

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 Monday and Tuesday, March 18-19, 1974, beginning at 4:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Black
Mr. Brimmer
Mr. Bucher
Mr. Clay
Mr. Holland
Mr. Kimbrel
Mr. Mitchell
Mr. Sheehan
Mr. Wallich
Mr. Winn

Messrs. Coldwell, MacLaury, Mayo, and Morris,
Alternate Members of the Federal Open
Market Committee

Messrs. Eastburn, Francis, and Balles, Presidents
of the Federal Reserve Banks of Philadelphia,
St. Louis, and San Francisco, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Bryant, Davis, Doll, Hocter, and
Parthemos, Associate Economists

Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account
Mr. Sternlight, Deputy Manager, System Open Market Account

Mr. Coyne, Assistant to the Board of Governors
Messrs. Keir and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Wendel, Assistant Adviser, Division of Research and Statistics, Board of Governors
Miss Pruitt, Economist, Open Market Secretariat, Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant, Board of Governors

Messrs. Boehne and Scheld, Senior Vice Presidents, Federal Reserve Banks of Philadelphia and Chicago, respectively

Messrs. Green and Sims, Vice Presidents, Federal Reserve Banks of Dallas and San Francisco, respectively

Chairman Burns welcomed Mr. Henry C. Wallich, recently appointed to the Board of Governors, to his first meeting of the Federal Open Market Committee. ^{1/}

The Secretary reported that advices had been received of the election by the Federal Reserve Banks of members and alternate members of the Federal Open Market Committee for the term of one year beginning March 1, 1974; that it appeared that such persons were legally qualified to serve; and that they had executed their oaths of office.

^{1/} Mr. Wallich had executed his oath of office as a member of the Committee prior to this meeting.

The elected members and alternates were as follows:

- Robert P. Black, President of the Federal Reserve Bank of Richmond, with Frank E. Morris, President of the Federal Reserve Bank of Boston, as alternate;
- Alfred Hayes, President of the Federal Reserve Bank of New York, with Richard A. Debs, First Vice President of the Federal Reserve Bank of New York, as alternate;
- Willis J. Winn, President of the Federal Reserve Bank of Cleveland, with Robert P. Mayo, President of the Federal Reserve Bank of Chicago, as alternate;
- Monroe Kimorel, President of the Federal Reserve Bank of Atlanta, with Philip E. Coldwell, President of the Federal Reserve Bank of Dallas, as alternate;
- George H. Clay, President of the Federal Reserve Bank of Kansas City, with Bruce K. MacLaury, President of the Federal Reserve Bank of Minneapolis, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after February 28, 1975, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, as the case might be, they would cease to have any official connection with the Federal Open Market Committee:

Arthur F. Burns	Chairman
Alfred Hayes	Vice Chairman
Arthur L. Broida	Secretary
Murray Altmann	Deputy Secretary
Normand R.V. Bernard	Assistant Secretary
Thomas J. O'Connell	General Counsel
Edward G. Guy	Deputy General Counsel
John Nicoli	Assistant General Counsel

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J. Charles Partee	Senior Economist
Stephen H. Axilrod	Economist (Domestic Finance)
Robert Solomon ^{1/}	Economist (International Finance)

Harry Brandt, Ralph C. Bryant,
Richard G. Davis, Raymond J.
Doll, Lyle E. Gramley,
William J. Hocter, James
Parthemos, James L. Pierce,
and John E. Reynolds Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Federal Open Market Committee after February 28, 1975.

By unanimous vote, Alan R. Holmes, Peter D. Sternlight, and Charles A. Coombs were selected to serve at the pleasure of the Federal Open Market Committee as Manager, Deputy Manager, and Special Manager for foreign currency operations, respectively, of the System Open Market Account, it being understood that their selection was subject to their being satisfactory to the Board of Directors of the Federal Reserve Bank of New York.

Secretary's Note: Advice subsequently was received that Messrs. Holmes, Sternlight, and Coombs were satisfactory to the Board of Directors of the Federal Reserve Bank of New York for service in the respective capacities indicated.

Consideration was then given to the continuing authorizations of the Committee, in accordance with the customary practice of reviewing such matters at the first meeting in March of every year.

1/ On leave of absence.

Secretary's Note: On February 26, 1974, certain continuing authorizations of the Committee, listed below, had been distributed by the Secretary with the advice that, in accordance with past practice, they would remain effective until otherwise directed by the Committee. Members were asked to so indicate if they wished to have any of the authorizations in question placed on the agenda for consideration at this meeting, and no such requests were received.

The authorizations in question were as follows:

1. Procedures for allocation of securities in the System Open Market Account.
2. Distribution list for periodic reports prepared by Federal Reserve Bank of New York.
3. Authority for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account in case the New York Bank is unable to function.
4. Resolutions providing for continued operation of the Committee and for certain actions by the Reserve Banks during an emergency.^{1/}
5. Resolution relating to examinations of the System Open Market Account.
6. Guidelines for the conduct of System operations in Federal Agency issues.
7. Regulation relating to Open Market Operations of Federal Reserve Banks.
8. Rules of Organization, Rules Regarding Availability of Information, and Rules of Procedure.

Reference was made to the procedure authorized at the meeting of the Committee on March 2, 1955 (and most recently amended on March 9, 1971, to authorize the Secretary to act on the Chairman's behalf

^{1/} With respect to the second of these resolutions, a final (unnumbered) paragraph had been inadvertently omitted from the text shown in the memorandum of discussion for the meeting of the Committee on September 21, 1971 (the date of the latest revision) and in copies distributed subsequently. The full text of the resolution was shown in an attachment to the memorandum of February 26, 1974, and is reproduced in Attachment A to this memorandum.

in considering proposals for the addition of members of the Board's staff to the list) whereby, in addition to members and officers of the Committee, minutes and other records could be made available to any other employee of the Board of Governors or of a Federal Reserve Bank with the approval of a member of the Committee or another Reserve Bank President, with notice to the Secretary.

It was stated that lists of currently authorized persons at the Board and at each Federal Reserve Bank (excluding secretaries and records and duplicating personnel) had recently been confirmed by the Secretary of the Committee. The current lists were reported to be in the custody of the Secretary, and it was noted that revisions could be sent to the Secretary at any time.

It was agreed to retain the existing procedure for making minutes and other records of the Committee available to employees of the Board of Governors and the Federal Reserve Banks, including authorization to the Secretary to act on the Chairman's behalf in considering proposals for the addition of members of the Board's staff to the list of those having access to Committee minutes and other records.

In connection with the Committee's review of its authorization for domestic open market operations, Chairman Burns noted that the report of the staff committee on bankers' acceptances,

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dated January 29, 1974, and entitled "Recommendations on Desk Operations in Bankers' Acceptances,"^{1/} included recommendations for revisions in paragraphs 1(b) and 1(c) of the authorization. He asked Mr. Sternlight, chairman of the staff committee, to comment.

Mr. Sternlight remarked that, in response to the FOMC's request at its meeting on September 18, 1973, the staff committee had considered what changes might be made in the form and substance of the FOMC's rules governing System operations in bankers' acceptances in light of the decision by the Board of Governors to revoke Regulations B and C. A new form for the rules was needed because the Board's Regulation B had constituted part of the chain of references underlying the present rules. The FOMC also had asked the staff committee to consider possible changes in the substance of the rules.

In its report, Mr. Sternlight continued, the staff committee had recommended that the elimination of reference to the Board's Regulation B from the FOMC's Regulation should be accompanied by a revision in the FOMC's authorization for domestic open market operations to incorporate a description of the types of acceptances suitable for System operations. The standards proposed in the

^{1/} A copy of this report has been placed in the Committee's files.

report were designed to ensure that System operations were confined to liquid, readily marketable acceptances. The standards involved certain modifications in the traditional "eligible" acceptance concept which were modest in nature and mostly in a liberalizing and modernizing direction. They would leave intact the basic trade-related nature of the acceptances that the Federal Reserve would purchase.

Mr. Sternlight observed that the staff committee had considered at some length the possibility of dealing in non-trade-related acceptances, or finance bills. While most members would lean toward recommending System operations in finance bills, the staff committee concluded that the subject deserved further study, which it was prepared to undertake if the FOMC so directed. The aim of such study would be to see whether System participation in the market for finance bills would add significantly to the scope of open market operations, and what effects such participation might have on the market for either finance bills or trade-related acceptances.

Mr. Sternlight added that the proposed language revisions in the FOMC authorization, shown in attachment A to the staff committee report, affected paragraph 1(b), relating to outright purchases and sales of acceptances, and paragraph 1(c), relating

to repurchase agreements. The changes suggested in paragraph 1(b) were intended mainly to incorporate the description of acceptances the Desk would be authorized to trade in. However, two of the changes were suggested simply to eliminate wording which appeared unnecessary. The language indicating that the Desk could buy or sell acceptances "on a cash, regular, or deferred delivery basis," seemed superfluous because that list exhausted the delivery bases which might be used. Secondly, the statement that aggregate holdings of bankers' acceptances should not exceed the lower of two figures--\$125 million or 10 per cent of the total volume of acceptances outstanding--could be replaced by language specifying a single limit of \$125 million; the 10 per cent limitation served no useful purpose since the volume of outstanding acceptances was currently in excess of \$8 billion.

Mr. Mitchell noted that the Board had placed reserve requirements on finance bills but not on eligible acceptances. Assuming that the Committee, after reviewing the results of the proposed study, decided to authorize an expansion of the scope of open market operations to cover finance bills as well as eligible acceptances, he wondered whether there would be grounds for arguing that the Board also should treat the two types of paper alike by placing reserve requirements on eligible acceptances.

Mr. Sternlight replied that he saw no reason why Committee action to expand the scope of open market operations in acceptances should necessitate Board action with respect to reserve requirements.

Mr. Mitchell then said he had had the impression at one time that a substantial volume of staff resources at the New York Reserve Bank was devoted to examining the acceptances proposed for purchase to determine whether the documentation was complete and whether they were satisfactory in other respects. He asked if that was the case at present.

Mr. Sternlight replied in the negative, adding that the Reserve Bank relied primarily on the commercial banks whose names appeared on the acceptances for such purposes.

Mr. Holmes noted that the Acceptance Department at the New York Bank handled purchases and sales for foreign central banks in addition to carrying out operations under the Committee's directives. The Bank guaranteed the acceptances it bought for foreign official accounts for a fee of 1/8 per cent, and the income it earned through such fees exceeded the Department's costs of operation, including overhead, by about \$420,000 in 1973. Earnings on the guarantee fee were participated among all Reserve Banks.

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In reply to a further question by Mr. Mitchell, Mr. Holmes remarked that the housekeeping operations involved in repurchase agreements on bankers' acceptances were limited to such routine actions as arranging for the delivery of the paper by the other party and for its subsequent return.

Mr. Holland said he was prepared to approve all of the recommendations of the staff committee except that relating to the deletion of the phrase "on a cash, regular, or deferred delivery basis" from paragraph 1(b) of the authorization. He agreed that the phrase was not essential, since the list of delivery bases mentioned was exhaustive. Nevertheless, the phrase did serve a useful purpose in making explicit the Desk's authority to buy and sell acceptances on a deferred basis as well as for cash and regular delivery.

After further discussion, the Committee agreed that it would be desirable to make the amendments to paragraphs 1(b) and 1(c) of the authorization recommended by the staff committee, except that involving the deletion of the phrase "on a cash, regular, or deferred delivery basis," and to direct the staff committee to make further studies of the desirability of expanding the scope of System operations in bankers' acceptances to include finance bills.

Mr. Broida noted that in its discussion last September the Committee had agreed in principle to delete the reference to the

Board's Regulation B from Section 270.4(c)(2) of the FOMC Regulation as soon as rules governing operations in bankers' acceptances had been incorporated in its authorization for domestic open market operations. He suggested that the Committee make both actions effective as of April 1, 1974, in order to provide time for the preparation of Federal Register notices relating to those actions and to the Board's revocation of Regulations B and C, which would be effective on the same date, and for the preparation of a press release describing the realignment and modernization of the System's rules relating to open market operations in bankers' acceptances.

By unanimous vote, Section 270.4(c)(2) of the Regulation Relating to Open Market Operations of Federal Reserve Banks was amended, effective April 1, 1974, to read as follows:

§ 270.4 Transactions in Obligations.

* * *

(c) In accordance with such limitations, terms, and conditions as are prescribed by law and in authorizations and directives issued by the Committee, the Reserve Bank selected by the Committee is authorized and directed--

* * *

(2) To buy and sell bankers' acceptances in the open market for its own account;

* * *

By unanimous vote, paragraphs 1(b) and 1(c) of the Authorization for Domestic Open Market Operations were amended, effective April 1, 1974, to read as follows:

(b) To buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers' acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed \$125 million.

(c) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, and prime bankers' acceptances of the types authorized for purchase under 1(b) above, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

By unanimous vote, the staff committee on bankers' acceptances was directed to conduct further studies of the desirability of expanding Federal Reserve open market operations in bankers' acceptances to encompass all types of prime acceptances, including finance bills.

The Chairman then noted that a memorandum from Mr. Holmes, dated March 11, 1974, and entitled "System Purchases of Federal Financing Bank Securities,"^{1/} had been distributed to the Committee. He asked Mr. Holmes to comment.

Mr. Holmes said he thought it would be desirable and appropriate for the Federal Reserve to support the Treasury's effort to consolidate the financing of Federal agencies to the largest extent feasible through the Federal Financing Bank, which had been established by legislation enacted in late 1973 and was expected to begin operations soon. As his memorandum indicated, unless the Committee directed otherwise the Desk would plan to treat FFB securities in the same manner as Treasury obligations in the conduct of open market operations. That would mean, of course, that the Committee's guidelines for System operations in Federal agency issues would not apply to FFB securities. The Desk would, however, take care to avoid becoming a dominant factor in the market for such obligations. After some supply of FFB securities had accumulated the Desk would consider lending them to dealers on the same basis as it lent other obligations, assuming that lending continued to be authorized by the Committee.

^{1/} A copy of this memorandum has been placed in the Committee's files.

Mr. Holmes observed that he planned to recommend adding a reference to Federal Financing Bank securities to paragraph 1(a) of the Committee's authorization for domestic open market operations, to make it clear that the Desk was authorized to trade in such securities under the authority to buy and sell U.S. Government securities. However, the Committee might want to consider that recommendation in conjunction with certain other recommendations of his relating to paragraph 1(a).

Mr. Mitchell asked whether Federal Financing Bank securities would be classified with U.S. Government securities or with Federal agency obligations in Federal statistical reports.

Mr. Axilrod replied that, while that question was still being discussed by the agencies involved, it was hoped to treat FFB obligations in a fashion similar to U.S. Government securities. In the Federal Reserve weekly statement it was likely that FFB obligations would be shown separately under the heading of U.S. Government securities, and not grouped with agency obligations.

Mr. Mitchell then asked whether the Federal Financing Bank was expected to take over all agency financing, so that the categories for agency obligations might eventually be phased out.

Mr. Holmes replied in the negative, noting that under the terms of the new law a number of agencies--including the Federal National Mortgage Association, Federal Home Loan Banks, Federal

Land Banks, Federal Intermediate Credit Banks, and the Bank for Cooperatives--were not authorized to finance through the Federal Financing Bank.

In reply to a question by Mr. Kimbrel, Mr. Holmes said he would not plan to bid for new issues of the Federal Financing Bank except in exchange for maturing issues. In his judgment, System acquisitions of securities from the FFB for cash, like such acquisitions from the Treasury of present Government obligations, would be considered direct lending to the Treasury, and thus subject to the provisions of paragraph 2 of the Committee's authorization.

Chairman Burns asked whether there were any objections to Mr. Holmes' recommendations with respect to System operations in Federal Financing Bank securities, and none was heard.

The Chairman then asked Mr. Holmes to comment on his memorandum dated March 11, 1974, entitled "Recommended changes in paragraph 1(a) of authorization for domestic open market operations."^{1/}

Mr. Holmes observed that one of the four changes in paragraph 1(a) suggested in his memorandum was to delete the phrase "on a cash, regular, or deferred delivery basis." He would now like to withdraw that recommendation, in view of the Committee's decision to

^{1/} A copy of this memorandum has been placed in the Committee's files.

retain the same phrase in paragraph 1(b). Of the remaining changes proposed, he had already referred to one--the addition of the words "including the securities of the Federal Financing Bank" after the opening phrase authorizing the Desk "To buy and sell U.S. Government securities." Another proposal was to add a parenthesis containing the phrase "including forward commitments" following the reference to System Account holdings of securities in the statement relating to the leeway for changes in holdings between meetings of the Committee, in order to make it clear that the leeway calculations were made on a commitment basis. Such a phrase had been included in the leeway clause prior to March 1964, but it had been inadvertently omitted when new language approved then to clarify the clause in certain other respects was transcribed.

Mr. Holmes observed that his remaining recommendation with respect to paragraph 1(a) was a substantive one--to increase the dollar amount of the leeway from \$2 billion to \$3 billion. As indicated in his memorandum, there had been a marked increase in recent years in the variation in System Account holdings between meetings, and during the past year he had found it necessary on three occasions to ask for a temporary increase in the leeway to \$3 billion. While the Committee had approved those recommendations promptly, it seemed to him that a permanent increase to \$3 billion would be reasonable now.

In response to questions by the Chairman, Messrs. Partee and Axilrod said they concurred in Mr. Holmes' recommendations with respect to paragraph 1(a), and Mr. O'Connell indicated that he found no legal objections to them.

After discussion, the Committee agreed that the revisions proposed by Mr. Holmes were appropriate.

By unanimous vote, paragraph 1(a) of the Authorization for Domestic Open Market Operations was amended, effective immediately, to read as follows:

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than \$3.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting.

Chairman Burns observed that a memorandum from the Committee's General Counsel, dated March 8, 1974, and entitled "Status of paragraph 2 of authorization for domestic open market operations,"^{1/} had been distributed. He asked Mr. O'Connell to comment.

^{1/} A copy of this memorandum has been placed in the Committee's files.

Mr. O'Connell noted that paragraph 2 of the authorization, which authorized the Federal Reserve Banks to purchase short-term certificates of indebtedness directly from the Treasury, had been in a state of de facto suspension since November 1, 1973, when the underlying statutory authority--contained in a provision of Section 14(b) of the Federal Reserve Act--had expired. Accordingly, question might be raised as to whether paragraph 2 should be retained in the authorization. In his opinion, there was no legal impediment to the retention of that paragraph, and retention could be justified on the grounds of administrative convenience, looking forward to the time at which new statutory authority would be enacted. If, as he would recommend, the Committee decided to retain paragraph 2 in the authorization, he would suggest that it direct the staff to include in the policy record for today's meeting a statement to the effect that the Committee had taken note of its present state of de facto suspension.

Mr. Holland said he thought a case could be made for keeping the Committee's various authorizations current by removing provisions that were inapplicable even temporarily, thus avoiding the false impression that the Committee could not act in timely fashion to adapt its instruments to changes in circumstances. Moreover, there was some uncertainty at present about the date at which new

legislation regarding direct lending to the Treasury would be enacted. For those reasons he would prefer to delete paragraph 2 from the authorization now and plan on restoring it when the new legislation was in place. However, he did not feel strongly about the matter.

Chairman Burns said he thought it was generally expected-- within the Congress and the Administration, and among Committee members--that new legislation would be enacted relatively soon. As far as he was concerned, the decision with respect to paragraph 2 could go either way; however, he had a slight inclination toward retaining the paragraph.

Mr. Hayes said he also would be inclined to retain the paragraph, to avoid the need for special action to restore it in the near future.

Mr. Brimmer expressed a similar view, on the understanding that the policy record for this meeting would include a statement regarding the de facto suspension of the paragraph along the lines recommended by Mr. O'Connell.

The Chairman asked whether there was any objection to retaining the paragraph for the present on that understanding, and none was heard.

The Committee took note of the present state of de facto suspension of paragraph 2 of the Authorization for Domestic Open Market Operations as a consequence of the expiration, on November 1, 1973, of the underlying statutory authority contained in a provision of Section 14(b) of the Federal Reserve Act.

Chairman Burns then referred to memoranda from the Manager, dated March 11, 1974, and from the General Counsel, dated March 13, 1974, both of which were entitled "Review of System Lending of Government Securities."^{1/} He asked Mr. Holmes to comment.

Mr. Holmes said that, as indicated in his memorandum, he thought there continued to be a need for the authority for the Desk to lend securities to help cope with the problem of delivery failures. He might call the Committee's particular attention to the increased use of the lending facility by New York City banks participating in the Government Securities Clearing Arrangement. That was an important factor in the growing use of the book entry system. With respect to the lending operation as a whole, repayments remained prompt and the operation continued to be quite profitable to the System. He recommended that the Committee find System

^{1/} Copies of these memoranda have been placed in the Committee's files.

lending of securities to be reasonably necessary to the effective conduct of open market operations, and that it renew the authority, which was contained in paragraph 3 of the authorization for domestic open market operations, subject to periodic review.

Mr. Holmes added that such reviews had been made at semi-annual intervals in the past. In light of the prospects that lending would continue to be necessary for some time to come, he recommended that the Committee shift to annual reviews, to be made at the time of the organization meeting in March of each year. If there were any significant change in the need for lending between the annual reviews he would, of course, inform the Committee promptly.

Mr. Brimmer observed that the Committee's General Counsel had consistently taken the view that the lending of securities in the System Account was legally authorized if the Committee found it to be reasonably necessary to the effective conduct of open market operations. On the basis of such opinions, the Committee had deemed it desirable in the past to review the authority at semi-annual intervals. He noted that in his present memorandum, Mr. O'Connell expressed the opinion that "there is no legal objection" to shifting to an annual review. He wondered, however, whether Mr. O'Connell would recommend such a shift.

Mr. O'Connell said he thought the question of the frequency of the review was a policy matter for decision by the Committee.

Mr. Brimmer then observed that he was prepared to support the Manager's recommendations that the authority be renewed at this time, subject to annual review in the future.

Chairman Burns asked whether there was any objection to the Manager's recommendations, and none was heard.

It was agreed that the authorization for the lending of Government securities from the System Open Market Account, contained in paragraph 3 of the Authorization for Domestic Open Market Operations, should be retained at this time, subject to annual review.

The Chairman then noted that three memoranda concerning a proposed expansion of the lending authority^{1/} had been distributed to the Committee. He asked Mr. Holmes and Mr. Axilrod to comment.

Mr. Holmes noted that the proposal, which had originated in a suggestion by the Association of Primary Dealers in Government Securities, was that the System lend securities to dealers not only

^{1/} The memoranda referred to were (1) from the System Account Manager, dated February 5, 1974, and entitled "Proposed expansion of authority to lend securities from System Open Market Account;" (2) from the Board Staff, dated October 3, 1973, and entitled "Dealer Association request for a broadening of System security lending;" and (3) from the General Counsel, dated March 8, 1974, and entitled "Loan of System Account securities to cover dealer short sales."

to avoid delivery failures--the sole basis on which such lending was now authorized--but also to permit dealers to sell securities that were in demand in the market but which they did not own. Dealers would thus be enabled to establish short positions in individual issues; however, since the loans by the System would be made against the collateral of other securities of comparable maturity held by dealers in their portfolios, they would not be enabled through such loans to establish a net short position in any given maturity area.

As the memoranda indicated, Mr. Holmes continued, he would be prepared to recommend such an expansion of the lending authority, provided that adequate safeguards were established to avoid abuse. The Board staff was inclined to take a negative view of the proposal. The General Counsel had expressed the opinion that the same legal test applied to lending for this purpose as to lending for the purpose of coping with delivery failures; i.e., the activity in question was legally authorized provided that the Committee found it to be reasonably necessary to the effective conduct of open market operations.

Mr. Holmes observed that developments in the market today could be used to illustrate one important merit of the proposal. Because dealers were trying to lighten their inventories of one of

the new issues in the Treasury's February financing--the 7 per cent notes of 1981--the price of that issue was off by a full point in today's trading. If dealers had been able to borrow and sell securities of nearby maturity against the collateral of those notes, the impact of their desire to go short would have been spread among several issues rather than concentrated on one. There was no way to prevent dealers from going short when they wanted to, but it seemed useful to have some device that would spread out the market effects. In general, he thought the proposed expansion of lending would make for a more fluid and stable market, and thus would provide a better base for System open market operations.

Mr. Axilrod said the Board's staff leaned toward a negative view of the proposal for several reasons. First, the staff was concerned about the potential for public misunderstanding. It was true that, because of the requirement for collateral, the System would not be enabling dealers to take a net short position in a particular maturity area. Because short sales would be involved, however, misinterpretations to the effect that the System was helping dealers "bear" the market for U.S. Government securities were likely to arise. Secondly, questions of equity would be involved in any arrangement that permitted dealers, but no other groups of market participants, to make portfolio adjustments of the kind contemplated. In his view,

equity questions did not arise in System lending to dealers to prevent delivery failures, because of the central role of dealers in the market mechanism, as intermediaries between buyers and sellers. Such considerations in themselves would not necessarily be overriding if there were strong offsetting advantages to the proposal, but the Board staff was not persuaded that the advantages would be that strong. He did not mean to suggest that the development of better lending facilities would not be helpful to the market; he did, however, have some doubts about the necessity for the Federal Reserve to offer the proposed facilities at this time.

Mr. Hayes asked whether it might be desirable to have a subcommittee of the FOMC designated to review the considerations involved.

Chairman Burns expressed the view that, since the opportunities for misunderstanding were so great, very clear advantages would have to be demonstrated before the proposal was considered seriously by the Committee. While the proposed expansion of lending might enable the market to function somewhat more smoothly, in his judgment a decisive case in its favor had not been made.

Mr. Hayes said the argument in favor of the proposal--that it would contribute to a better-functioning market for Government securities--seemed to him to have somewhat more substance than

those against, the most important of which appeared to be the risk of misunderstandings of the short selling involved. It should be possible to deal with any misunderstandings on that score by demonstrating that the System was not facilitating net short positions on the part of dealers.

Mr. Black remarked that that position rested on the premise--which was not necessarily warranted--that critics would take a rational view of the matter.

Mr. Mayo noted that the Treasury was, of course, concerned about the functioning of the Government securities market. He asked whether the Treasury was willing to lend securities from the trust accounts for the purpose proposed.

Mr. Holmes observed that the Treasury had never been willing to join with the System in lending securities to avoid delivery failures, despite some favorable sentiment within the Department. Accordingly, it was highly unlikely that the Treasury would participate in lending for the present purpose. He thought it would have no objections to the System's doing so, however.

Mr. Morris said that if the Committee were inclined to undertake lending operations of the type proposed--and he thought it probably would be desirable to do so--it might be best first to ask the Treasury for a letter expressing the view that such a course was in the public interest.

In reply to a question by Mr. Mayo, Mr. Holmes commented that it would be necessary to give careful thought to the width of the maturity ranges that were used in determining whether the collateral offered was "in the same maturity area" as the securities borrowed. The ranges proposed by the Dealer's Association--which were shown in one of the attachments to his memorandum--struck him as rather broad.

Mr. Holland observed that there were two considerations, in addition to the potential for misunderstanding, that led him to take a negative view of the proposal. First, there would be considerably more risk than in the case of lending to cover delivery failures that the dealer would not be able to repay the loan by its due date, so that the System would be forced either to extend the period of the loan or sell off the collateral. Where the problem was a delivery failure, the dealer already owned securities identical to those he borrowed, and had only to wait for the delayed delivery to be effectuated in order to be able to repay the loan. In borrowing for short sales, the dealer would ordinarily plan on making repayment by buying the needed securities in the market or by borrowing them from someone else, which was a much more uncertain process. As a result, the record of repayment performance would not be nearly as clean as in the case of fails.

Secondly, Mr. Holland continued, while the proposal was intended to deal with a deficiency in the market, that deficiency was a consequence of Treasury debt management techniques. Accordingly, responsibility for finding a solution lay more with the Treasury than with the Federal Reserve. One possibility would be for the Treasury to offer a "maturity exchange service," comparable to its present denominational exchange service. If the maturity exchange service were available to all holders of marketable Governments, the equity problem inherent in the present proposal could be avoided.

Mr. Eastburn asked what the consequences would be if the Committee did not approve the Manager's proposal.

Mr. Holmes replied that they would not be serious. The proposed expansion of lending would improve the performance of the market and make it easier for the System to conduct its open market operations, but he did not view the issue as a life-or-death matter.

Mr. Mitchell said he thought Mr. Holland's suggestion for a maturity exchange service had more merit than the proposed lending operation as a possible means of resolving the problem, and should be pursued with the Treasury. He would be interested in having the Manager's opinion of the suggestion.

Mr. Holmes expressed the view that a maturity exchange service offered a potential solution. It might pose a problem,

however, in that the market would not be sure of the size of an issue that would be outstanding at any particular time.

Mr. Mayo said he would consider that problem to be a serious one; if the outstanding volume of individual issues could fluctuate from day to day, holders of those issues might feel discriminated against and the freedom of the market could be significantly impaired.

Mr. Brimmer observed that since the summer of 1972, when the dealer's association had first advanced the suggestion for an expansion of System lending operations, the staff had done a great deal of work on it. On the basis of the memoranda that had been distributed, he would favor turning the proposal down. He would strongly urge that other possibilities be pursued--including that suggested by Mr. Holland, which struck him as promising. However, he would not want to postpone a decision on the particular proposal before the Committee while those studies were being carried out.

Mr. Black remarked that he would have some difficulty in concluding that the proposed new lending authority was reasonably necessary to the effective conduct of open market operations, particularly in light of Mr. Holmes' response to Mr. Eastburn's question.

Mr. O'Connell noted that he had had the same reaction when he heard Mr. Holmes' response to that question.

The Chairman said it appeared that the Committee did not favor the proposed expansion of the lending authority, but that it

would like to have the Manager and Board staff members explore alternative means of dealing with the problem at which the proposal was directed, including discussions with the Treasury. He asked whether there were any objections to that course, and none was heard.

Mr. Hayes observed that in conversations with the Treasury the staff might find greater backing for an expansion of the lending authority than had been evidenced to date. In that event, he assumed it would be agreeable to the Committee for the staff to submit a new proposal along those lines.

There was no disagreement with Mr. Hayes' suggestion.

Chairman Burns then noted that a memorandum from the Manager, dated March 15, 1974, and entitled "Proposal to bid for Treasury bills on a noncompetitive basis"^{1/} had been distributed. He asked Mr. Holmes to comment.

Mr. Holmes noted that in the weekly and monthly auctions of Treasury bills it had been the Desk's practice to bid on a competitive basis in rolling over maturing bills held by the System Open Market Account, Treasury investment accounts, and foreign official accounts. In order to be reasonably sure of securing the

^{1/} A copy of this report has been placed in the Committee's files.

desired bills, the Desk obtained information from dealers just before the bidding deadline regarding their likely bids. Because System and foreign central bank holdings of Treasury bills had been growing relative to the total volume outstanding, the Desk was now bidding for 50 to 60 per cent of the bills offered in an auction, compared to about 10 or 15 per cent a few years ago, and was encountering more problems. As a result of the increased volatility of interest rates, it was more common now for rate ideas to change in the last minute or two before the auction deadline and hence for the Desk to miss in the auction or receive only a partial award on its bid. In such cases, the bills inadvertently run off had to be replaced through purchases in the market--a difficult process and one potentially disruptive to System policy objectives. And, with the growing size of the Desk's bids, the consequences of an unintentional miss had become more serious.

Also, Mr. Holmes observed, the dealers were dissatisfied with the present bidding arrangements. Not knowing the size of official holdings of maturing bills in an auction, they did not know the amounts available to the rest of the market. They were aware that misses by the System could suddenly supply the market with a much larger volume of bills than otherwise. And they were reluctant to give the Desk information about their own bids

which was then used to outbid them in acquiring bills for foreign official accounts.

As noted in his memorandum, Mr. Holmes continued, the Treasury had agreed to a procedure designed to cope with those problems. Under the proposal, the Desk would submit bids on behalf of official holders of maturing bills on a noncompetitive basis-- that is, it would receive awards at the average price established by the competitive bidders. In addition, the Treasury would announce in advance of each bill auction the total amount of official holdings of maturing bills that would be eligible for noncompetitive rollover. It would be understood that, as in the past, the Desk would not necessarily roll over its total holdings; it would reserve the right to submit competitive bids when it wanted to run off bills or bid "on the margin." The procedure would be similar to that now followed in auctions of coupon issues in quarterly refundings, except that in the bill auctions it would be followed for foreign official accounts as well as for System and Treasury accounts. In his judgment, the average price at which the System acquired bills over time would be the same on the new basis as it had been on the old.

In reply to questions, Mr. Holmes said that the Treasury announcement regarding official account holdings of maturing bills

would disclose the total of such holdings, without breakdowns for the three types of official holders. At present, noncompetitive bids were permitted only for small bids--up to \$200,000--and the aggregate volume of such bids ranged in individual auctions from 10 to 15 per cent.

Mr. Brimmer observed that about 12 years ago he had done some research on the question of whether the average price received by the Treasury in a securities auction tended to rise or fall when the proportion of bidders placing competitive bids increased. He had not reviewed that work recently, but according to his recollection it would support the position that the Government would tend to be better off if a large participant, like the System, placed its bids on a competitive basis.

Mr. Holmes expressed the view that allowance had to be made for the special characteristics of the System's bids. First, the amount bid for never exceeded the holdings of maturing bills. Second, the price at which the bid was submitted was based on information regarding the probable bids of dealers. He thought the record would demonstrate that on the average the Desk had been successful in its effort to bid at the market consensus; it was not a market maker.

Mr. Coldwell asked whether a discontinuation of competitive bidding by a bidder receiving roughly half of the bills auctioned would not have an impact on the tail of the bidding.

In reply, Mr. Holmes said he thought the average price received by the Treasury in individual auctions might be affected to some extent, depending on the relative size of official account holdings. At times when the Treasury's announcement revealed that official holdings were relatively large, other participants might compete more intensively for the remaining supply, thereby tending to raise the average price; when official holdings were small, the average might be reduced. Over time, however, the two types of situations would balance out.

Mr. Holland noted that he had first heard of the proposal under discussion when it was advanced by Government securities dealers at a recent meeting with Treasury officials, in which he had participated as a representative of the Board of Governors. Until that time, he had not appreciated how disadvantaged the dealers felt by their lack of information on the size of official account holdings of maturing bills. The dealers also observed that they were providing the Desk with information regarding their bidding ideas which the Desk then used for the purpose of outbidding them in the auction. He had the feeling that the dealers' concerns

were legitimate and that the proposed change in procedure was a reasonable means for dealing with them.

Mr. Brimmer asked about the basis for Mr. Holmes' conclusion that the new procedure would not have an appreciable effect on average auction prices over time.

Mr. Holmes replied that that conclusion reflected his best judgment, supported by some review of the record; it was not based on a formal scientific analysis.

Mr. Axilrod expressed the view that a detailed analysis would bear out the Manager's impression that the Desk's bids were very close to the auction average, so that on balance that average would not be significantly affected by the proposed change in procedure. As Mr. Holmes had noted, the Desk would retain its present options of bidding to run off maturing holdings and of placing supporting bids at the margin, and thus it would lose none of its present ability to meet its reserve objectives. Under the present procedure, the Desk sought to insure that its bid was at or close to the auction average by soliciting last-minute bidding information from dealers that they gave to no one else; under the proposed procedure, it would achieve the same end by placing a noncompetitive bid. In effect, the objective now achieved by indirect means would be accomplished directly. The new procedure also would have the

advantage of avoiding the present risk of unintentional misses. Finally, he thought it would be desirable for market participants to know the size of official account holdings and, therefore, the volume of bills available to the public in the auction.

Mr. Brimmer noted that market participants could not be sure about the volume of bills available to the public so long as the System reserved the option of placing a competitive bid.

Mr. Axilrod added that under the proposed procedure, as well as under present practice, market participants would have to make a judgment as to whether the System's reserve objectives would lead it to run off some or all of its maturing holdings. Thus, all the proposal really would do was remove the additional uncertainty for dealers relating to the size of official account holdings.

Mr. Mitchell said he did not believe a conclusive case had been made that the change in procedure would have no significant effect on the prices received by the Treasury. He would favor some additional research on that point.

Mr. Mayo remarked that if the System did not bid competitively it might be easier for a few dealers to dominate a particular auction.

In response, Mr. Holmes noted that the Treasury now employed a rule of thumb under which no one dealer could be awarded more than 25 per cent of the issues offered in an auction. That rule might be modified to deal with the possibility Mr. Mayo had mentioned.

Mr. Holland expressed the view that the reduction of uncertainty with respect to official holdings would make for a better market. Under the present procedure, an individual dealer might bid to acquire a large proportion of the supply of bills available to the public partly because he believed he could make a better guess than the market as a whole of the size of official holdings; under the proposed procedure, all participants would have precise information on the matter. And he was inclined to agree with the dealers' view that there was an element of unfairness in an arrangement under which the System solicited information on bidding ideas which the dealers felt they could not withhold from the central bank, and then used that information to the disadvantage of the dealers.

Mr. Brimmer remarked that he did not understand how dealers were disadvantaged if the System's objective was simply to enter a bid close to the average.

Mr. Axilrod observed that the dealers' concern related primarily to the use of the information in question for the purpose of placing bids for foreign accounts.

In reply to questions by Mr. Black, Mr. Holmes said he thought foreign central banks would have no objections to the change in procedure. He would, of course, inform them in advance if the

change were made. On the whole, he thought the System would derive greater benefits from the new procedure than the dealers would.

Mr. Brimmer observed that because of the late date at which Mr. Holmes' memorandum had been distributed, he had not yet had time to give adequate consideration to the proposal. Accordingly, he hoped the Committee would not dispose of it today.

Mr. Coldwell said he also would favor postponing a decision, in order to give the staff time to develop additional information regarding the likely effects of the proposed change on the tail of the bidding.

Mr. Holmes observed he would be happy to have some work done in that area. He would hope, however, that a decision would not be deferred unduly long.

Mr. Holland remarked that he also saw advantages in acting on the matter reasonably promptly, and Mr. Hayes expressed similar sentiments.

Mr. Mitchell commented that the kind of research he personally had in mind would involve an analysis of a sample of bill auctions over the past 3 or 4 years, and should not prove to be time-consuming.

Mr. Axilrod observed that the staff might include in its study for selected auctions, the total size of the issue, the proportions

taken by the several official accounts, the nature of the bidding, and perhaps a rough judgment as to the effect on the outcome that the use of the proposed new procedure might have had.

Mr. MacLaury noted that the open questions related mainly to the effect of the proposed procedure on the prices paid for the bills auctioned, a matter that was of more direct concern to the Treasury than to the System. If after due consideration the Treasury had agreed to the proposal, he wondered whether the System could not rely on their judgment.

The Chairman remarked that there was much force in Mr. MacLaury's observation. At the same time, since some members were interested in obtaining more information, he would suggest that the matter be deferred until the next meeting.

There was general agreement with the Chairman's suggestion.

In response to a question by the Chairman, Mr. Broida reported that the staff committee that had been designated to make recommendations for any needed changes in the Committee's foreign currency instruments hoped to complete its report following the April meeting, for consideration by the Committee in May. He suggested that at today's meeting the Committee might want to reaffirm those instruments in their existing form.

By unanimous vote, the
Authorization for Foreign
Currency Operations shown
below was reaffirmed:

I. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, and with the Bank for International Settlements:

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

B. To hold foreign currencies listed in paragraph A above, up to the following limits:

(1) Currencies purchased spot, including currencies purchased from the Stabilization Fund, and sold forward to the Stabilization Fund, up to \$1 billion equivalent;

(2) Currencies purchased spot or forward, up to the amounts necessary to fulfill other forward commitments;

(3) Additional currencies purchased spot or forward, up to the amount necessary for System operations to exert a market influence but not exceeding \$250 million equivalent; and

(4) Sterling purchased on a covered or guaranteed basis in terms of the dollar, under agreement with the Bank of England, up to \$200 million equivalent.

C. To have outstanding forward commitments undertaken under paragraph A above to deliver foreign currencies, up to the following limits:

(1) Commitments to deliver foreign currencies to the Stabilization Fund, up to the limit specified in paragraph 1B(1) above; and

(2) Other forward commitments to deliver foreign currencies, up to \$550 million equivalent.

D. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

<u>Foreign bank</u>	<u>Amount of arrangement (millions of dollars equivalent)</u>
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	2,000

<u>Foreign bank</u>	<u>Amount of arrangement (millions of dollars equivalent)</u>
Bank of France	2,000
German Federal Bank	2,000
Bank of Italy	3,000
Bank of Japan	2,000
Bank of Mexico	180
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	1,400
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

3. Currencies to be used for liquidation of System swap commitments may be purchased from the foreign central bank drawn on, at the same exchange rate as that employed in the drawing to be liquidated. Apart from any such purchases at the rate of the drawing, all transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates and no attempt shall be made to establish rates that appear to be out of line with underlying market forces.

4. It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in accordance with Section 14(e) of the Federal Reserve Act.

6. The Subcommittee named in Section 272.4(c) of the Committee's rules of procedure is authorized to act on behalf of the Committee when it is necessary to enable the Federal Reserve Bank of New York to engage in foreign currency operations before the Committee can be consulted. All actions taken by the Subcommittee under this paragraph shall be reported promptly to the Committee.

7. The Chairman (and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors) is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities; and

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

By unanimous vote, the
Foreign Currency Directive
shown below was reaffirmed:

1. The basic purposes of System operations in foreign currencies are:

A. To help safeguard the value of the dollar in international exchange markets;

B. To aid in making the system of international payments more efficient;

C. To further monetary cooperation with central banks of other countries having convertible currencies, with the International Monetary Fund, and with other international payments institutions;

D. To help insure that market movements in exchange rates, within the limits stated in the International Monetary Fund Agreement or established by central bank practices, reflect the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public; and

E. To facilitate growth in international liquidity in accordance with the needs of an expanding world economy.

2. Unless otherwise expressly authorized by the Federal Open Market Committee, System operations in foreign currencies shall be undertaken only when necessary:

A. To cushion or moderate fluctuations in the flows of international payments, if such fluctuations (1) are deemed to reflect transitional market unsettlement or other temporary forces and therefore are expected to be reversed in the foreseeable future; and (2) are deemed to be disequilibrating or otherwise to have potentially destabilizing effects on U.S. or foreign official reserves or on exchange markets, for example, by occasioning market anxieties, undesirable speculative activity, or excessive leads and lags in international payments;

B. To temper and smooth out abrupt changes in spot exchange rates, and to moderate forward premiums and discounts judged to be disequilibrating. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified or curtailed unless upon review and reassessment of the situation the Committee directs otherwise;

C. To aid in avoiding disorderly conditions in exchange markets. Special factors that might make for exchange market instabilities include (1) responses to short-run increases in international

political tension, (2) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, and (3) market rumors of a character likely to stimulate speculative transactions. Whenever exchange market instability threatens to produce disorderly conditions, System transactions may be undertaken if the Special Manager reaches a judgment that they may help to reestablish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. In such cases, the Special Manager shall consult as soon as practicable with the Committee or, in an emergency, with the members of the Subcommittee designated for that purpose in paragraph 6 of the Authorization for Foreign Currency Operations; and

D. To adjust System balances within the limits established in the Authorization for Foreign Currency Operations in light of probable future needs for currencies.

3. System drawings under the swap arrangements are appropriate when necessary to obtain foreign currencies for the purposes stated in paragraph 2 above.

4. Unless otherwise expressly authorized by the Committee, transactions in forward exchange, either outright or in conjunction with spot transactions, may be undertaken only (i) to prevent forward premiums or discounts from giving rise to disequilibrating movements of short-term funds; (ii) to minimize speculative disturbances; (iii) to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders; (iv) to allow greater flexibility in covering System or Treasury commitments, including commitments under swap arrangements, and to facilitate operations of the Stabilization Fund; (v) to facilitate the use of one currency for the settlement of System or Treasury commitments denominated in other currencies; and (vi) to provide cover for System holdings of foreign currencies.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on February 20, 1974, were approved.

The memoranda of discussion for the meetings of the Federal Open Market Committee held on January 21-22 and February 20, 1974, were 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 February 20 through March 13, 1974, and a supplemental report covering the period March 14 through 18, 1974. Copies of these reports have been placed in the files of the Committee.

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

Since the previous Committee meeting, we have intervened in the exchange markets for a total of \$155 million equivalent in marks, French francs, and Belgian francs. The French francs were supplied from Treasury balances; the Belgian francs from our own holdings. Much of the intervention--\$133 million--was done in German marks, of which \$9 million was supplied from Treasury balances and the remaining \$124 million by Federal Reserve drawings on our swap line with the German Federal Bank. Of these swap drawings, \$4 million have been repaid, leaving \$120 million outstanding. The 50-50 sharing of risks and losses on drawings under the swap line with the German Federal Bank remains in force.

The main purpose of our intervention was to check an accelerating erosion of dollar rates across the board. By February 22, the dollar had fallen about 10 per cent from its January highs, market traders had repeatedly suffered losses on their dollar positions, and the risk of a new speculative

attack was mounting. We were particularly concerned about the erroneous but recurrent market rumors that the Federal Reserve was secretly intervening to push down dollar rates in an effort to improve the U.S. export trading position. Our appearance as sellers of marks, French francs, and Belgian francs helped to reassure the market, I think, particularly on February 27 when we conducted our largest operation so far, \$100 million in a single day. Since then, dollar rates have held steady, although they have been depressed a bit from time to time by temporary liquidity squeezes in the Swiss and German money markets. And last Monday we had to contend with misinterpretations of a statement by the German Finance Minister which the market erroneously viewed as a possible prelude to a new revaluation of the mark.

At the present, on an uncovered basis European short-term rates are running 1 to 3 percentage points above U.S. and Euro-dollar rates. For the time being, however, forward discounts on even the strong European currencies are roughly compensating for these interest rate differentials, leaving little or no interest arbitrage margin. Nevertheless, so far as the dollar is concerned, the situation is vulnerable; any revival of speculation against the dollar could quickly erase the forward discounts on such inherently strong European currencies as the mark and the Swiss franc. And this could quickly recreate the old, familiar vicious circle in which speculation against the dollar opens up an adverse interest arbitrage incentive, and that in turn leads to more speculation against the dollar. I think we have been helped on this score in recent weeks not only by the stiffening of U.S. rates but also by the fact that there has been a great deal of anticipatory borrowing in the Euro-dollar market, at a time when the inflows of funds to that market from the oil-producing countries have not yet attained the volume they will reach later on. On the basis of information that we have been collecting from the oil companies--and I must add that those companies have been quite forthcoming--it now appears that the major buildup in payments to the oil-producing countries will occur in April. If, as expected, the bulk of those

funds flow to the Euro-dollar market in the form of short-term placements, Euro-dollar rates will be severely depressed and the whole situation with respect to interest rate relationships will be even more vulnerable.

I might mention two other points. At the last BIS meeting the Bank of Italy succeeded in getting an agreement from its Common Market partners on credits of \$1.9 billion, in addition to the \$3 billion line they have with the Federal Reserve. This is indicative of the continuing strong pressures on the lira; in recent months intervention by the Bank of Italy has been at a rate close to \$1 billion per month. The other point, which might have a considerable bearing on the developments in the exchange markets and in the Euro-dollar market, is the recent decision of the British government to offer guarantees to official holders of sterling balances. The guarantees will not be in terms of dollars, as in the past, but in terms of about 10 currencies weighted by their share in British trade. I think there is a fair chance that these guarantees, in combination with the high short-term rates available in London, will be effective in inducing countries acquiring sterling to hold on to that currency; if so, it could very well mean that a large part of sterling payments for oil--the sums involved are substantial--might remain fairly well immobilized, thereby safeguarding the markets from the unfortunate consequences of constant shifts of funds in response to interest rate differentials.

Mr. Eastburn recalled that at the previous meeting he had asked whether the Special Manager thought the Committee should attempt to influence international interest rate differentials as a matter of policy. Mr. Coombs had responded in the negative, suggesting only that the Committee keep a close watch on those rate relationships. He wondered whether the Special Manager held the same view today.

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Mr. Coombs replied that he did. It would be especially important to remain alert to the differentials in April, when heavy flows of oil money to the Euro-dollar market could depress short-term Euro-dollar rates and enlarge the differentials against short-term rates in, say, Switzerland, Germany, Belgium, and the Netherlands. As he had indicated, he was particularly worried about the possibility that the effects on arbitrage incentives would be magnified by speculative flows, which could eliminate the existing forward discounts on strong European currencies and perhaps convert them to premiums. That kind of pattern had developed many times in the past. Foreign exchange operations could prove helpful in forestalling its development now, insofar as they helped to prevent speculative flows from gaining strength. In his opinion, however, the most useful single step would be a strong official expression of the view that it was necessary to avoid an external depreciation of the dollar--barring some change in the fundamentals--because of the consequences it would have for domestic inflation. The German Finance Minister had made such a statement with respect to the mark a few days ago.

Chairman Burns asked about the force such a statement would carry and the nature of the commitment it might imply.

Mr. Coombs responded that a statement along those lines could be quite helpful to market psychology. In particular, an indication that the U.S. Government was determined to defend the dollar at current exchange rates for the purpose of avoiding the inflationary consequences of depreciation could provide a highly useful counterforce to the market's present belief that the Germans were determined to prevent the mark from going down. The commitment implied by the statement would depend on its specific phrasing, which would, of course, have to be considered carefully.

In reply to a further question by the Chairman, Mr. Coombs said that any further rise in domestic U.S. interest rates would tend to ameliorate the external problem of the dollar, which threatened to become increasingly difficult. Conversely, a slippage in U.S. interest rates could greatly complicate the problem.

Mr. Brimmer asked whether the heavy oil payments anticipated for April were likely to occur in the first or second half of the month. That question might be relevant to the policy decisions the Committee took today, since its next meeting was tentatively scheduled for mid-April.

Mr. Coombs replied that the figures he was getting from oil companies did not provide information on intra-monthly payments. He might note, however, that in terms of monthly totals the increase in

oil payments from March to April was expected to be substantial. For the five largest U.S. oil companies alone, dollar payments were scheduled to more than double--from \$1.3 billion in March to \$2.8 billion in April. On a worldwide basis, dollar payments were expected to rise from \$3.3 billion to \$6.5 billion. Sterling payments also would increase substantially, by the equivalent of several billion dollars.

In response to questions by Chairman Burns, Mr. Coombs said he expected European interest rates to remain high; he had seen no evidence whatsoever of official intentions to bring them down. As he understood it, the European monetary authorities were maintaining tight monetary policies primarily to counter inflation. Countries such as Britain that were experiencing large balance of payments deficits also were naturally interested in attracting Arab oil money by direct or indirect means. That, however, would not be damaging to the position of the dollar; the risk that concerned him was of flows of oil money to countries in strong balance of payments positions. He had no reason to believe that the monetary policies of the latter countries were being influenced by the desire to attract oil money.

Mr. Holland referred to the Special Manager's comments regarding forward discounts and premiums. He asked whether

Mr. Coombs thought that Federal Reserve operations in the forward market might be more useful than a corresponding volume of spot market operations in forestalling undesirable speculative flows.

In reply, Mr. Coombs remarked that he had not been thinking in terms of forward operations; he thought the spot market would be the main area of concern. In his view, the System should be prepared to intervene in that market, perhaps forcefully, if the situation appeared to call for it.

Mr. Wallich asked whether Mr. Coombs, in his comments on a possible depreciation of the dollar, was thinking primarily in terms of the exchange rate for the dollar against the German mark or against all foreign currencies taken together.

Mr. Coombs observed that certain currencies, such as the mark and the Swiss franc, tended to act as bellwethers; if the dollar were to encounter difficulties, it was likely that the signs would appear first in the markets for those currencies and then would spread to others.

By unanimous vote, the System open market transactions in foreign currencies during the period February 20 through March 18, 1974, were approved, ratified and confirmed.

Mr. Coombs noted that two System swap drawings on the National Bank of Belgium, totaling \$31.8 million, would mature

for the eleventh time on April 18 and 25, respectively. Since the swap line had been in continuous use for more than a year, specific authorization by the Committee was required for their renewal. The Treasury's negotiations with the Belgians concerning the terms of repayment of the swap drawings were still uncompleted, and he saw no alternative to renewing the drawings at maturity. He might note that the System had paid as much in interest on the drawings as the Treasury had hoped to save through the negotiations.

By unanimous vote, renewal for further periods of 3 months of System drawings on the National Bank of Belgium maturing on April 18 and 25, 1974, was authorized.

Mr. Coombs then reported that, following advance notice by telephone last Friday, the New York Bank today had received a formal request from the Bank of England for an increase in their swap line with the System from \$2 billion to \$3 billion. As the members knew, there had been extensive discussions in the press and elsewhere of the difficulties facing the British, and it was clear that their needs for additional financing were real. In his judgment, the British might be considered somewhat more creditworthy than certain other central banks in the System's swap network, for two reasons. The first was a factor he had mentioned earlier--the likelihood that funds accruing to oil-producing countries in the

form of sterling would be kept in London. That would provide a source of credit, and perhaps a fairly stable one. The second was a longer-run factor: the North Sea oil resources now under development were expected to begin having significant effects on Britain's external position by 1980. The British were attempting to put together a combination of short-, medium-, and long-term financing that would carry them through the intervening period.

Mr. Coombs added that if the Committee approved the proposed swap line increase, the British would like to have it made effective and announced in about a week, when their new budget would be published. In connection with the statement on the budget, they expected to disclose their complete financing plan, covering the period until about 1980; and they would like to include information on the swap line increase in the more general announcement.

Mr. Brimmer said he assumed the British did not want to increase the swap line solely for the sake of the psychological effect of the announcement. On a visit to the Bank of England in January, he had received the impression that they might be interested in drawing on the line. He asked whether the Special Manager had reason to believe they might want to draw now.

Mr. Coombs replied that in the preliminary discussions the British authorities had asked about the possibilities of drawings. After consulting with Chairman Burns, he had advised them that drawings of moderate size--measured in hundreds of millions of dollars rather than billions--would be agreeable, on the understanding that the Bank of England would bear the full risk of exchange rate fluctuations; i.e., that they would repay the same number of dollars they had borrowed. As usual for such drawings, the interest rate would be equal to the U.S. Treasury bill rate.

Mr. Brimmer asked whether it would be correct to view the proposed increase in the swap line essentially as an increase in British reserves that would enable them to avoid borrowing from the International Monetary Fund or other sources where discipline would be applied; and whether it would mean, in effect, that the Federal Reserve would finance a good part of the deficit of the United Kingdom for the next several years.

Mr. Coombs replied that he would not be inclined to interpret the proposal in that way. He thought the British would be negotiating with the IMF for a standby credit facility that would provide a means for repaying any short-term debts they might incur. The main advantage of the swap line, from their point of view, was that

it provided a means for raising amounts on the order of \$200 million or \$300 million on very short notice, when needed to deal with exchange market problems that might arise from one day to the next. In his judgment, the British had demonstrated during the 1960's that they would take advantage of all reasonable opportunities to pay down swap debts to the System by means of drawings on the IMF.

Mr. Brimmer said it was also the case in the 1960's that the System had been unwilling to extend credits to the British unless there were arrangements to insure that they would not run on for long periods. He personally would not want the System to get into a position now which led to its financing long-term credits to the British.

Mr. Mitchell remarked that he shared Mr. Brimmer's concern. The North Sea oil development program might make the British credit-worthy over the longer run, but he would not like to have the Federal Reserve wait until 1980 for repayment of any drawings made now. Before the System agreed to permit the British to draw on the swap line, he would want to reach highly specific understandings with them that the drawings would be repaid within a reasonable period.

Mr. Coombs agreed. In the event that either the British or the Italians proposed to draw on the swap lines, he thought the System should raise questions on such matters as the backstop

facilities available to them, the order in which they proposed to repay various creditors by drawings on standby facilities in the Fund, the plans they might have for raising medium-term funds in the Euro-dollar market, and so forth. In referring to the North Sea oil program he had not meant to suggest that the System might have to wait until 1980 for repayment, but only that the British were relying on that program to provide means for repaying any medium-term debt they might incur. In the interim, however, they might have need from time to time for immediately available funds, in order to cope with speculative flows.

Mr. Coombs added that the British--and, incidentally, the French also--appeared to have better opportunities for raising medium-term money than the Italians did. The Italian balance of payments deficit was deeper and there was less light at the end of the tunnel for them.

Chairman Burns asked Mr. Bryant for his views regarding the proposed increase in the swap line with the Bank of England.

Mr. Bryant said he agreed with Mr. Coombs that the difficulties facing the United Kingdom this year were somewhat less marked than those facing Italy. Nevertheless, Britain's difficulties could well be serious. For that reason, he would feel more comfortable about the proposed increase if more

information were available about British policy, particularly with respect to their plans for medium-term borrowing. A staff paper assessing the economic situation in Britain^{1/} had recently been distributed to the Committee, but it contained little information about medium-term borrowing prospects. He understood, however, that pursuit of those questions might be inconsistent with the need for an early response to the Bank of England.

Mr. Coombs observed that the increase that had been proposed in the swap line would imply no commitment with respect to the terms on which drawings might be made. One possibility that might be pursued in subsequent negotiations would be for the British to make pro rata drawings on the Federal Reserve and on Common Market central banks. As he had mentioned earlier, the Italians had just arranged for credits from those central banks totaling nearly \$2 billion.

Mr. Wallich remarked that the proposal to increase the British swap line with the System, like the scheme recently advanced by the IMF, was characteristic of a general tendency to employ short-term means for financing payments deficits arising out of the oil situation. It was possible to go along with such proposals,

^{1/} A copy of this memorandum, dated March 1, 1974, and entitled "The Economic Situation in the United Kingdom," has been placed in the Committee's files.

since up to a point the tendency to rely initially on short-term means for financing medium- or long-term needs was understandable. It was clear, however, that short-term credits were basically inappropriate for dealing with the oil problem--unless, of course, one expected some substantial change such as a large decline in oil prices. For some countries, the only ultimate solution might be a change in exchange rates. In any case, when short-term credit facilities were employed, it was important to place them in the context of some more general financing scheme.

Mr. Hayes said he did not disagree with Mr. Wallich's observations. He would like to stress, however, that the main gain from swap line increases in the past had often taken the form of a favorable psychological effect from the announcement of the increase; time and again, such announcements had been effective preventive measures against the kind of speculation that created major problems. If the proper timing were to be achieved, however, it was not always possible to reach firm advance understandings about the size of any drawings and about specific means for financing repayments. While he agreed that any actual drawings by the Bank of England should be based on clear understandings regarding repayments, he thought an increase in the British line now, like

the recent increase in the Italian line, would be a constructive step.

Mr. Holland said he thought all members of the Committee would agree that the swap lines were not an appropriate means for permanent financing of deficits created by the oil situation. They might also agree, however, that the potential for large swings in short-term capital flows had been heightened by various circumstances relating to actual and prospective oil payments, and that the London money market was among those most likely to be affected by such swings. In his judgment, an increase in the System's swap line with the Bank of England would be warranted as providing better facilities for coping with such swings, which might be marked to some extent by speculative overtones. However, he would favor holding discussions with the British for the purpose of making it clear that the swap line was intended for use only in dealing with short-run problems, and that they were expected to use other means for financing longer-term needs.

Mr. Holland asked Messrs. Coombs and Bryant whether they concurred in his comment.

Mr. Coombs said he did. He added that he thought Mr. Holland's reasoning was wholly consistent with the views of the Bank of England.

It would, of course, take some time for them to work out the needed arrangements for longer-term financing.

Mr. Bryant said he also concurred. He might note, however, that he still had some residual concerns. For one thing, an increase in the size of the British swap line, as in the case of the recent increase in the Italian line, was likely to create a presumption that the line was available for use. For another, it was quite difficult in practice to distinguish between short- and long-term flows; a capital flow this week that appeared to be of a short-term nature might well prove nine months hence to require long-term financing.

Mr. Hayes remarked that that risk had always been present in drawings under the System's swap network. Nevertheless, over the years the record indicated that most drawings had been repaid within an acceptable period, either as a result of a reversal of the underlying flows or by being funded.

Chairman Burns observed that the Federal Reserve itself had been mainly responsible for drawings that proved to be long-term in nature.

Mr. Brimmer agreed, noting that the System's current debt to the National Bank of Belgium was a case in point. He thought however, that there was a qualitative difference in the present

case, in that it was known in advance that the British needed medium- or long-term funds. He would see nothing objectionable in the extension of long-term credits to the British by the U.S. Government. However, he would consider it improper for the Open Market Committee to decide on its own to extend credit to another central bank when that credit was being sought on behalf of a government that needed long-term financing. The problem would be resolved in his own mind if the U.S. Treasury were prepared to take over the debt at some point. In that connection, he asked whether the Treasury had expressed a view on the proposed swap line increase.

Chairman Burns said he had not yet discussed the matter with Treasury officials. However, he was confident that they would strongly approve the proposal. His confidence was based partly on a thorough-going discussion he had held with the Secretary of the Treasury before the enlargement of the Italian swap line had been approved. The Secretary of State also had been consulted at that time with respect to the general policy; as the members would recall, it had been decided to include a statement in the press announcement of the enlargement of the Italian swap line to the effect that "the Federal Reserve will consider possible increases in its other swap lines, as needed." Various considerations argued strongly for the proposed increase in the British swap line--

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particularly at present, when there was a new Government in Britain that was beset with difficulties and faced with many uncertainties.

At the same time, the Chairman continued, he agreed entirely with Mr. Brimmer that the System should not undertake to extend long-term credits to the British. When the Italian swap line had been enlarged the Committee had agreed that it should be made clear to the Italians that any drawings would be for 3-month terms, and that if the drawings were renewed it would be on the understanding that full repayment would be made by the end of a year. He thought a similar explicit understanding should be reached with the British. In both cases, of course, there would remain some possibility that the debts would run on for more than a year. Nevertheless, the System should remind all of its swap partners as the need arose that they were expected to use avenues other than the swap network for permanent financing. It could also offer to help the central banks involved to arrange for permanent financing, through the IMF or other sources.

Mr. Wallich observed that it was useful to bear in mind that in the bargaining process now under way with oil-producing countries, the consuming countries would tend to weaken their bargaining positions if they rushed to finance high-priced oil imports by any available means, however inappropriate; in effect,

they would appear to be validating the present level of oil prices. He was not suggesting that the consuming countries should incur the risks that would be involved in demonstrating an inability to pay for oil imports unless prices were reduced. Nevertheless, an indication of somewhat less than full readiness to employ short-term facilities for financing oil imports would be desirable.

Chairman Burns concurred in Mr. Wallich's comment, adding that the United States was moving slowly with respect to the IMF scheme for just that reason.

The Chairman then said he would determine the Treasury's attitude with respect to the proposed increase in the swap line with the Bank of England. Assuming the Treasury was favorably inclined, he asked whether the members would be agreeable to the increase.

No views to the contrary were expressed.

Thereupon the meeting recessed until 9:30 a.m. the following morning, Tuesday, March 19, 1974. Committee attendance was the same as on Monday afternoon. Staff attendance was the same as on Monday except that the following also were present:

Messrs. Gramley, Pierce, and Reynolds,
Associate Economists

Mr. Melnicoff, Managing Director for
Operations and Supervision, Board
of Governors

Messrs. Eisenmenger, Taylor, and
Andersen, Senior Vice Presidents,
Federal Reserve Banks of Boston,
Atlanta, and St. Louis, respectively
Mr. Kareken, Economic Adviser, Federal
Reserve Bank of Minneapolis

Chairman Burns observed that he had discussed the proposed enlargement of the System's swap line with the Secretary of the Treasury last evening, and the latter had consulted about the matter with the Secretary of State. Both officials were favorably inclined toward the action.

Mr. Coombs said he understood that the Bank of England would like to have the increase made effective as of Monday, March 26.

By unanimous vote, the Committee authorized an increase from \$2 billion to \$3 billion in the System's swap line with the Bank of England, and the corresponding amendment to paragraph 2 of the Authorization for Foreign Currency Operations, effective March 26, 1974.

Secretary's Note: Prior to this meeting notes by Governor Wallich summarizing developments at the March Basle meeting were distributed to the Committee. A copy of these notes is appended to this memorandum as Attachment B.

Chairman Burns 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:

The economic news of the past month, on balance, has been on the encouraging side. To be sure, overall activity has continued to decline, with industrial production off another 0.6 per cent last month, retail sales soft--especially in real terms--and new car sales down further to their lowest point thus far. But manufacturers' new orders rebounded in January, and the decline reported earlier for January in non-farm employment was revised upward, with an appreciable rise in nonmanufacturing jobs reported for February. Moreover, there was fresh survey evidence that business plant and equipment spending plans continue strong, and the February upturn in housing starts, though probably temporary, serves as a harbinger of the possibilities for recovery in this sector as the year progresses.

Our economic projection, as presented in the green book,^{1/} shows a little deeper decline than before in real GNP over the first half, reflecting mainly the apparent softness in consumer spending. But second-half prospects appear to be a little stronger than before, and the projection for the year as a whole is little changed. Basically, the evidence continues, in our view, to support the expectation that weakness is not likely to spread importantly beyond the industries most directly affected by the fuel shortage, and that recovery later in the year will be supported by some upturn in housing, a significant

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

increase in domestic small car output and sales, and continued expansion in business fixed investment.

Our GNP projection, as you know, had assumed a continuing oil embargo and a consequent shortfall in oil supplies throughout 1974. This assumption now is incorrect, since an ending of the embargo for at least a limited period was announced yesterday. We have been working on the implications for the economy of an improvement in oil supply, assuming further that there will be some increase in the flow of Arab oil but that imported oil prices will remain high. Our conclusions are still quite preliminary, since the supply and real income effects of this new development are diverse and partly offsetting, but I have asked Mr. Gramley to discuss briefly our initial estimates with you today.

Mr. Gramley made the following statement:

At the outset I want to emphasize what Mr. Partee has just said--that my remarks represent very preliminary staff judgments on the probable effects of the lifting of the embargo. Let me begin by listing the assumptions underlying the exercise.

First, we assume no change in the posted price of Arabian oil over the remainder of this year. As you know, a freeze on the posted price for the 3 months beginning April 1 has already been announced.

Second, we assume a moderate recovery in Arabian oil production--one that would not put much downward pressure on the market price of imported crude over the remainder of this year. Any increase in world supply of oil would obviously act as a depressing force on market prices. But we believe that there would also be a substantial rise in U.S. demands for oil if restrictions on sale and use of gasoline, heating fuel, and other petroleum products were lifted. Higher prices for petroleum since last fall have fostered economies in the use of this energy source. But price elasticities of demand are relatively low in the short run, and we believe that, at the present price of imported crude, imports might rise by up to 2 million barrels per day if supplies became readily available.

Third, we assume that 80 per cent of the increase in domestic expenditures for gas and oil would take place in the consumer sector, and would in the main represent a rise in the consumption of gasoline for passenger car use. The remaining 20 per cent would reflect a rise in industrial uses of gasoline and other petroleum products.

Our preliminary staff judgments on the probable effects of an ending of the embargo, in terms of the changes we would make in the current green book projection, are set forth in the two-page table^{1/} that you have before you. As shown at the top of the first page, we would add an additional half million units to our projection of domestic-type auto sales. A pickup in auto sales compared with our earlier projection could begin rather promptly, we think, probably in the second quarter. We would also look for a stronger rebound in residential construction over the remainder of 1974, and a somewhat higher rate of business fixed investment in the second half.

The crucial issue, however, will be the willingness of consumers to maintain their spending on goods and services other than gas and oil in the face of a large increase in their outlays for petroleum products. Our assumption in this regard is perhaps best illustrated by what happens to the personal saving rate. In our green book projection, the saving rate over the next three quarters was projected to be in the range of 6-1/2 to 7 per cent. In the alternative, the saving rate is projected to be about a full percentage point lower. This is quite an optimistic assumption about how consumers might respond to the increased availability of gas and oil. Even so, as the data on the next page show, the result would still be to encourage only a relatively moderate improvement in over-all economic activity.

Thus, the growth rate of real GNP in the third and fourth quarters might rise to about 3-3/4 per cent, instead of the 2.7 per cent average rate for the two

^{1/} A copy of the table referred to is appended to this memorandum as Attachment C.

quarters projected in the current green book. By the fourth quarter, the unemployment rate might be around 5.8 per cent, instead of the 6.2 per cent in our current projection. This may seem, at first blush, a rather weak economic response to a major change in energy supplies. We believe, however, that there are reasons for expecting only a moderate response if the price of imported crude stays at about its current level of \$10 a barrel.

Increased imports of 2 million barrels of oil per day at current prices would raise the average price of domestic and imported crude by about 7 per cent, and would increase the retail price of gasoline by 1 to 2 cents per gallon. As shown in the table, we estimate that the fixed-weight price index for private product would increase in the second half by 3 to 5 tenths more, at annual rates, than we had projected in the green book. This is not an alarming increase. But the implications for consumer budgets of a 2 million barrel per day rise in imports at today's prices are disturbing.

If the increase in domestic expenditures for petroleum products were distributed by sectors as we have assumed--with 80 per cent in the consumer sector--consumer expenditures for fuels would rise by something like \$12 billion at annual rates. About half of this amount would go for imports; about one-fourth would go for increased excise taxes; and a good part of the remainder would take the form of higher corporate profits in the petroleum industry. Only a small portion would end up as increased wage and salary payments in petroleum refining and distribution, and so the secondary effects on employment, income, and consumption in other sectors would be quite small. The rise in imports would thus act like an increased tax on consumers--a tax imposed at a time when consumer markets are already weak.

The outcome would, of course, be more favorable if the increase in Arabian oil supplies were large enough to depress world oil prices, and even more so if posted prices of Arabian crude were lowered. But unless such developments occur, the improvement in economic activity we can realistically expect with the

ending of the embargo will leave us short of full recovery from the effects on activity that imposition of the embargo has brought since last fall. In this connection, I would remind you that staff projections before the oil crisis developed were for a slowing of real growth this year. The oil crisis has altered the profile of cyclical developments in 1974, but the effects of inflation on the real income of urban workers, and the prospects for a significant slowing in the pace of business inventory accumulation, are still likely to limit the rate of growth over the remainder of the year.

Mr. Winn said he would like to get the staff's reactions to the likelihood of a scenario somewhat different from the one they had presented today. Suppose that there were price increases as a result of the removal of controls; that rapidly spreading labor unrest, such as was reflected in the recent strikes by San Francisco municipal employees, led to an acceleration of increases in wages and costs; that the changes in prices and costs produced economic distortions which in turn resulted in some modifications in expectations; and, in the international area, that the cost of imports rose as a result of a depreciating dollar. Under such conditions he wondered whether the more rapid inflation and greater economic distortions might not lead to greater strength in the second and third quarters than the staff had projected, and then to a rather sharp curtailment of activity in the fourth quarter.

Mr. Partee replied that, in his view, most of the factors that Mr. Winn had mentioned would be likely to have a depressing

effect on economic activity in the short run. Labor unrest was a case in point. He might note that the staff had not allowed for any unusual incidence of work stoppage in its projections, partly because the contract negotiations in the aluminum industry, which usually set the pattern for other bargaining agreements, had been concluded successfully. While labor discontent, which certainly was widespread, was likely to result in demands for larger wage increases and thus add to upward pressure on prices, those effects might be offset to some extent by weakness in commodity prices; futures prices in both domestic and international agricultural commodity markets had been declining for the past 3 weeks. The staff projections might not have made enough allowance for lower commodity prices, which would, of course, reduce desired rates of inventory accumulation.

Mr. Partee said he agreed that there were a great many uncertainties in the outlook. In the staff's judgment, however, the ending of the oil embargo would have only a modest stimulative effect on the economy because of the income redistribution effects Mr. Gramley had mentioned. In 1973, growth in economic activity had been held down by a large-scale transfer of income from urban workers to farmers. Farm income was not likely to increase so rapidly in 1974, although it was expected to remain high. However,

the rising share of income accruing to the oil industry was likely to have a similar effect, since the recipients probably had a lower-than-average marginal propensity to spend. Thus, while the ending of the embargo would no doubt result in a pick-up in new car sales and improvement in the housing market, on balance it was not expected to produce a substantial gain in economic activity.

Mr. MacLaury noted that Mr. Gramley had described the lower personal saving rate incorporated in the revised projection as an optimistic assumption. He (Mr. MacLaury) inferred that, Mr. Gramley thought consumers might be induced by the prevailing uncertainties to try to maintain higher levels of savings, rather than reducing savings in the effort to maintain expenditures on goods and services other than oil products.

Mr. Gramley said that Mr. MacLaury's inference was correct. While the increased availability of petroleum products at current high price levels would probably result in some reduction in the personal saving rate, it was possible that consumers might curtail other expenditures more and savings less than the projections allowed for.

Mr. MacLaury then asked if the staff had any new thoughts on the possible effects that sustained high prices of oil might have on demands in other developed countries and therefore on U.S. net exports.

In response, Mr. Bryant said there was no significant difference between the staff's current assessment of the situation and that made a month ago. Some participants in recent European meetings, however, appeared to have shifted their concern a bit away from the contractionary effects of the oil situation on real activity to its inflationary impacts on prices. Thus far, data on U.S. exports suggested no diminution in foreign demand; exports had been very high in January.

Mr. Partee commented that one important effect of the termination of the oil embargo was to add the United States to the list of countries which would have a balance of payments deficit. If oil prices remained at current levels, the increment in payments for oil imports would be very large.

The Chairman said it was worth noting that the major impact of the oil embargo had been on the United States; supplies of oil and gasoline in other developed countries recently had been ample. In both Europe and Japan, inventories had risen to comfortable levels and the conservation measures that had been adopted earlier had now been almost entirely eliminated. The major question concerned the degree to which existing conservation measures in the United States would be retained, now that the embargo had been lifted. He would hazard the guess that efforts to conserve fuels would continue, but on a reduced scale.

Mr. Hayes observed that the Board staff's appraisal of the economic outlook was quite similar to that developed at the Federal Reserve Bank of New York. There was, however, some difference with respect to the outlook for automobile sales. The green book indicated that sales would decline to an annual rate of 7-1/4 million units in the second quarter from 7-1/2 million units in the first quarter. Had it been the view of the Board staff that shortages of small cars and concern about the availability of gasoline would cut more deeply into auto sales in the second quarter than in the first? He would have been somewhat more optimistic about second-quarter sales even if the embargo had continued.

In response, Mr. Partee noted that seasonally adjusted auto sales had drifted down over the course of the first quarter. The green book projection had been based on the assumption that sales would be maintained in the second quarter at roughly the average levels reached in February and early March. Surprisingly, the data suggested that the decline in sales in January and February had been in small cars--at least if the seasonal adjustments were accurate. Although that development had appeared temporary, it had seemed likely that total new car sales would be poor if the embargo continued. As Mr. Gramley had noted, the projected rate of sales had been increased by a half million units to allow for the lifting

of the embargo. Because production of small cars was already running at capacity levels, the increase in sales would necessarily be accounted for mainly by large cars.

Mr. Hayes then asked about the interest rate assumptions underlying the staff projection of a recovery in housing starts.

Mr. Partee replied that, although the staff had not worked out detailed projections of interest rate relationships, it had assumed that mortgage credit would be reasonably available. Because the demand for mortgage credit was relatively low at present, it would not be necessary for inflows to thrift institutions to be on the scale reached in 1972 and 1973, when a record level of housing activity had been financed. While it was anticipated that mortgage rates would drift downward over the first half of 1974, the availability of mortgage credit might be reflected somewhat more in a liberalization of non-rate terms than in declining rates.

Mr. Hayes asked whether the assumption of a downdrift in mortgage rates was consistent with the recent updrift in short-term rates.

Mr. Partee agreed that that assumption would have to be reviewed carefully in view of recent developments in short-term credit markets.

In conclusion, Mr. Hayes asked whether the staff would agree that the official estimate of a \$9.4 billion Federal budget deficit in fiscal 1975 was optimistic.

Mr. Parcee replied that, while he had no firm evidence on the point, he thought the risk was that expenditures in fiscal 1975 would exceed rather than fall short of the level projected in the budget.

In reply to a question by Mr. Brimmer, Mr. Gramley said the assumption regarding the growth rate of money was the same in the revised projection presented today as in the original green book projection.

Mr. Brimmer then noted that revised projections had been presented for real GNP but not for nominal GNP. The latter were of interest because upward revisions would imply an increase in the transactions demand for money, which in turn would have consequences for interest rates.

In response, Mr. Gramley said it was assumed in the revised projection that the increase in interest rates during the latter half of 1974 would be shifted up somewhat by the larger rise now expected in nominal GNP and thus in the transactions demand for money, but that the principal effects, in terms of restraint on economic activity, would not be felt until some time in 1975. He added that in developing

the projections to be presented at the next FOMC meeting the staff would work through the implications of increased transactions demands more carefully than had been possible in today's projections.

Mr. Colwell expressed surprise at Mr. Partee's comments about softness in consumer spending. The staff of the Federal Reserve Bank of Dallas had just completed a rather large survey of retailers in the Eleventh District, covering sales of durable and nondurable goods and services. The retailers surveyed were quite optimistic, although sales were off slightly in real terms and shifts in buying patterns indicated cost consciousness on the part of consumers. For example, consumers had adapted to beef shortages by buying less, and they had not returned to their earlier scale of purchases even when beef had become more readily available. However, retailers had managed to keep their inventories at reasonable levels; their main concern was that they had run down stocks they had acquired earlier at lower prices than they now had to pay. On the whole, given the optimism of survey respondents, one wondered whether it was not a mistake to regard the recent behavior of retail sales as disappointing.

Mr. Partee noted that the tone of the remarks on retail sales in the Dallas Bank's contribution to the red book^{1/} differed

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

from that in most other District reports which included comments on such sales, suggesting that the situation in the Eleventh District was not typical of the nation as a whole. His own observations had been based on national data which indicated an irregular downward movement in retail sales in real terms since April 1973. Over recent months total retail sales exclusive of automobile sales, which had been notably weak, had about leveled off; they had drifted up a little in nominal terms and perhaps drifted down a little in real terms. In relation to previous cyclical experience, such behavior represented softness in the consumer sector.

Mr. Coldwell remarked that the developments Mr. Partee had described could be regarded as a relatively good performance, in light of the uncertainties faced by consumers over the past 9 months.

Mr. Hayes commented that, excluding automobiles, the downtrend in the physical volume of retail sales had been only slight.

The Chairman observed that the heavy indebtedness of American households was an important factor in the downtrend in the physical volume of retail sales since last spring. Currently, one out of every six dollars of disposable personal income was used for repayment of instalment debt. That represented a sizable drain on consumer buying power. Purchases of "big ticket" items in

general, not only autos but also mobile homes and appliances, had been weak. The slackness of demand for conventional new homes might also be cited. Consumer debt had risen rapidly in late 1972 and in 1973, and delinquency rates also had increased sharply. The economy appeared to be suffering from an over-extension of consumer credit, along with credit generally.

Mr. Coldwell then observed that Eleventh District builders found themselves with a growing inventory of unsold homes because of buyer resistance to high prices. Although financing costs also were fairly high, mortgage credit was available. However, down-payment requirements appeared to be a major constraint on sales. He asked whether the staff believed that that situation prevailed nationally.

Mr. Partee responded that, for the nation as a whole, inventories of unsold single family homes held by merchant builders still represented almost a year's supply--an historically high ratio. There appeared to be several contributing factors, of which one certainly was the sharp increase in home prices over the last year or two. Uncertainty about fuel supplies probably also had been an important factor in recent months. A third factor was credit terms--including down-payment ratios and standards of creditworthiness, as well as rates--which evidently had become more restrictive since the

summer of 1973. If growing competition for mortgages were to induce lenders to relax non-rate credit terms, that should help home sales.

Mr. Balles noted that while the revised projection contained good news with respect to the rate of increase in real output and the level of unemployment, it also contained some bad news in the form of a higher estimate for the rate of increase in the GNP deflator. He wondered whether the staff shared his concern that a wage explosion might follow the price and profits explosions that had already occurred. Perhaps he was too much influenced by the San Francisco municipal strikes to which Mr. Winn had referred; by virtually shutting the city down last week, the municipal workers had achieved some large wage gains. The increase in basic pay was about 6 per cent; including special supplemental increases, fringe benefits, and the effects of numerous prospective job reclassifications, the over-all increase might approach 10 per cent. He asked about the staff's assumptions with respect to potential wage increases in 1974 and their impact on costs and prices.

Mr. Partee replied that for some time the staff's 1974 projection had incorporated about an 8 per cent increase in compensation rates, somewhat higher than the 1973 rate. Furthermore,

it was expected that slowing productivity gains would result in a large advance in unit labor costs.

Mr. Partee went on to note that the rate of increase in the index of average hourly earnings had shown a distinct moderation over the past 5 months. He found the slowdown inexplicable, and he certainly anticipated that it would be reversed soon; as the year progressed, he expected demands for higher wages to be strong and urgent. Thus far this year, contract negotiations in the basic industries had been settled quickly, with fairly moderate wage increases accompanied by full cost-of-living protection through escalator clauses. If, as he expected, that pattern continued, actual wage increases would be determined more by the future rate of price advance than had been the case in the past.

Mr. Eastburn observed that before this meeting his staff had worked out two possible patterns for the growth rate of real GNP in 1974, assuming in both cases that the oil embargo would continue. The first pattern, which was based on the assumption that the slowdown in economic activity was primarily a result of demand deficiencies, was saucer shaped; the second, which involved the assumption that the slowdown was largely shortage-induced, indicated a more rapid upturn in the second and third quarters-- and in one version even suggested a sizable rise in real GNP in

the second quarter. Now that the oil embargo had been terminated, those results made him wonder whether the recovery in GNP might be more rapid than suggested by the Board staff's revised projection-- at least if the slowdown had been more a consequence of supply shortages than of demand deficiencies.

Mr. Partee responded that in any projection there was, of course, the possibility of erring in one direction or the other. If sales of automobiles or houses should now pick up faster than anticipated, however, the major effect in the short run would not be on the over-all growth rate of GNP but on the distribution of the change between inventory accumulation and final expenditures. He was not aware of any evidence that the weakness in consumer spending was attributable to shortages to any great extent. There were, of course, shortages of some particular consumer goods, such as compact cars, but by and large retail stores had been offering fairly wide selections of clothing, furniture, appliances, and other goods. In his judgment, the sluggishness of consumer spending was attributable mainly to the decline in real income, and as mentioned earlier by the Chairman, to the burden of consumer debt.

Mr. Partee remarked that business spending for plant and equipment probably had been held down by shortages, so that an improvement in deliveries might result in a faster rise in business

fixed investment than projected. It should be noted, however, that the staff's plant and equipment projection was consistent with the latest Commerce Department survey of business investment plans, with no allowance for shortfalls of actual from planned spending such as had occurred in other recent quarters.

Finally, Mr. Partee noted, there was the question of inventory accumulation. It was obvious, both from the red book and from the recent purchasing agents' report, that businessmen were still concerned about shortages of strategic materials and would probably continue to accumulate substantial inventories of such materials, at least in the short run. The staff's projections for the near term were consistent with a substantial buildup in inventories of strategic materials; they allowed for a continued high level of over-all inventory investment, even though stocks of automobiles--which had been an important factor in the accumulation of the fourth quarter of 1973--were not expected to rise further.

Mr. Gramley said he might add a few comments. The available evidence did not support the view that the decline in economic activity had been induced by a lack of petroleum products for use in industrial processing. The December and January declines in industrial production had been primarily a function of slowdowns in auto assemblies, and the further decline of February was

concentrated mainly in the industries supplying automotive parts and materials. It appeared likely, therefore, that a substantial part of the drop in real GNP between the fourth quarter of 1973 and the first quarter of 1974 would be found to be attributable to autos and parts, and that the extent of the recovery in the second quarter would depend on the magnitude of the rebound in auto sales. In his opinion the half-million increase in unit sales of domestic autos now projected by the staff for the second quarter was on the optimistic side.

As for the latter half of the year, Mr. Gramley continued, the key question, in his judgment, was whether the price of imported crude oil would decline. In the absence of good evidence to the contrary, the staff had assumed that imported crude prices would remain at present levels. The increased availability of petroleum products at current high prices would have the same economic effect as the imposition of a substantial tax on consumers.

Mr. Eastburn referred to Mr. Partee's comment that the production of small cars was already close to capacity, and asked whether the producers' shift from large to small cars was about on schedule or was proceeding more rapidly than expected.

Mr. Gramley replied that recent production rates appeared consistent with the information on conversion plans the staff had

obtained around the first of the year through telephone conversations with economists of the major automobile companies. The production of small cars had risen to an annual rate of about 3 million units, suggesting a modest increase in small-car capacity since the fourth quarter. The expected large increase in capacity was yet to come; one major producer did not anticipate much increase in small car output prior to the 1975 model year.

Mr. Francis commented that at least in some cases the automobile companies appeared to be making the shift to small cars very rapidly. He had heard from one informed observer that some assembly lines would be changed over in 2 months and that many of them would be shifted within 3 to 6 months.

Mr. Gramley noted that the responses in the staff's telephone inquiries suggested that production of compacts and subcompacts might reach an annual rate close to 5 million units by the fourth quarter of 1974. Thus, the survey results were not inconsistent with an expectation of a substantial conversion to small-car production over the course of the next few months.

Mr. Mitchell said it was not clear to him whether the staff expected the oil shortage to be dealt with by price rationing, by rationing through queues, or by shifts in production and consumption patterns. If the price of gasoline were to settle at a level 50 per cent above

the pre-embargo level, the impact on the housing and recreation industries over the next few years might be larger than envisioned by the staff. If the price increase were on the order of 20 per cent, the impact would probably not be great.

Mr. Partee observed that the average price of gasoline had gone up by about 50 per cent, from around 35 cents per gallon to a range of 50 to 55 cents. The price of home heating oil had risen by an even larger percentage.

Mr. Gramley added that the staff projection assumed that, with an additional supply of 2 million barrels of oil per day, going mainly into gasoline most of the existing non-price rationing mechanisms would be eliminated--that is, sales would be permitted on Sundays, the long queues would disappear, and consumers would, in effect, be able to buy all the gasoline they wanted at prevailing prices. Even with the 2 million barrel per day increase in supplies, however, the share of petroleum products as a percentage of total energy sources in the United States would be lower than originally projected by the staff in November 1973, prior to the oil crisis.

Mr. Morris remarked that he was somewhat concerned about the availability of financing for the projected volume of housing starts. The econometric model of Data Resources Incorporated projected a volume of housing starts only slightly higher than that

called for in the staff's revised projection. However, the DRI model indicated that thrift institution deposits would have to grow at a 12 to 14 per cent rate in order to finance that level of activity. In contrast, the Board staff's projections indicated that thrift institution deposits would grow at a rate of only 6 to 7 per cent.

Mr. Partee responded that there were other factors which had to be taken into account. For one thing, thrift institutions could borrow from the Federal Home Loan Banks. Secondly, in recent years commercial banks had become increasingly important as a source of funds to the mortgage market. If, as anticipated, the current bulge in short-term business credit demands subsided, banks might well continue to be major suppliers of mortgage credit. Furthermore, arrangements for bond sales and tandem mortgage sales by GNMA and FNMA represented another potential supplement to the mortgage market. Simulations run with the flow-of-funds model late last year had not suggested any difficulties in the financing of the projected volume of residential construction activity. While the outlook for savings inflows had worsened somewhat since then, in view of the structural shifts that had occurred he did not believe it would be necessary for thrift institution deposits to grow at a rate as high as 12 to 14 per cent.

Chairman Burns observed that the sizable tandem mortgage plan now under serious consideration by GNMA could change the financing outlook considerably. He added that in the recent past the financing of residential construction had been carried on primarily by governmentally sponsored agencies. The economy now had resources for mortgage financing that did not exist 10 or 20 years ago.

Mr. Clay noted that there were mixed signs of strength and weakness in the economy. On the one hand, new orders placed with manufacturers rose in January and the strength in planned capital outlays for the year was reconfirmed by the McGraw-Hill and Commerce Department surveys. At the same time, retail sales declined in February and the January gain had been revised downward. It was not clear to him, however, that a fall-off in consumer demand at this point was necessarily undesirable. The combination of a reduction in consumer spending and an increase in capital spending could serve to slow the rate of inflation.

Mr. Partee agreed that that would be true in the long run; in the short run, an increase in spending on plant and equipment presumably would be even more inflationary than an equivalent increase in consumption spending, given the capacity situation. Furthermore, a shift from consumption to investment might well be associated with a net softening in the economy, if the former fell more than the latter rose.

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Mr. Clay said he would not want to see the reduction in consumer demand persist indefinitely. However, he considered consumer resistance to higher prices an indication of intelligent behavior that would offer a wholesome restraint on inflationary pressures.

The Chairman remarked that the recent change in the real terms of trade resulting from the rising price of imported oil might well result in a standard of living somewhat lower than would have prevailed otherwise.

Mr. Clay observed that the new, higher price of oil might very well represent its true economic value. It was conceivable that energy in general had been underpriced for some time, and that the whole economy would now have to adjust to the real price.

Chairman Burns then said he would like to call to the attention of the Committee some simple but important facts concerning the current inflation. While inflation was a worldwide phenomenon, the U.S. record was becoming progressively poorer relative to that in other nations. He recently had some calculations made for the 14 major OECD countries, in which the level of the consumer price index in each month since January 1973 was compared with the level in the same month of the preceding year. The rise in consumer prices was smaller in the United States than

in any of the 13 other OECD countries for the year ending in January 1973. The situation continued the same for the monthly comparisons month from February through July 1973, but then the picture began to change. Over the year ending in August, consumer prices rose more in the United States than in Austria, Belgium, Germany, Norway, and Sweden. By December the Netherlands had been added to the list of OECD nations with smaller rises in consumer prices than the United States, and incomplete data for January and February 1974 suggested that the relative position of the United States had deteriorated further.

Calculations using the wholesale price index resulted in a similar picture, the Chairman observed. Over the year ending in January 1973, wholesale prices had risen more in 9 of the other countries than in the United States. By August and September, however, the rise in the U.S. wholesale price index exceeded that in all but 2 or 3 of the other nations, and in subsequent months the situation had remained much the same.

Although a great deal had been written about the rate of inflation in Great Britain, Chairman Burns continued, the data showed that the recent U.S. experience was worse. Over the year ending in January 1974, wholesale prices rose at rates of 21 per cent in the United States and 15 per cent in the United Kingdom. In February, the comparable year-over-year increases were 20 per cent

for the United States and 17 per cent for the United Kingdom. A year ago it was possible to say that inflation was less rapid in the United States than in other countries and to draw the conclusion that that would have a favorable influence on the U.S. balance of payments. It should be borne in mind that such statements could no longer be made. It should also be borne in mind that there had been little or no relaxation of monetary policy in European countries or in Japan in recent months.

Mr. Wallich remarked that he believed there were more elements of strength in the economy than suggested by the staff projections, but he was concerned about one potential element of weakness. The substantial bulge in inventory accumulation in the fourth quarter had resulted mainly from the oil situation, and it seemed likely that inventory investment would taper off, as it apparently had begun to do in January. He wondered if the staff thought such a development would postpone the cyclical turning point and delay the economic recovery.

In reply, Mr. Partee said he expected inventory behavior to be a dampening influence on the economy for the remainder of 1974. The staff projection called for a progressive reduction in the rate of inventory accumulation from the \$18 billion rate recorded in the fourth quarter of 1973 to about \$7 billion in the fourth quarter of 1974.

Of course, the change in business inventories was one of the most difficult of the GNP categories to predict. It was possible that the change in inventories would become negative during the year, but because businesses had kept their inventory-sales ratios at moderate levels and had generally followed conservative policies, the staff thought a classic cyclical decline in inventory accumulation was unlikely. It would be important, however, to follow developments in that area closely as the year progressed.

He might note, Mr. Partee continued, that some business analysts were forecasting a recession in 1975 rather than in 1974, mainly on the basis of their expectations that a large inventory correction would develop next year, concurrently with a stabilization or downturn in business capital spending. In effect, they considered the current decline in economic activity to be a minor dip in advance of a general recession in 1975.

Mr. Brimmer observed that, despite the modest improvement in the economic outlook described by Mr. Gramley, and despite the current high rate of inflation, policy makers were still faced this year with what essentially was a recession. There was no easy way out of the dilemma, but it was important to note that there would be a great deal of misery in the country even if the unemployment rate rose no higher than 5.8 per cent by the end of the year.

Mr. Clay remarked that much of the recent inventory accumulation might reflect stocks acquired by users of oil products in an effort to protect themselves against shortages. If that were the case, the process of running down stocks should be accomplished without much negative impact on the economy.

The Chairman commented that the inventory situation was distorted not only by the oil crisis but also by the price control program, and it would not be possible to analyze it properly until the controls were lifted. That probably would occur soon.

In reply to a question by Mr. Bucher concerning the projected reduction in the saving rate, Mr. Gramley said he should emphasize that that projection reflected highly preliminary judgments. It seemed reasonable to assume that consumers would tend to maintain their spending on other goods and services at a time when their expenditures on gasoline and oil were rising because of increased supplies at higher prices--a process that would result in some decline in the personal saving rate. He considered that relatively optimistic assumption regarding consumer behavior useful in making a first approximation to the likely extent of the economic recovery. However, he had some doubts as to whether the actual decline in personal saving would be as large as he had indicated. Indeed a smaller decline was likely to be shown in the projections prepared for the

next meeting, which would be based on a more elaborate and careful analysis of the various relevant considerations than that underlying today's projections.

Mr. Bucher then noted that in the revision of the projections the rise in the fixed-weight deflator for the third and fourth quarters of 1974 had been increased by 0.3 and 0.5 percentage points, respectively, to 6.1 and 6.2 per cent. He understood that the increase was attributable primarily to upward revisions in the projections of petroleum prices. He wondered, however, about the extent to which food prices contributed to the anticipated rise in the deflator.

Mr. Gramley replied that the rate of increase in food prices was expected to taper off in the latter half of 1974. That was one factor accounting for the projected slowing of the rise in the deflator in the second half.

In response to a question by the Chairman about the likely trend of meat prices, Mr. Gramley noted that any projections of agricultural prices were highly uncertain; indeed, recent forecasts had involved some phenomenally large errors. However, the large supplies of cattle now on the range at least gave one reason to hope that meat prices would decline over the course of the year.

The Chairman observed that slaughter rates were currently high because of the unfavorable relationship between prices of cattle and prices of feed grains. He wondered if that would not have adverse effects on meat prices later in 1974.

In reply, Mr. Gramley said he thought the high slaughter rate would have unfavorable implications for beef supplies and prices mainly beginning in 1975. In the short run, of course, high slaughter rates tended to reduce meat prices. It was the opinion of the staff's agricultural economist that the slaughter rate might increase in coming months, although there was some uncertainty on that point.

Mr. Clay expressed the view that the decline in food prices was a temporary aberration and that rising food prices might again be a contributor to inflation by the end of the year. The cattle marketing situation had been distorted by controls, and cattle had been fattened too long. That was undesirable from the viewpoints of both producers and consumers because production costs tended to rise substantially in the later stages of preparing cattle for market. It was his opinion that high production costs--including grain prices--would keep the cost of beef high, and might result in increased production of lower-quality, grass-fed beef.

Mr. Partee noted that the staff projection allowed for a 4 to 5 per cent rate of increase in food prices in the latter half of 1974. That was less rapid than the rise in the over-all deflator for the second half of the year because it was anticipated that prices of manufactured goods in that period would begin to reflect rapidly rising unit labor costs.

Mr. Clay observed that his staff's expectations for food prices were about the same as those of the Board staff. However, his staff believed that meat prices would fluctuate but average prices would be relatively stable in the last half of 1974.

Mr. Coldwell remarked that feedlot operators in the Eleventh District reported a large overhang of cattle ready for slaughter, which would have an impact on prices. However, the operators also expected the slaughter rate to drop back in August and September to levels well below current market demands. Any near-term drop in prices was therefore likely to be temporary.

Mr. Francis commented that a number of commercial feeding operations were reported to be in financial difficulties because they were taking losses of \$125 to \$200 a head on cattle currently being slaughtered. It was possible that some feedlots might go out of business, and there was some question about the willingness or ability of feedlot operators in general to maintain the volume of operations. The outlook was uncertain, but it was clear that the

industry had problems which were likely to affect meat prices for some time to come.

Mr. Holland remarked that the revision in the staff's GNP projection described this morning had implications for the expected relationships between growth rates in monetary aggregates and interest rates, and therefore for the specifications associated with the alternative policy courses discussed in the blue book.^{1/} If one were not a strict monetarist--and he was not--and if one felt that the degree of pressure presently being exerted by monetary policy was appropriate for dealing with inflation, he would conclude that the 6-month targets for the monetary aggregates, and possibly also the 2-month ranges of tolerance, should be recalculated. Perhaps that could be done before the end of today's meeting, so that the information on which the Committee based its policy decision would be as current as possible.

In reply, Mr. Partee noted that the staff seemed to be having greater difficulties than usual in maintaining consistency in the assumptions incorporated in various parts of the documentation it prepared. The analysis in the blue book reflected expectations of more upward pressure on interest rates than had been

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

anticipated only a few days earlier, when the green book was prepared; and, as Mr. Holland had suggested, the revision of the GNP projections presented today would imply somewhat different relationships between monetary growth rates and interest rates than were set forth in the blue book. He did not think the relationships involving the March-April ranges of tolerance for the aggregates would be significantly different, since the growth rates for that period were already determined to a large extent. As to the relationships involving the longer-run targets for the aggregates, he would hesitate to offer the Committee hastily prepared revisions; the implications of the change in GNP projections for the relationships in question had to be worked through carefully, sector by sector.

In reply to a question by Mr. Sheehan, Mr. Gramley said that, as Mr. Partee had noted earlier, the staff had not yet worked out the mortgage rates and fund flows likely to be associated with its revised projection of housing starts. The earlier projection, shown in the green book, was based on expectations of some easing in mortgage credit terms. Personally, he thought it was reasonable to expect the ending of the embargo to call for some increase in the projected level of housing starts over the rest of 1974; he did not expect mortgage terms to tighten

enough in that period to choke off the expected rise. In 1975, however, the story might well be different.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period February 20 through March 13, 1974, and a supplemental report covering the period March 14 through 18, 1974. Copies of both reports have been placed in the files of the Committee.

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

Open market operations over the period since the Committee last met gradually turned toward a more restrictive stance as the aggregates, particularly M_1 , exhibited more strength than had been anticipated. Early in the period, when financial markets were reacting rather strongly to the failure of open market operations to validate market expectations of a continued easing of policy, the Federal funds rate was kept steady at around 9 per cent, in accordance with the Committee's wire agreement of March 1. After the restoration of the 8-1/4 to 9-1/2 per cent range of tolerance by wire agreement on March 11, and with M_1 stronger than desired, the Desk aimed for a more restrictive supply of reserves, expecting initially that Federal funds would trade in a 9-1/8 to 9-1/4 per cent range. And, last Friday, when new data further confirmed the stronger-than-desired growth in M_1 , the Desk became an even more reluctant supplier of reserves, anticipating that the funds rate would move to the 9-1/2 per cent top of the Committee's range, which it did yesterday.

As noted in the blue book, both short- and long-term rates moved significantly higher. Market expectations of an easier monetary policy were frustrated, and

a mood of pessimism enveloped the markets when economic news turned out to be somewhat better than expected and published M_1 data exhibited explosive growth. Government dealers entered the period with heavy inventories--over \$1.6 billion--of Treasury securities maturing in more than one year, mainly stemming from their underwriting of the February Treasury refunding. Reduction of those inventories to about \$400 million in a declining market involved them in heavy financial losses. Some dealers are quite bitter, feeling that the Federal Reserve led them down the primrose path. Others--a little more honestly--bemoan their own lack of judgment in acting so strongly on the belief that the System had embarked on a policy of continuous easing.

Yesterday's regular Treasury bill auction illustrates the rise in short-term rates over the period. Average rates of 8.04 and 7.88 per cent were set for 3- and 6-month bills, up 103 and 110 basis points from the rates established in the auction just preceding the last meeting of the Committee. While the rise was sharp, it should be noted that there had been about as large a decline in short-term rates between the January and February meetings of the Committee. The extreme volatility of interest rates in recent months, while a sign of these times of uncertainty, is a matter of some concern with respect to the longer-run orderly functioning of the financial markets. In this connection, the Joint Federal Reserve-Treasury Study Group of the Government Securities Market has stepped up its activity and is acting on a number of suggestions made in a meeting with dealers a short time ago. As part of that effort I have asked dealers to submit, on a voluntary basis, monthly profit and loss statements so that we can have a more current view of the financial health of the market.

The Treasury is planning to announce shortly--perhaps this week--a \$4 billion cash offering, which probably will involve tax-anticipation bills and short-term notes. Given the short maturities and the use of the auction technique, even keen considerations would not appear to be of much importance. The amount is larger than the market expects, however, and given the

gloomy atmosphere, it may not all be smooth sailing. Should the Committee decide today on a policy that would involve a rise in the Federal funds rate, I think it would be important to make that quite clear in the market before the first stage of the Treasury financing.

Finally, I should note that despite the recent poor profit performance, there is still an interest in getting into the Government securities business. A week ago Friday, we added two names to our list of reporting dealers--First Pennco and Donaldson, Lufkin and Jenrette. After a further period of surveillance, we would expect to start doing business with both firms. This will bring us to a new high of 25 dealer firms.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period February 20 through March 18, 1974, were approved, ratified, and confirmed.

Mr. Axilrod made the following statement on prospective financial relationships:

The unexpectedly large rise in M_1 in early March brings the level of the series somewhat above the Committee's long-run, 5-3/4 per cent growth path that starts in December 1973. If our estimate for the month of March as a whole holds up, M_1 growth for the first quarter will be at a 6.7 per cent annual rate. Growth was also relatively rapid in the last few months of 1973. But taking a 15-month time frame--from the end of 1972 to date--the annual rate of growth in M_1 would be a shade under 6 per cent--5.9 per cent, to be specific.

With expansion of nominal GNP projected to pick up in the spring and summer from the low first-quarter pace, the staff expects that further increases in interest rates would probably result from efforts to

keep M_1 to the path indicated by the Committee at its last two meetings. Alternative B^{1/} represents a pattern of interest rates and aggregates which the staff believes will bring M_1 back to path by September. Alternative C encompasses a more rapid move back to path for M_1 and, hence, would appear to involve a sharper rise in interest rates in the short run. This alternative involves the risk, however, of M_1 falling well below path by summer from the cumulative impact of the restraint that is set in motion. Alternative A can be interpreted as accepting a new and somewhat faster growth path for M_1 and would not be expected to involve any further tightening of money market conditions and possibly some easing.

These relationships are, as the Committee well knows, subject to great uncertainty, particularly in a period such as now when the basic projections of GNP may be subject to larger-than-usual margins of error and when inflation seems to have led to shifting and unpredictable attitudes toward interest rates, credit, and money demand on the part of borrowers, lenders, and savers. This would suggest that the Committee may wish to consider expressing its short-run operating guides in terms of rather wider ranges of tolerance for aggregates and/or interest rates. Under current circumstances, for example, the 2-month range for the monetary growth rates might be at least three percentage points. If such a widening of the blue book ranges were accomplished by lowering the bottom of the range, this would, for example, enable the Committee to express its willingness under current circumstances to accept a prompter return of M_1 to the long-run path, if that turns out to be possible, without requiring any significant deviation of money market conditions from the ranges the Committee specifies.

On the other hand, with the potential pull on money demand from large price increases apparently great, the Committee would probably also want to keep adequate leeway for interest rate flexibility--to avert

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

the risk, for instance, of fostering an excessively low real rate of interest in a period of continuing, strong expectations of rising prices. On the other hand, the Committee may also wish to have flexibility on the downside because of the risk of maintaining high market rates should money and credit growth suddenly weaken. In that context, it might be pointed out that the recent rise in short-term market rates has brought them close to their January 1974 highs; bill rates are there, and other short-term rates are within 25 to 50 basis points of those highs. Long-term rates have moved somewhat above the levels of January 1974. As compared with the highs of the summer of 1973, short-term rates are currently 1 to 2 percentage points below those peaks, while long-term market rates are only 20 to 40 basis points below.

If interest rates do have to rise further in the weeks ahead in pursuance of the Committee's policy toward reserves and aggregates, we will be moving back toward the establishment of short-term rate levels that may begin to threaten savings flows to intermediaries and to tighten mortgage market conditions. In bond markets, rates will probably rise above their summer of 1973 levels, and some upward pressure on mortgage rates may be exerted from that quarter also. This type of pressure might be eased to some degree if the Desk purchased coupon issues in the market more frequently and in larger volume in the months ahead than has been the case in the past.

Monetary policy in the period ahead will have to be conducted in the face of the \$4 billion Treasury cash financing. Since this financing will most likely be in the bill and short-term coupon area, it would not ordinarily require a significant degree of even keel. However, the recent adverse market experience with the mid-February refunding raises the possibility of stronger-than-usual over-all market interest rate repercussions from signs of a tighter money market. This suggests the need for a little more even keel than such a financing would usually require, particularly in light of possible adverse implications for intermediaries and the mortgage market of rising short-term rates.

Mr. Bucher referred to Mr. Axilrod's comment that alternative A would be expected to involve no further tightening of money market conditions and might lead to some easing. According to the blue book, maintenance of the funds rate at around its recent level of 9-1/4 to 9-1/2 per cent might be accompanied by some further upward adjustment in short-term rates, particularly as the forthcoming Treasury financing was absorbed. Some market observers appeared to be interpreting the recent rise in the funds rate as an aberration, which also suggested that some further market adjustments lay ahead. He asked how the staff would assess the prospects for increases in short-term rates even if the funds rate remained at its current level.

Mr. Axilrod responded that the Federal funds rate had just reached 9-1/2 per cent, which he would now interpret as the "current" level. He would expect the persistence of that level, and of the effects it implied for dealer financing costs, to be associated with at least some further upward adjustments in short-term market rates. Moreover, the \$4 billion Treasury financing in prospect probably was at least \$500 million higher than market participants generally were expecting.

Mr. Holmes remarked that he agreed with Mr. Axilrod. Although a substantial adjustment had occurred yesterday, when

Treasury bill rates had risen by almost one-quarter of a percentage point, some further adjustment could occur--particularly in view of the \$4 billion of short-term Treasury securities that the market would have to absorb.

Mr. Black asked whether a further significant increase in the funds rate might risk creating disorderly market conditions.

In response, Mr. Holmes observed that the recent rapid adjustment in rates, while producing difficulties for the dealers holding large inventories of securities, had not led to disorderly conditions. In his view, a further rise in the funds rate would result in a repetition of that experience, and would not generate disorderly conditions; short-term rates would again adjust upward, and the higher rates would bring investors back into the market. As he had noted in his statement, however, any upward adjustment in the funds rate that might be called for by today's policy decision should be brought about quickly, before the financing.

Mr. Holland asked whether it was correct to infer from Mr. Holmes' remarks that he, like Mr. Axilrod, believed that the Committee would be well advised to instruct the Desk to give a little more weight to even keel considerations during the forthcoming financing than it had in connection with the previous

financing. In any case, he (Mr. Holland) wondered why the staff had proposed to put parentheses around the reference to the financing in alternatives B and C for the directive.

Mr. Holmes replied that even though the prospective financing was of a kind that ordinarily had not called for even keel, he thought the Desk should pay more attention to it than it had to short-term financings in the past.

Mr. Axilrod remarked that the parentheses--which could easily be deleted--had been suggested to avoid giving the degree of prominence to the forthcoming short-term financing that was customarily given to large coupon financings. With the exception of a \$4 billion bill financing several years ago, the Committee had not applied even keel to short-term financings.

Mr. Mayo observed that in the past he had advocated ranges of tolerance of more than two percentage points for the short-run growth rates in the aggregates. Consequently, he was happy to endorse Mr. Axilrod's suggestion today for a widening of the ranges to three percentage points. He noted, however, that a range of 6 to 9 per cent for M_1 would encompass all three alternatives presented in the blue book; the alternatives did not appear to be significantly different from one another.

In response, Mr. Axilrod observed that the 2-month ranges of tolerance for both M_1 and M_2 shown for the three alternatives in the blue book did not differ much from one another because a move toward restraint, for example, would have relatively little effect on deposits during the first 4 weeks. When the Desk held back on the provision of reserves and the Federal funds rate rose as a consequence, member banks initially tended to borrow more from the Reserve Banks, partly offsetting the effects of the Desk's operations on total reserves. In the very short run, therefore, the effects on the rate of growth in deposits was small. Growth in deposits was retarded over succeeding months, however, in response to the rise in the general level of short-term interest rates.

As he had noted in his statement, Mr. Axilrod added, he thought the Committee might want to reduce the lower limit of the short-run ranges by one percentage point in order to reflect a willingness to accept a more prompt return of M_1 to the long-run growth path, if that turned out to be possible without requiring any significant deviation of money market conditions from the specified range.

Mr. Brimmer said he would like to pursue the question of even keel in connection with the forthcoming short-term financing.

He was concerned about the possibility that market conditions might develop in which some assistance was needed from monetary policy instruments other than open market operations. If, for example, the Board concluded in the near future that a change in reserve requirements was appropriate, he questioned whether it should feel bound by even keel constraints. He had understood even keel to mean that the System normally would not change the stance of monetary policy while a Treasury financing was in process, but that it was not bound by that constraint. He was troubled by a conjuncture of circumstances at the present time which might pose severe conflicts for monetary policy, and he would not want to have inhibitions placed on the conduct of policy.

Mr. Axilrod commented that his remarks with respect to the forthcoming Treasury financing were not intended to suggest that a decline in the Federal funds rate from its current 9-1/2 per cent level would be desirable. His point was that, since the market had not yet fully adjusted to the recent rise in the funds rate, considerable caution should be exercised with regard to the timing and magnitude of any further rate increases in view of the prospective financing--even though the System ordinarily had applied even keel only to longer-term issues.

Chairman Burns remarked that, in view of the shift to the auction technique in selling Treasury securities, even keel considerations should be less important than in the past.

Mr. Holland observed that over recent years the Committee had been moving in the direction of attaching less importance to even keel considerations, and he would not suggest any reversal of that trend. He would suggest, however, that somewhat more attention be given to even keel in the forthcoming financing than had been given in the February refunding. In that instance, the Committee's instructions to the Manager had resulted in operations conducted a little too late, relative to the timing of the financing, that had led the market to misinterpret the stance of policy.

Chairman Burns commented that, while that interpretation might be correct, he nevertheless felt that the System should not take too seriously the expectations of Government securities dealers regarding monetary policy. The dealers were businessmen undertaking risks, and the Federal Reserve did not have a responsibility to assure their success and their profits. Because of the huge Federal deficit and the frequency of Treasury financings, the Committee would run the risk of frustrating the goals of monetary policy if it gave too much attention to even keel considerations.

Mr. Brimmer noted that, particularly because the goals of monetary policy were complex and often conflicting, he shared the Chairman's concern about the possibility that policy might be frustrated. Recently, one goal had been to assure an availability

of funds consistent with a structure of interest rates over the rest of the year that would bring about a revival in the housing sector. If interest rates rose much beyond the levels they had attained recently, that goal would be called into question.

Mr. Mayo remarked that, as long as the Treasury employed its present procedures for financing the national debt, the Federal Reserve did have a responsibility to assist in creating a fairly calm atmosphere in the market in order to help in the secondary distribution of Treasury issues, whether the yield was fixed or was determined by an auction. If the Treasury were to shift to a commission system in issuing securities, the situation could be quite different.

Chairman Burns observed in that connection that he was much impressed by the size of the Federal deficit in the five fiscal years 1970 through 1974. Taking into account off-budget outlays and outlays by Government-sponsored enterprises, as well as the outlays reported under the unified budget, the cumulative deficit in that period amounted to \$110 billion, rather than the published total of \$68 billion. While the Federal Reserve always would accommodate the Treasury up to a point, the charge could be made--and was being made--that the System had accommodated the Treasury to an excessive degree. Although he was not a monetarist, he found a basic and inescapable truth in the monetarist position that inflation could not have persisted

over a long period of time without a highly accommodative monetary policy.

Mr. Sheehan asked Mr. Holmes about the profits experience of the Government securities dealers in recent years.

Mr. Holmes replied that more than half of the dealers had lost money in 1973, and during the past month their realized and unrealized losses probably had been in the neighborhood of \$25 to \$30 million. On the other hand, profits had been remarkably good in 1971 and 1972. He did not have information at hand on total industry profits by years, but would supply such information after the meeting for inclusion in the record.^{1/}

Mr. Axilrod said he might add a comment to clarify his own position with respect to even keel in the period ahead. The issue, as he saw it, was not so much a matter of the state of the Government securities market itself; rather, it involved a possible conflict of objectives, along the lines of Mr. Brimmer's observation. In particular, the interaction of a possible tightening of money market conditions and a large Treasury financing could lead to greater upward adjustments of interest rates than the Committee might wish to contemplate in the very short run, before it had been able to evaluate fully the implications of rising rates for residential construction activity.

^{1/} The tabulation Mr. Holmes supplied is appended to this memorandum as Attachment E.

Mr. Wallich remarked that, granting the objective of keeping the distribution system for Government securities intact, there must be ways, other than generous even keeling, of accomplishing that objective. For instance, the Treasury might issue public statements putting market participants on notice that in future there would be less support to the market.

Chairman Burns observed that the Committee was ready for its deliberations concerning monetary policy.

Mr. Eastburn commented that he would support Mr. Axilrod's suggestion to widen the March-April ranges of tolerance for the aggregates. He believed that the longer-run path of 5-3/4 per cent growth in M_1 was a desirable objective of policy, and the important issue, therefore, was the strategy that would return growth to that path. Recent experience suggested that it was important to focus more on the longer-run path than the short-run projections in the event that developments were favorable to a return to path. Accordingly, whatever short-run rate of growth would be consistent with a return to path should be encompassed by the 2-month range of tolerance. With respect to the March-April period, a 6-1/2 per cent rate of growth would return M_1 to the 5-3/4 per cent path by April, and that rate should be encompassed by the short-run range adopted by the Committee. Under

alternative B, therefore, he would drop the lower limit of the M_1 range to 5-1/2 per cent.

Continuing, Mr. Eastburn said he thought the Committee should reconsider its recent decision against publishing the longer-run targets or suggesting them by reference to past rates of growth in the operational paragraph of the directive. Over the last 3 years more than half the directives compared the targets with behavior of the aggregates in a past period. The directive issued in August, for example, called for "slower growth in monetary aggregates over the months immediately ahead than has occurred on average thus far this year." With respect to the drafts of the operational paragraph before the Committee today, alternatives A and C contained a reference to behavior of the aggregates in a past period, but alternative B did not. He favored alternative B, and preferred that the language suggest a more specific reference point in the fashion of alternatives A and C. He proposed the following substitute language for alternative B:

". . .the Committee seeks to achieve bank reserve and money market conditions that will foster growth in the monetary aggregates over the quarters ahead at a somewhat slower rate than achieved over the past year."

Chairman Burns observed that after deliberation at the December meeting the Committee had decided not to publish its longer-run targets. That decision could be reconsidered at any time, and in view of Mr. Eastburn's comments, such reconsideration should be undertaken promptly. However, the issue required careful study and debate, and it could not be dealt with today. Mr. Eastburn might distribute to the Committee the results of his review of directive language over the past 3 years, and the staff would prepare some additional background materials, so that the Committee could reconsider its decision at a Monday afternoon session of the April meeting. Pending such reconsideration, he believed the language of the operational paragraph of the directive should not implicitly disclose the longer-run targets.

Mr. Eastburn remarked that while he favored publication of the longer-run targets, he was not pressing for reconsideration of the issue at this meeting; he agreed that it was an important question that should be discussed carefully. Therefore, he also agreed that, in the event the Committee favored either alternative A or alternative C, the language for the operational paragraph should be altered to remove the reference to growth in the aggregates over recent months.

Mr. Hayes commented that in assessing policy objectives today, he believed that the Committee must again give primary weight to bringing inflation under control. Up to this point, he saw no reason to alter the view that the current decline in activity would prove to be relatively mild and brief and that it reflected in large part the effects of the energy crisis and other shortages of various types. The easing of the oil embargo should prove to be a significant plus within a reasonable period of time. Despite such a development, some further period of weak output and rising unemployment seemed likely. Nevertheless, an effort to prevent that would surely bring about what the Chairman had referred to as "two-digit" inflation. The consequences of that, in turn, could well be substantially increased social strains and, ultimately, a far sharper economic reaction. In other words, he believed the Committee simply had to allow time for some breathing space to open up in the economy or face even more serious problems later on.

In framing objectives at this time, Mr. Hayes said, the Committee should certainly take account of the fact that for reasons that were, as usual, rather mysterious, M_1 growth in the first quarter now appeared likely to seriously overrun the roughly 4-1/2 per cent growth rate anticipated a month ago. Thus the Board staff's current projection was for about a 6-3/4 per cent growth

rate, following on the heels of a 7-1/2 per cent rate in the previous quarter. With that in mind, he thought the 5-1/4 per cent growth in M_1 for the second and third quarters combined projected by the staff under alternative B represented the outside limit of what the Committee should aim for over this period.

Mr. Hayes observed that under those circumstances, and in view of the staff projections, he thought the Committee would have to be prepared to see some further rise in the Federal funds rate during the period ahead from the current level of around 9-1/2 per cent. On balance, he would prefer a range along the lines of alternative B, with the Manager moving promptly to a firm 9-3/4 to 10 per cent, and subsequently probing higher--with due regard to Treasury financing operations--if the aggregates were close to or above the top of their 2-month tolerance ranges. He would both widen and lower the ranges under alternative B, preferring 4 to 8 per cent for M_1 and 5 to 9 per cent for M_2 . He realized that a further rise in the funds rate could, in the current market atmosphere, produce a sharp rise in both short- and long-term interest rates. The Committee should take that risk, recognizing that it could relax its reserve stance once the aggregates were under control. He would also note that the rise in rates in recent weeks had been helpful on the international side. Needless

to say, the Committee had to remain very alert to capital flows in the weeks and months ahead. With regard to the directive, the language of alternative B with its reference to maintaining bank reserve and money market conditions "consistent with moderate growth in monetary aggregates over the months ahead" continued to be satisfactory. Mr. Eastburn's proposed substitute also would have been satisfactory, but he agreed that it raised issues that it would be better to defer.

Mr. Morris remarked that the facts that had become available during the past 4 weeks had led to a modest shift in his position. He was more cautious now than earlier both because the economic statistics were of a more mixed character than he had expected and because the bulge in M_1 growth--which earlier was suspect because of its association with the large decline in Treasury balances--no longer could be explained away. As a consequence, he would not advocate, as he had in recent months, that the Federal funds rate be moved down--at least not until the situation became more clear.

On the other hand, Mr. Morris said, he still believed that the economy was in the early to middle stages of a recession. Although the staff projected an upturn at midyear--and he saw no reason to quarrel with the projections--the indicators offered no

clear evidence of an upturn. Therefore, it was a little too early to move toward a more restrictive policy; he would prefer that such a policy move be delayed until the evidence clearly indicated that economic activity had turned up. Thus there were risks in both alternatives B and C, and although he had modified his position, he favored alternative A. If the projections were correct, that policy course would result in a 6-1/2 per cent rate of growth in M_1 over the second and third quarters combined. While he would not be too happy about such a rate of growth, it would not be alarming for a period of recession. In those circumstances, he favored the suggestion to widen the short-run ranges for the aggregates.

Mr. Mayo observed that economic prospects appeared to be a little better now than a month ago, and he would not want to do anything that would inhibit improvement. Like Mr. Morris, he did not believe that there was evidence pointing to an upturn in activity--although the prospective lifting of the oil embargo was bound to be beneficial--and he would want to proceed cautiously. As he had pointed out at the February meeting, a 6 per cent growth path for M_1 in the first and second quarters combined had merit. In effect, alternative B represented such a path; the indicated

rate of 6.7 per cent in the first quarter, combined with the second-quarter rate of 5.7 per cent projected under alternative B, yielded a rate of 6.2 per cent for the two quarters combined. In general, he favored alternative B--with the wider, three percentage point short-run ranges for the aggregates--and believed it to be consistent with the longer-run objective of a 5-3/4 per cent path. The 5 per cent rate of growth for the third quarter projected under alternative B might be a little too restrictive, but the Committee would have an opportunity to consider that prospect again at its next meeting.

Specifically, Mr. Mayo continued, he would suggest ranges of 6 to 9 per cent for M_1 in the March-April period and the appropriate three percentage point ranges for RPD's and for M_2 . He favored a range of 9 to 10-1/2 per cent for the funds rate. He would not object if the rate moved up a little from its recent level, which was near the mid-point of that range, although he hoped that it would not go over 10 per cent. In line with Mr. Axilrod's suggestion, he would encourage the Desk to watch for opportunities to buy coupon issues so that further increases in long-term rates might be inhibited.

Chairman Burns remarked that total employment was at a peak--that there had been a leveling off rather than a decline.

While a slowdown or recession in economic activity clearly had occurred, it was confined almost entirely to the automobile industry and residential construction. Real consumer spending had declined, but business fixed investment had risen. The reduction in real consumer purchases had been caused by the inflation-induced erosion in real income of the average wage earner--which had declined 4 per cent over the year to January 1974--and by the large increase in consumer debt that had occurred during the upsurge in consumer buying of autos and household goods in late 1972 and the first half of 1973. Although the reaction in consumer buying could go too far and last too long, it probably was healthy. Monetary stimulation at present could lead to further increases in consumer debt that would be undesirable.

Mr. Bucher commented that the current economic situation was aptly characterized by the remark an economic consultant was said to have made to a client: "Be sure to keep in touch as I intend to make frequent forecasts." He agreed that the rates of growth of the monetary aggregates in February and those forecast for March appeared to be disturbingly high, and continuation of relatively high rates of growth could lead over the longer run to intensification of inflationary pressures. The prospect of "double-digit" inflation was frightening, but even with further increases

in prices of petroleum products, the GNP deflator was projected to rise at rates of 6.1 and 6.2 per cent in the third and fourth quarters of this year. However, the question was whether it would be appropriate to move in the near term to correct for the excessively high growth in M_1 relative to the Committee's longer-run target path or to pause, pending a better reading on both the money stock and the effect the lifting of the oil embargo would have on the economy.

To an unknown extent, Mr. Bucher continued, the growth rate of M_1 in the February-March period might be associated with special factors. Private deposit balances were probably enlarged by the unusually sharp decline in U.S. Government deposits, related in part to tax refunds. In addition, some of the growth might be explained by a rebuilding of cash balances following the decline in M_1 in January. Moreover, currency growth was quite large in February; the behavior of currency was difficult to explain and such sizable changes often had been erratic and generally had been transitory. If such special factors had increased demands for cash balances, it could be that their diminution or disappearance would lead to more moderate growth in M_1 in coming months. Under alternative A--as Mr. Axilrod had indicated, and Mr. Holmes had agreed--increases in market rates of interest already in process could well continue. That would help to slow growth in M_1 , even though the

projections did not indicate a return to the target path. In any event, projections of M_1 growth in the present environment seemed particularly subject to uncertainty.

Mr. Bucher observed that since the last FOMC meeting, market interest rates had risen substantially, and as indicated, current rate levels might not fully reflect the recent upward adjustment in the Federal funds rate. Moreover, some upward interest rate pressure might result from the upcoming large Treasury financing. Thus, in his view, it would be desirable to permit those adjustments to occur without additional pressures that would emanate from a funds rate above 9-1/2 per cent. Given the current and prospective weakness in economic activity and the importance of providing an environment for a recovery in the credit-sensitive housing sector--and the large increase in housing starts in January was widely viewed as an aberration--this was an appropriate time to pause and await additional information with regard to the course of the monetary aggregates and the direction of the economy. If developments over the next month suggested the need to tighten, the April Committee meeting would appear to be soon enough. At this time, he could accept alternative A, and like Mr. Morris, he would widen the short-run ranges of tolerance for the aggregates. The language of the operational paragraph, including the reference to growth over the past 6 months, was acceptable to him.

Mr. Black remarked that the Committee was confronted with an unusually difficult problem. Most members no doubt would agree that inflation was the major problem. But the rapid rate of growth in M_1 --which was somewhat unexpected--was occurring at a time when the market for short-term securities was unsettled. It might be, as Mr. Bucher had suggested, that the high rate of monetary growth was an aberration; at a time of large changes in Treasury balances, it might be better to pay more attention to the bank credit proxy, which had been growing moderately. Because of the current sensitivity of the markets--owing to the rapid rise in short-term rates and market expectations that the System would push rates up further--and because of the forthcoming Treasury financing, there were constraints on what the Committee could do. He would be concerned that further increases in rates would abort the budding recovery in the mortgage market. It also needed to be borne in mind that the economy was suffering from built-in inflation--resulting from the fuel problem, from shortages of other materials, and from wage pressures--that monetary policy could not dissipate; it was a problem that, unfortunately, had to be dealt with over a longer period, perhaps a year.

Consequently, Mr. Black said, he would not reduce the longer-run target for M_1 below 5-1/2 per cent. Although generally

favoring a wide range for the funds rate, at this time he would establish a relatively narrow range of 9 to 10 per cent because of the current market situation. And he would adopt the language of alternative B. If growth in the aggregates proved to be lower than the rates projected, the System would have avoided upsetting the market. However, if the aggregates continued to grow rapidly, he would be prepared at the April meeting--or in consultation before that meeting--to move the funds rate up a notch further.

Mr. Balles observed that, compared with some others, he had more confidence in the projections which suggested that the economic outlook had been strengthened by the lifting of the oil embargo. Unfortunately, however, a higher rate of inflation also appeared likely. In view of the changed economic outlook, he believed that Chairman Burns' statements on appropriate monetary and fiscal policy in his recent testimony before the Joint Economic Committee were especially relevant.

Continuing, Mr. Balles remarked that while participating in the daily call during the past month, he had expressed his concern and apprehension about the overshoots in the aggregates in view of the problem of "two-digit" inflation. While recognizing that Desk operations had been constrained by the upper limit of the range of tolerance for the Federal funds rate, he nevertheless

was reminded of the Chairman's observation concerning the overshoot in the first quarter of 1973, to the effect that the System had been providing too many reserves. He was beginning to feel at this time that growth in reserves was excessive. Consequently, he leaned more toward alternative C than alternative B in order to return monetary growth to the 5-3/4 per cent path--which the Committee had agreed upon at its last two meetings--by June rather than September. Measured on a quarterly average basis, which he believed was the best method, M_1 was indicated to grow over the first half of 1974 at an annual rate of 6.2 per cent under alternative C, compared with 6.5 per cent under alternative B and 6.9 per cent under alternative A. In his view, growth at the 6.2 per cent rate would be quite adequate if an effort was to be made to reduce inflationary pressures and growing inflationary expectations. For the language of the operational paragraph, however, he favored alternative B.

Chairman Burns remarked that it might be helpful if the Committee's Senior Economist gave his policy recommendations at this point.

Mr. Partee said he would like to make a few points about the thrust of Committee policy. First, he believed that the objective of holding down on the rate of monetary growth should be

continued in order to dampen inflationary pressures. Second, the pursuit of such a policy objective at this time, as always, involved the danger of precipitating a cumulative decline in economic activity that subsequently would require remedial fiscal and monetary policies of an inflationary character. Third, the termination of the oil embargo had reduced the risk of a cumulative decline in activity; while the specific quantitative impact of the embargo's end might be debatable, the direction of its impact was not. And as Chairman Burns had noted, up to this point there was very little evidence that a cumulative decline had in fact been developing. Finally, therefore, the Committee was now in a better position to run the risk of higher interest rates in pursuit of a moderate rate of monetary growth, even though higher interest rates might dampen the projected recovery in residential construction; the recovery in housing no longer appeared to be as crucial an element as before in the projected expansion in economic activity in the second half of the year. While such a policy course clearly would not maximize real output and employment, it represented a reasonable compromise between the objectives for output and prices. In that light, he could support alternative B.

Mr. MacLaury commented that he had found helpful the device used in the blue book of differentiating the alternatives for policy

in terms of the time period required to return M_1 to its longer-run growth path. On the other hand, he would urge that throughout the blue book quarterly averages be used in measuring rates of growth in the aggregates. Like Mr. Balles, he found the quarterly averages a more satisfactory method of measurement.

With respect to the economic outlook, Mr. MacLaury said, he was in agreement with those who interpreted the developments of the past month as lessening the risks of a cumulative downturn and improving prospects for an upturn later in the year. Accordingly, like Mr. Morris, he had modified his policy position somewhat. The most important decision the Committee made, in his view, was its choice of a longer-run path for monetary growth, and he would now be content with the growth path of 5-3/4 per cent rather than the 6 per cent path that he had advocated at the last meeting. Having some skepticism about the recent data and the indicated strength in the aggregates, however, he did not see a need to pursue a return to the 5-3/4 per cent path by June, as called for under alternative C, especially because of the staff's judgment that such a course would lead to a shortfall from path later on. He would be happy with alternative B, modified to reduce the lower limits of the short-run ranges of tolerance for the aggregates. Because of his skepticism about the recent strength

in the aggregates, he would set an upper limit of 10 per cent for the funds rate, specifying a range of 8-3/4 to 10 per cent. While some might view alternative B as a restrictive policy because of its implications for money market conditions and interest rates, he would not consider it as such because it represented an effort to return monetary growth to the longer-run path at a time when growth had been well above path.

Finally, Mr. MacLaury observed, he had not interpreted the language that Mr. Eastburn had proposed for the operational paragraph of the directive as precedent-setting; he considered it a matter of preference whether, as often in the past, the Committee's longer-run targets were referred to in relation to rates of growth in some past period. However, he agreed that it would be desirable to consider the whole subject at another time.

Mr. Mitchell remarked that from time to time in the past the Committee had debated the question of how specific the language of the directive should be, and more recently the adoption of longer-run targets for the aggregates had raised the additional issue of whether to disclose those targets in the policy record. His own view was that the Committee ought to be more specific in describing what it was doing, but he agreed that the issue should be debated and resolved at another time.

Mr. Clay observed that most interest rates had reversed their downward slide and had advanced strongly since the last Committee meeting. Those advancing rates could not be attributed to a tightening in monetary policy, with virtually all the aggregates either piercing or being near the upper ranges of tolerance specified by the Committee. Neither could those advancing rates be attributed to increased demand for loans because of expected sharp increases in economic activity. The most logical explanation was that they were inflation oriented. Since both monetary and fiscal policy had been highly expansive, the recent weaknesses in the economy and increasing interest rates must be attributed to something other than failure to follow expansive monetary and fiscal policies.

Mr. Clay remarked that failure to recognize the impact of expansive policies probably was largely responsible for much confusion in economic analysis. The blue book forecasted rather sharply increasing short-term rates unless monetary policy followed a substantially easier stance than had been prescribed by the Committee for some time. In his view, however, there was a strong probability that an easier monetary policy now might increase rather than alleviate the problems associated with increasing short-term interest rates. Increases in interest

rates were provoked by inflation as well as, in the short run, by a tightening of policy; the economy had reached the point where increases in interest rates were likely to occur with almost any monetary policy.

Recent growth of M_1 and M_2 , Mr. Clay continued, would provide plenty of liquidity to fuel a recovery later this year if the rate of inflation could be retarded. Indeed, given the rapid rate of monetary growth already experienced in the first quarter, aggregate growth rates indexed by M_1 growth of less than 5 per cent over the second and third quarters now seemed to be necessary to insure a recovery without accelerating inflationary problems. As he had indicated, achieving lower monetary growth rates probably would mean increasing short-term rates. In the next few weeks, the funds rate likely would rise above the 9-1/2 per cent area. Given current market sensitivity to System actions, that increase was likely to cause further rises in other rates. In a period in which inflation rates would indicate negative real costs for short-term borrowing, increases in interest rates to bring inflation under control likely would not discourage recovery in the latter part of the year.

Therefore, Mr. Clay said, his preference would be to use the language of alternative C and the long-term targets somewhat

above those of alternative C, as indexed by an M_1 growth rate of 4-3/4 per cent. In his judgment, such a specification would be compatible with the Federal funds and associated short-term ranges of alternative B.

Mr. Kimbrel remarked that inflation continued to be the primary concern, and the rate of increase in prices in the United States relative to that in other countries raised questions about the creditability of Federal Reserve policies to deal with it. In the Atlanta District, as in the country as a whole, economic weakness was localized. Nonfarm employment had declined only in Florida of the six states in the District, and there the reductions had been localized. Florida bankers had reported that they understood their own problem and ultimately would be able to deal with it. However, they were much more concerned about inflation than about the energy crisis or their immediate difficulties. Unemployment seemed to be confined mainly to the automobile industry, and reports suggested that the unemployed were drawing from 90 to 95 per cent of their normal pay; consequently, they were not experiencing substantial income losses at the moment.

Mr. Kimbrel observed that, because of the need to deal with inflation, he would hope that the rate of monetary growth could be returned to the longer-run path by June while avoiding

unreasonable disruption. Accordingly, he favored the specifications of alternative C, although he preferred the language of alternative B. He would be inclined to take into consideration near-term developments in the money market, shading a little on the downside, but somewhat higher levels of the funds rate would be required; a price had to be paid sooner or later. He hoped that flows to thrift institutions would not be unnecessarily disrupted, but in any case flows had improved and the institutions were beginning to seek outlets for funds. And while having an orderly Treasury financing was an important objective, it could not be the main determinant of policy.

Mr. Wallich remarked that he was impressed with the emphasis placed on monetary aggregates in the discussion. He was concerned that the interest rate which figured most prominently in the discussion--the funds rate--was not really the one most relevant for development of the economy; long-term bond and mortgage rates were the relevant rates. The funds rate, he recognized, was an operating target because short-term rates were the only ones the Committee could control, but he wanted to consider what open market policy would do to long-term as well as to short-term rates.

Mr. Wallich observed that what the Committee did at this point would have its principal impact 6 to 9 months from now; in the shorter run, only such financial variables as interest rates and capital flows would be affected. Looking ahead 6 to 9 months, he was inclined to believe that the cyclical turning point would have been left well behind by then. The economy clearly was a lot stronger than it had seemed a month or two ago, and it would gain further strength if, indeed, the embargo had ended. From a cyclical standpoint, therefore, the economy was moving into a new expansion. It was doing so under conditions of inflation at a rate of from 5 to 10 per cent; a rate of unemployment only about one percentage point above what passed for full employment nowadays; real shortages of industrial capacity and materials; a large budget deficit; and interest rates close to 10 per cent. If policies adopted now brought about an acceleration of the expansion, they would lead to a rapid resumption of capacity pressures, a faster rate of increase in prices, and still higher interest rates. In the next boom, then, prices might be rising in a range of 10 to 15 per cent. That had been the experience in some European countries.

At this point, Mr. Wallich remarked, it would be a mistake to accelerate the recovery; the objective should be to pursue a path of monetary growth such that economic activity continued to

expand, but at a rate not necessarily much faster than its potential and perhaps even below. Although that might lead to political problems, real GNP would be rising and the economy would not be going into recession. At the same time, excess capacity would be increasing somewhat, providing some possibility of a gradual reduction in the rate of inflation. He would reject as both substantively and politically unsound a policy of so tight a rein that economic activity failed to recover at all and excess capacity built up rapidly.

In terms of immediate action, Mr. Wallich said, he did not believe sufficiently in the importance of M_1 or any of the aggregates to argue for returning to a particular path very rapidly if that would bring about a jump in interest rates. Over time, a return to path was desirable, and he would not quarrel with an M_1 growth rate of 5 to 6 per cent. After allowance for the upward trend in the income velocity of money and the effects of very high interest rates, such a rate of growth in M_1 would support growth in nominal GNP at a rate on the order of 7 to 9 per cent. Thus he was among those who favored alternative C, but with a proviso that he would not be eager to return M_1 to its growth path by June.

Mr. Holland observed that the outlook for real GNP was stronger now than a month ago for a number of reasons, some of which had traditional cyclical significance and others of which did not. He was, however, skeptical of the estimate of the size of the fillip to GNP growth provided by termination of the oil embargo. In large part because of the oil situation, the outlook also was for a faster rise in prices. Although skeptical of the validity and persistence of the recent acceleration in growth in the monetary aggregates, he believed that the present stage in the formulation of economic policy was serious enough that it would be prudent to move in the direction of resisting the developments that those admittedly imperfect indicators were suggesting. Thus, he wanted monetary policy to be supplying somewhat more resistance to inflationary developments than he favored a month ago. In talking about increased resistance to inflationary pressures, however, it was necessary to recognize that there was an adjustment process involved. The process of resisting a strengthening in GNP-related and other demands for money involved allowing some bulge in monetary growth to develop and then squeezing it out. That sort of development was the most reasonable prospect and was the one the Committee should be trying to attune its policy prescription and specifications to.

While attracted to alternative B, Mr. Holland said, he believed that the longer-run targets should be adjusted. If there were inadequate analytical support for adjusting them, he would prefer to drop them altogether; adoption of the targets specified under alternative B represented, to him, a hope more than an analytical decision. He would suggest raising the targets for M_1 and the credit proxy to 6 per cent. It was consistent not to raise the target for M_2 because interest rates would rise sufficiently to slow down inflows of time and savings deposits to banks and nonbank thrift institutions. Such a policy would not add to inflationary pressures; rather, it would be a realistic approach to a process of working down the growth rates in the aggregates and of working down the inflationary steam in interest rates and credit conditions over a longer period of time than the next 6 months. Such a policy would be likely to involve some rise in interest rates, which he was prepared to accept. However, the Committee should be careful to avoid acting so abruptly as to produce a sharp jump in rates, which would be counter-productive. In the current environment, the possibility of such a jump could not be excluded.

Mr. Holland said he would widen the short-run ranges of tolerance for the aggregates by one-half of a percentage point in both directions. For the funds rate, a range of 9 to 10-1/2 per cent

was reasonable, given the interval of modest but nevertheless real even keel in the period ahead. For reasons that were stated in Part I of the Manager's annual report for 1973, it was important to instruct the Manager to move the funds rate promptly rather than to wait until the aggregates approached the upper limits of their ranges. He wanted the System to be niggardly in supplying reserves in the near term so that the funds rate would move up to around 9-3/4 per cent before the Treasury financing; even keel would then unfold against that greater degree of reserve restraint and pressure on the price of reserves.

Mr. Holland added that the Manager would need to remain in close touch with the Chairman as money market conditions tightened so that a pause could be called for in the event of undue market reactions. On the other hand, should growth in the aggregates be revised downward--and the chances of that happening were not insignificant--he would like the Manager to so inform the Chairman before undertaking any easing actions. In such an event, as he had said before, he would like the Board to have an opportunity to consider a realignment of reserve requirements as an alternative. Finally, he endorsed the suggestion that the Manager might constructively buy coupon issues as part of his reserve-supplying operations in the period ahead, with due regard for even keel.

Chairman Burns remarked that governments were weak in all of the democratic countries of Europe--indeed, in virtually all countries of the world except for a few of the totalitarian regimes. Because weak governments could not cope with the problem of inflation, the task had become the inevitable responsibility of central banks. Although their ability to deal with inflation was limited, central banks were discharging that responsibility at present. How long they could continue to do so was uncertain, since apart from the Federal Reserve--and, to a degree, the German Federal Bank--central banks were no longer independent.

Because the System had substantial independence, the Chairman observed, it could resist political pressures to pursue inflationary policies, and it should do so. Moreover, at the present time neither the Administration nor the Congress was urging the Federal Reserve to pursue a more expansionary course. One of the distinguished liberal members of the Congress recently had commented to him that the System was not exercising with sufficient determination the independent power that the Congress had deliberately granted to it.

There was no question in his mind, the Chairman continued, that inflation was the major economic problem facing the nation, as well as the world. However, he would not favor adopting the

specifications of alternative C today; the Committee should avoid abrupt shifts in its policy stance, and in his opinion a rise in the Federal funds rate of the magnitude likely under that alternative would be unduly sharp in the short run. Although his views were subject to change as the Committee's deliberations proceeded, at the moment he was inclined toward the B specifications, perhaps with some reduction in the 10-3/4 per cent upper limit shown for the funds rate. He also favored the suggestion to reduce the lower limits of the 2-month ranges for growth rates in the aggregates.

Mr. Francis remarked that the developments with regard to the monetary aggregates over the past couple of months were disconcerting, but not altogether surprising. Several points appeared noteworthy. Even though the Committee had not adopted the alternative A specifications in January, the level of M_1 now indicated for March was \$300 million greater than called for by those specifications and the Federal funds rate had moved to the upper end of the range shown under A in the January blue book. The directive had called for slower growth in aggregates than actually occurred.

In the February blue book, Mr. Francis continued, levels of the aggregates specified under all alternatives for both March and June were reduced considerably, and the ranges of the funds rate

constraint were lowered significantly. In the past month growth of M_1 had been greater than called for under the February alternative A, even though the Federal funds rate exceeded the A range. But last month the Committee again had issued a directive, based on blue book specifications, calling for much slower growth of M_1 than indicated under alternative A. At that time, it was his belief that there would be more upward pressure on rates and greater growth in the aggregates.

Mr. Francis noted that the growth of M_1 specified under alternative C in the current blue book was at the upper end of what he would like. Given past operating strategy, he was again concerned that even if the Committee were to adopt a directive calling for growth of aggregates on the order of the B or C alternatives, the actual outcome again might be something more like A. If so, then the growth of M_1 through the first two, and possibly three, quarters of this year would be at a 7 per cent rate--the same as the average of the past 3 years. He continued to believe that the dangers for error were on the side of greater monetary growth than desired. To minimize that risk, he would suggest raising the upper end of the Federal funds rate range sufficiently to give the Desk latitude to slow the growth of reserves and the monetary base.

Mr. Francis urged that the Committee adopt the C alternative for M_1 through June, but not accept the suggestion that a sharp drop in M_1 growth in the third quarter would be inevitable. He might add that, when he observed that over the last year the monetary base had continued to grow at the previous year's rate of 7.7 per cent, and when he noted the deviation of growth in money from growth in the base, he felt considerable concern, based on historical experience, that there still might be pressure for the money growth rate to move back to that of the base.

Mr. Coldwell commented that he had not advocated easing actions at recent meetings because he considered inflation to be the nation's main economic problem. He still held that view. The lifting of the oil embargo added another element to the picture, if only in that it would tend to raise some expectations and to improve consumer psychology. He thought the end of the embargo would help clarify the underlying situation, but the situation would not become really clear until wage and price controls were removed. He suspected that problems arising in the international area were likely to be especially important in the next few months; in particular, he was worried that the dollar might come under additional downward pressure as a consequence of the embargo's end.

Mr. Coldwell went on to say he shared the view that the Committee tended to focus too closely on the growth rate in M_1 . It would be well, in his judgment, to pay more attention to interest rate relationships over the longer run; he was especially concerned about the prospect of entering a new period of expansion with the Federal funds rate in the neighborhood of 10 per cent and other key interest rates in an 8 to 10 per cent range.

With respect to the directive, Mr. Coldwell continued, he would favor making one revision in the staff's draft of the paragraph describing the Committee's general policy stance. In the list of objectives shown in the draft, one was given as "cushioning weakness in economic activity." He would prefer to describe the objective in terms of "supporting a resumption of real economic growth."

Chairman Burns remarked that that proposal was acceptable to him. He asked whether there were any objections to it, and none was heard.

As to the operational paragraph, Mr. Coldwell continued, he was disturbed by the variety of historical time periods that had been suggested at various points as a basis for describing the monetary growth rates desired by the Committee. For example, in the language suggested for alternatives A and C in the blue book, the desired

growth rates were expressed relative to the rates that had occurred over the past 3 months. In the draft directives distributed subsequently, the past 6 months was used as the time reference; and in his proposal today, Mr. Eastburn had suggested using the past year. If the Committee were going to use such constructions, he thought it should be consistent with respect to the length of the period cited; he would favor 6 months. His own preference for the operational paragraph was as follows: ". . .the Committee seeks to achieve bank reserve and money market conditions consistent with about the same rate of growth in monetary aggregates as over the past 6 months."

Mr. Coldwell said he agreed that the short-run ranges for the monetary aggregates should be widened to 3 percentage points. He would favor ranges of 5 to 8 per cent for M_1 and 6 to 9 per cent for M_2 for the March-April period. With respect to the funds rate, he would set the range at 9-1/4 to 10-3/4 per cent. He hoped that the Desk would act promptly to achieve a rate around 9-3/4 per cent, and would then await new information on the aggregates before seeking further changes.

Mr. Brimmer referred to the Chairman's comment that total employment had leveled off but not declined, and remarked that that should not be surprising; total employment tended to decline in a substantial recession, but in a mild recession unemployment increases

usually were a consequence of faster growth in the labor force than in employment. This year, with the civilian labor force growing to about 91 million persons, an unemployment rate of 5-1/2 per cent would mean over 5 million people out of work--nearly a million more than in 1973. That fact should be of concern to the Committee. He also did not share Mr. Wallich's view that the unemployment rate equivalent to full employment was only 1 percentage point below the present rate.

However, Mr. Brimmer continued, he thought a policy course similar to that the Chairman had suggested would be appropriate. The unemployment rate was higher than might have been expected, and certainly higher than he would have desired; he did not think it should be tolerated for an extended period. For the time being, however, it might have to be accepted if the desired results with respect to inflation were to be achieved. He believed the Committee should neither tighten nor ease at this point, and that any errors made should be in the direction of accepting somewhat higher interest rates. Although he was not persuaded that a turnaround in the economy was assured, he concurred in Mr. Partee's analysis and conclusions; in particular, he agreed that the risks of a cumulative downturn were now reduced. The course he favored was consistent with the alternative B specifications, with the 2-month ranges for the aggregates widened from those shown in the blue book.

Mr. Brimmer said he agreed that any firming actions that might be required should be taken before the Treasury financing; he certainly would not want to firm in the midst of the financing. He would, however, repeat his earlier observation that even keel considerations should not prevent the Board from taking other policy actions it might decide were appropriate, such as an adjustment with respect to reserve requirements. He would favor purchases of coupon issues, although he would attach less importance to that type of operation than some others might.

Chairman Burns observed that, details of language aside, he could accept virtually every statement Mr. Brimmer had made.

Mr. Sheehan remarked that the information that had become available since the Committee's previous meeting lent more support to the position on policy the Chairman had taken in recent months than to the position he (Mr. Sheehan) had taken. He was not persuaded, however, that all signs of weakness in the economy would evaporate now that the oil embargo had been lifted. He believed that the economic outlook would be clearer in a month or two; at this point, he would agree with Mr. Brimmer that policy should be neither tightened nor eased.

Mr. Winn said he felt uneasy about a number of possible developments, including international flows and possible shifts

of funds from nonbank thrift institutions to banks, and he considered it important that the Desk have adequate flexibility to deal with the kinds of flows it might be faced with in the coming month. Because of his concern about inflation, and particularly in light of the wage-cost pressures that lay ahead, he would favor maintaining a posture of restraint. While he could accept an outcome anywhere within the range covered by the blue book alternatives, he would lean toward C.

Mr. Mitchell observed that some of the preceding speakers evidently were much more confident about where the economy was headed than he was. His intuition suggested that the outlook was more bearish than the data suggested or others seemed to believe. Interest rates recently had fallen further than the Committee had expected or desired as a result of market misinterpretations of the stance of policy, and now, he thought, they were likely to increase further than they should. If the Desk acted to raise the Federal funds rate to 9-3/4 per cent within the next few days, the market would interpret that development as a signal of the Committee's response to high growth rates in the aggregates, and expectations of further upward pressure on interest rates would spread. He doubted that any useful policy purpose would be served by the fears of disintermediation that would result. An increase in the

funds rate would be particularly unfortunate if it coincided with the prospective Treasury financing.

Mr. Brimmer remarked that he also would not advocate an immediate increase in the funds rate.

In response to a question by the Chairman, Mr. Holmes said the Treasury was likely to announce the financing some time this week. However, from the point of view of even keel considerations, the significant date was not that of the announcement but of the auction; that was likely to be within a period of 6 to 9 days.

Chairman Burns observed that there evidently would be adequate time for the Desk to achieve a higher funds rate before the financing if the Committee so desired. He believed, however, that such a move should not be made immediately. In general, he would consider it a mistake for the Desk to give the market signals about the Committee's policy decision the day after a meeting. At present, moreover, it should be recognized that the funds rate had risen substantially in just the last few days. If a further increase were to be sought, he would favor waiting until new data on the aggregates were available later in the week before acting. But the move could not be delayed too long if it was to be accomplished before the auction date for the financing.

Mr. Holmes said it appeared likely at the moment that there would be a need to supply reserves in the near term. If so, an increase in the funds rate could be achieved by supplying fewer reserves than otherwise. That process tended to produce less of a reaction in the market than the process of actually withdrawing reserves.

In a concluding observation, Mr. Mitchell said he would be inclined to dissent from the consensus that appeared to have emerged from the Committee's discussion if he felt more strongly than he in fact did. He did not expect to dissent so long as the final decision was about what he now expected it to be.

Chairman Burns then remarked that he would offer a few brief comments on the economic outlook before turning to the directive and specifications. First, it was evident that the economy was going to be sluggish this year. Secondly, a significant amount of unemployment was unavoidable at a time when the economy was undergoing structural shifts. Third, while he saw no evidence of a cumulative decline in activity and doubted that one would occur, he was aware from close study of past experience that once a slowdown was under way it could turn out to be much larger than anyone might anticipate on the basis of current information.

The Chairman then asked the members to express their preference between alternative B, as drafted by the staff, and the following language: "To implement this policy, while taking account of international and domestic financial market developments, including the prospective Treasury financing, the Committee seeks to achieve bank reserve and money market conditions that would moderate growth in monetary aggregates over the months ahead."

Mr. Mitchell asked whether the proposed new language would not be subject to the same objection as that suggested earlier by Mr. Eastburn.

Chairman Burns said he thought it would not, because no reference period was specified.

A majority of members expressed a preference for the language read by the Chairman.

Chairman Burns then referred to Mr. Mitchell's earlier comment about the degree of confidence with which some views on the outlook had been expressed. The manner in which people spoke in meetings such as this was influenced by the need for brevity. He was sure that, however they may have formulated their statements, all participants in today's meeting approached the problem of economic forecasting in a spirit of true humility. He also believed that the differences of view today were narrower than particular

terms used in the discussion might suggest. No one had proposed that the economy should be put through the wringer; no one had suggested that monetary growth should come to an end; and no one had indicated that the Committee could ignore interest rates entirely.

The Chairman then said he would offer certain suggestions for the specifications and ask whether they met with the general approval of the members even though they might not agree precisely with the preferences originally expressed. His suggestions, briefly, were to adopt the longer-run targets shown under alternative B; the short-run ranges of tolerance for the aggregates shown under B, except that the lower limit of each range would be reduced by one percentage point; and a range of 9 to 10-1/2 per cent for the Federal funds rate.

Mr. Holland observed that, for reasons he had indicated earlier, he would have preferred modifications in the longer-run targets shown in the blue book to allow for the latest revisions of the GNP projections. However, he could accept the Chairman's proposal.

Mr. Black asked whether the proposal would contemplate having the Desk seek a higher funds rate late this week, along the lines the Chairman had suggested earlier.

Mr. Holland said he would like in that connection to ask a question of the Manager. If the data becoming available on Wednesday and Thursday indicated that the aggregates were at least as strong as now projected, suggesting the desirability of raising the funds rate to about 9-3/4 per cent, would there be sufficient time before the auction date to do so?

In reply, Mr. Holmes noted that the auction date had not yet been established. If, as he thought likely, the auction would be in 6 to 9 days, there should be adequate time for the purpose.

A discussion ensued of the various considerations likely to affect the timing of the auction and the degree of flexibility the Treasury might have with respect to the specific date.

Mr. Hayes said he would be inclined to begin moving toward a higher funds rate immediately. The advantages of acting well ahead of the auction date seemed to him to outweigh any risks of giving market participants clues to the Committee's policy decision.

Chairman Burns asked whether there would be any objections to delaying any change in the objective for the funds rate until late in the week unless conversations with the Treasury about the timing of the auction indicated that an earlier move would be desirable.

No objections were raised.

The Chairman then proposed that the Committee vote on a directive consisting of the staff's draft of the general paragraphs, with the amendment Mr. Coldwell had suggested earlier in the statement of general policy, and the language for the operational paragraph he (the Chairman) had read. It would be understood that the directive would be interpreted in accordance with the following specifications. The longer-run targets--namely, annual rates of growth for the second and third quarters combined--would be 5-1/4, 7-3/4, and 5-1/2 per cent for M_1 , M_2 , and the bank credit proxy, respectively. The associated ranges of tolerance for growth rates in the March-April period would be 4 to 7 per cent for RPD's, 5-1/2 to 8-1/2 per cent for M_1 , and 6-3/4 to 9-3/4 per cent for M_2 . The range for the weekly average Federal funds rate in the inter-meeting period would be 9 to 10-1/2 per cent.

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 domestic policy directive:

The information reviewed at this meeting suggests that real output of goods and services is declining in the current quarter, in large part because of the oil situation, and that prices are continuing to rise rapidly. In February industrial production and manufacturing employment declined again, while total nonfarm payroll employment recovered, and the unemployment rate was unchanged at

5.2 per cent. Prices of farm and food products and industrial commodities increased sharply, although less so than in the preceding 2 months. Increases in wage rates appear to have moderated in recent months.

After depreciating during the first 3 weeks of February, the dollar has since shown little net change against leading foreign currencies. The U.S. trade surplus remained large in January, despite a further sharp rise in the cost of petroleum imports.

The narrowly defined money stock, after having declined in January, increased sharply in February and early March. Broader measures of the money stock rose substantially in February, as net inflows of consumer-type time deposits remained relatively strong. Business short-term borrowing at banks and in the open market has continued at a rapid pace. Following earlier declines, both short- and long-term market interest rates have risen appreciably in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resisting inflationary pressures, supporting a resumption of real economic growth, and maintaining equilibrium in the country's balance of payments.

To implement this policy, while taking account of international and domestic financial market developments, including the prospective Treasury financing, the Committee seeks to achieve bank reserve and money market conditions that would 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 F.

3/19/74

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It was agreed that the next meeting of the Committee would be held on Monday and Tuesday, April 15 and 16, 1974, beginning on Monday afternoon.

Thereupon the meeting adjourned.

Arthur L. Zaida
Secretary

RESOLUTION OF FEDERAL OPEN MARKET COMMITTEE AUTHORIZING
CERTAIN ACTIONS BY FEDERAL RESERVE BANKS DURING AN EMERGENCY

(As last revised September 21, 1971)

The Federal Open Market Committee hereby authorizes each Federal Reserve Bank to take any or all of the actions set forth below during war or defense emergency when such Federal Reserve Bank finds itself unable after reasonable efforts to be in communication with the Federal Open Market Committee (or with the Interim Committee acting in lieu of the Federal Open Market Committee) or when the Federal Open Market Committee (or such Interim Committee) is unable to function.

(1) Whenever it deems it necessary in the light of economic conditions and the general credit situation then prevailing (after taking into account the possibility of providing necessary credit through advances secured by direct obligations of the United States under the last paragraph of section 13 of the Federal Reserve Act), such Federal Reserve Bank may purchase and sell obligations of the United States for its own account, either outright or under repurchase agreement, from and to banks, dealers or other holders of such obligations.

(2) Such Federal Reserve Bank may in its discretion purchase special certificates of indebtedness directly from the United States in such amounts as may be needed to cover overdrafts in the general account of the Treasurer of the United States on the books of such Bank or for the temporary accommodation of the Treasury, but such Bank shall take all steps practicable at the time to insure as far as possible that the amount of obligations acquired directly from the United States and held by it, together with the amount of such obligations so acquired and held by all other Federal Reserve Banks, does not exceed \$5 billion at any one time.

(3) Such Federal Reserve Bank may engage in operations of the types specified in the Committee's authorization for System foreign currency operations when requested to do so by an authorized official of the U.S. Treasury Department; provided, however, that such Bank shall take all steps practicable at the time to insure as far as possible that, in light of the information available on other System foreign currency operations, its own operations do not result in the aggregate in breaching any of the several dollar limits specified in the authorization.

Authority to take the actions set forth shall be effective only until such time as the Federal Reserve Bank is able again to establish communications with the Federal Open Market Committee (or the Interim Committee), and such Committee is then functioning.

ATTACHMENT B

Henry C. Wallich
March 18, 1974

Notes on BIS Meeting of March 11-12, 1974

The discussion at the BIS meeting in Basle on March 11 and 12, 1974 focussed on the problems of the Euro-currency market, in addition to the usual discussion of country conditions.

The magnitude of the capital flows back from the OPEC countries continues to be estimated in the \$25-50 billion range at an annual rate. It was pointed out by Christopher Dow and others that this is the order of magnitude by which the Euro-currency market has been increasing annually so far and that nothing altogether unusual or unmanageable seemed to be ahead.

Despite the general expectation of a massive inflow into the Euro-currency market, very little OPEC money seems actually to have been seen. A possible explanation given by McDonald is that the oil companies pay the OPEC countries with a three-month delay, and that an additional two months or so is absorbed in computing the amounts due; the big flows therefore might not begin until some time during the summer.

It seemed generally to be assumed that the OPEC countries would aim to invest their money with high liquidity and as high a rate of return as possible. Longer term commitments, concessionary terms, equity or direct investment, and especially investment in the United States seemed to be regarded as having low probability.

The question whether the borrowing needs of oil importing countries would create excess demand in the Euro-currency markets or whether the investments by the OPEC countries would on the contrary generate an excess supply of funds was not treated in details on these terms. Instead, the discussion turned on term structure effects. Emminger especially argued that the demand of the borrowers was of a medium-term nature and would be satisfied by roll-over credits. The supply from the OPEC countries would be short-term funds. This was likely to lead to a drop in short-term rates and a rise in longer term rates. That would be a desirable development, he argued, because it would tend to drive borrowers to sources other than the Euro-currency market while also inducing lenders to seek other outlets.

Some concern was expressed about the tendency of the OPEC countries to concentrate their deposits in a few well known banks. This condition was already leading to congestion, with the maximum capital on deposit ratios in London (1:18) being approached in some cases. The BIS, which is seeking to play a role in directing Arab funds, believes that it can do a better job than the Arabs in spreading the money more widely among depositary banks.

The possible need for lenders of last resort was discussed. In case of a need to come to the aid of a Euro-currency bank in difficulties, which central bank would have the responsibility? The central bank in whose market the difficulties occurred? The

central bank in whose currency the liabilities in question were denominated? If the bank in question were the branch of a foreign bank, this presumably would throw the responsibility upon the head office of the branch in the first place and upon the central bank of the country of the head office in the last resort.

The need for more detailed statistical information was stressed and the type of information that could feasibly be collected was turned over for examination to the technical level. The Euro-currency markets will be on the agenda once more for the April 8 meeting.

The discussion of country conditions showed a more optimistic picture than the gloomy one that had prevailed a month previously. Only a few countries may need to borrow in 1974 to cover their oil deficit. Some of these, such as France, have already completed much of their borrowing. Italy and secondarily the U.K. present the main problem cases.

Italy has tried to diversify its borrowing away from the Eurodollar market, where it may be approaching its credit ceiling. The IMF, and swap lines with the Federal Reserve and with Common Market countries, were referred to by Governor Carli as additional sources. The standby agreement with the IMF specified elimination of the non-oil current account deficit in 1975, and limited the amount of credit expansion. This in turn goes some way toward limiting the budget deficits.

For the United Kingdom, Gordon Richardson conveyed a picture of severe inflationary pressures emanating in part from the 36 per cent settlement of the mineworkers. He thought, however, that the deflationary effects of the oil deficit would provide all the anti-inflationary monetary and fiscal action that seemed appropriate at this time.

With respect to Germany, as well as in general, Otmar Emminger questioned the contractive effect of the oil deficit. The resulting flow of funds into the Eurodollar market, the prospective decline of short-term rates in that market as a result, together with higher wage demands resulting in part from higher living costs based on higher oil prices, all would combine to make the net effect of the oil situation expansionary. He foresaw no balance-of-payments problems for Germany, at most a small current account deficit, but massive cost-push pressure from a public service wage increase of about 13 per cent in the face of a previously expected 10 per cent.

Before 1975 and after, the picture becomes more clouded. It is unlikely that continued borrowing in the Euro-market by the countries now heavily in deficit will be possible. For some 30 developing countries that are not oil producers moreover the situation is very serious as of now.

ATTACHMENT CEffects of a Lifting of the Oil Embargo
on Key Economic Variables

	1974		
	<u>Q II</u>	<u>Q III</u>	<u>Q IV</u>
Domestic-type auto sales (Annual rate, millions of units)			
1. Green book projection	7-1/4	7-1/2	8-1/4
2. Alternative	7-3/4	8	8-3/4
Difference	+1/2	+1/2	+1/2
Housing starts (Annual rates, thousands of units)			
1. Green book projection	1,500	1,650	1,750
2. Alternative	1,575	1,750	1,850
Difference	+ 75	+100	+100
Business Fixed Investment (Billions of 1958\$)			
1. Green book projection	95.6	96.5	97.2
2. Alternative	95.6	97.5	98.2
Difference	--	+1.0	+1.0
Personal saving rate (Per cent of disposable income)			
1. Green book projection	7.0	6.9	6.6
2. Alternative	6.2	5.9	5.4
Difference	-0.8	-1.0	-1.2
Growth in real GNP (Per cent annual rate)			
1. Green book projection	-1.5	1.9	3.5
2. Alternative	-0.9	3.7	3.7
Difference	+0.6	+1.8	+0.2

	<u>1974</u>		
	<u>Q II</u>	<u>Q III</u>	<u>Q IV</u>
Increase in fixed-weight (Deflator for private GNP)			
1. Green book projection	7.3	5.8	5.7
2. Alternative	7.5	6.1	6.2
Difference	+0.2	+0.3	+0.5
Unemployment rate (per cent)			
1. Green book projection	5.8	6.0	6.2
2. Alternative	5.7	5.7	5.8
Difference	-0.1	-0.3	-0.4

Drafts of Domestic Policy Directive for Consideration by the
Federal Open Market Committee at its Meeting on March 18-19, 1974

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that real output of goods and services is declining in the current quarter, in large part because of the oil situation, and that prices are continuing to rise rapidly. In February industrial production and manufacturing employment declined again, while total nonfarm payroll employment recovered, and the unemployment rate was unchanged at 5.2 per cent. Prices of farm and food products and industrial commodities increased sharply, although less so than in the preceding 2 months. Increases in wage rates appear to have moderated in recent months.

After depreciating during the first 3 weeks of February, the dollar has since shown little net change against leading foreign currencies. The U.S. trade surplus remained large in January, despite a further sharp rise in the cost of petroleum imports.

The narrowly defined money stock, after having declined in January, increased sharply in February and early March. Broader measures of the money stock rose substantially in February, as net inflows of consumer-type time deposits remained relatively strong. Business short-term borrowing at banks and in the open market has continued at a rapid pace. Following earlier declines, both short- and long-term market interest rates have risen appreciably in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resisting inflationary pressures, cushioning weakness in economic activity, and maintaining equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPH

Alternative A

To implement this policy, while taking account of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with moderately greater growth in monetary aggregates over the months ahead than has occurred over the past 6 months.

Alternative B

To implement this policy, while taking account of international and domestic financial market developments (including the prospective Treasury financing), the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead.

Alternative C

To implement this policy, while taking account of international and domestic financial market developments (including the prospective Treasury financing), the Committee seeks to achieve bank reserve and money market conditions consistent with somewhat less growth in monetary aggregates over the months ahead than has occurred over the past 6 months.

DEALERS' NET INCOME FROM GOVERNMENTS BEFORE TAXES

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>9-Year Average</u>
Dealer Banks' Profits	-4.5	8.5	1.4	-3.1	2.2	71.9	18.0	10.3	-0.3	+11.6
Nonbank Dealers' Profits	-8.3	23.3	25.3	-3.4	-0.-	114.9	120.2	28.8	-18.1	+31.4
Dealer Banks and Nonbank Dealers' Profits	-12.8	31.8	26.7	-6.5	2.2	186.8	138.2	39.1	-18.4	+43.0

Note: These data may not reflect consistent cost allocations by the dealers over time and may not be comparable for the different dealers. The numbers are preliminary. The number of dealers included has increased steadily over the period shown from 17 to 25.

ATTACHMENT F

March 19, 1974

Points for FOMC guidance to Manager
in implementation of directive

Specifications
(As agreed, 3/19/74)

- A. Longer-run targets (SAAR):
(second and third quarters combined)
- | | | |
|--|----------------|--------|
| | M ₁ | 5-1/4% |
| | M ₂ | 7-3/4% |
| | Proxy | 5-1/2% |
- B. Short-run operating constraints:
1. Range of tolerance for RPD growth rate (March-April average): 4 to 7%
 2. Ranges of tolerance for monetary aggregates (March-April average):

M ₁	5-1/2 to 8-1/2%
M ₂	6-3/4 to 9-3/4%
 3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings): 9 to 10-1/2%
 4. Federal funds rate to be moved in an orderly way within range of toleration.
 5. Other considerations: account to be taken of international and domestic financial market developments, including the prospective Treasury financing.
- C. If it appears that the Committee's various operating constraints are proving to be significantly inconsistent in the 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.