alternative A

To implement this policy, while taking account of international developments, the Committee seeks to achieve bank reserve and money market conditions that will support growth in monetary aggregates over the months ahead at about the average rates recorded in the first half of the year.

Alternative B

To implement this policy, while taking account of 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.

Alternative C

To implement this policy, while taking account of developments in capital markets, the Committee seeks to achieve bank reserve and money market conditions that will support somewhat slower growth in monetary aggregates over the months ahead.

ATTACHMENT B

STRICTLY CONFIDENTIAL (FR)

August 15, 1972

Points for FOMC Guidance to Manager In Implementation of Directive (As agreed upon 2/15/72)	SPECIFICATIONS (As agreed, 8/15/72)
1. Desired rate of growth in aggregate reserves expressed as a range rather than a point target.	5-9% seas. adj. annual rate in RPD's in Aug.-Sept.
2. Range of toleration for fluctuations in Federal funds rate--enough to allow significant changes in reserve supply, but not so much as to disturb markets.	4-1/2 to 5-1/4%
3. Federal funds rate to be moved in an orderly way within the range of tolerance (rather than to be allowed to bounce around unchecked between the upper and lower limit of the range).	
4. Significant deviations from expectations for monetary aggregates (M_1, M_2, and bank credit) are to be given some allowance by the Manager as he supplies reserves between meetings.	Aug.-Sept. Average (SAAR) M_1: about 5.5 M_2: about 7.5 Proxy: about 7.5
5. If it appears the Committee's various objectives and constraints are not going to be met satisfactorily in any period between meetings, the Manager is promptly to notify the Chairman, who will then promptly decide whether the situation calls for special Committee action to give supplementary instructions. In addition, the Chairman may want to consult with the Committee before the next scheduled meeting if developments in financial markets appear to be raising policy implications.	

ATTACHMENT C

CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

August 17, 1972

The Honorable William Proxmire
Chairman
Joint Economic Committee
Washington, D. C. 20510

Dear Mr. Chairman:

I am writing in reply to your letter of August 2 regarding release of the policy record following meetings of the Federal Open Market Committee.

The decision to release the record approximately 90 days after each FOMC meeting was made in 1967, and was thoroughly reviewed in February of 1971. The reasons for deferred publication set forth in the FOMC's rules regarding availability of information are that earlier disclosure might--

> "(1) interfere with the orderly execution of policies adopted by the Committee in the performance of its statutory functions;
> (2) permit speculators and others to gain unfair profits or to obtain unfair advantages by speculative trading in securities, foreign exchange, or otherwise;
> (3) result in unnecessary or unwarranted disturbances in the securities market;
> (4) make open market operations more costly;
> (5) interfere with the orderly execution of the objectives or policies of other Government agencies concerned with domestic or foreign economic or fiscal matters; or
> (6) interfere with, or impair the effectiveness of, financial transactions with foreign banks, bankers, or countries that may influence the flow of gold and of dollar balances to or from foreign countries."

The policy directives adopted by the FOMC ordinarily are formulated with a time horizon of more than one month in view. However, each directive governs open market operations only for the period until the next meeting--usually about a month later--at which time the Committee reviews the situation and adopts a new directive, again with a time horizon of more than a month. The primary reason for releasing the policy records about three months after the meetings to which they apply is that, after such an interval, observers are unlikely to interpret the directive cited as relevant to the Committee's open market objectives at the time of release. The purpose is to avoid these two kinds of risks:

(1) If the directive is in fact relevant to current objectives--as would always be the case if it were released before the following meeting--its release might have an impact on expectations so abrupt as to interfere with the orderly functioning of financial markets. Even if reactions were more moderate, release could still impair our ability to implement policy changes gradually, or to probe in a particular direction with the option of backing off if need be.

(2) If the directive is not relevant to current objectives--as would be the case if it were released after an intervening meeting at which the Committee had modified its objectives--but is interpreted as relevant by observers, market rates could fluctuate sharply and needlessly as participants first acted on the basis of wrong judgments and then came to realize that they had not gauged correctly the intent of policy.

The importance of these risks is likely to vary from time to time, depending on the nature of the policies being pursued and the frequency and magnitude of policy changes; and judgments may, of course, differ as to the length of the lag which is likely to prove reasonably satisfactory as a regular matter. Experience has shown that 90 days is sufficient for the purpose and, as you point out, the once-a-year use of a somewhat shorter lag to assist your Committee's deliberations on the President's Economic Report has had no untoward results. The FOMC might at some point decide that a lag somewhat shorter than 90 days would be serviceable as a regular matter; but I believe that release within a few hours or a few days after each meeting would seriously hinder the Federal Reserve in carrying out its policies.

The immediate results of the FOMC's directives, in terms of the movements in the System's portfolio and in reserves of member banks, are published in the weekly statement of condition of the Federal Reserve Banks, which is made available the day after the close of the statement week. Through this and other periodic releases, the System makes public detailed and voluminous information about its operations, very probably more information than any other central bank in the world.

In short, I believe that arrangements approximately like those in current use strike a reasonable balance between the public's right to know about monetary policy and the public's interest in successful implementation of that policy.

Sincerely yours,

Arthur F. Burns