

MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, March 18, 1975, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Baughman
Mr. Bucher
Mr. Coldwell
Mr. Eastburn
Mr. Holland
Mr. MacLaury
Mr. Mayo
Mr. Mitchell
Mr. Sheehan
Mr. Wallich

Messrs. Balles, Black, Francis, and Winn,
Alternate Members of the Federal Open
Market Committee

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

Mr. Broida, Secretary

Chairman Burns reported to the Committee on a matter under consideration by the Board of Governors, and responded to questions.

The following then entered the meeting:

Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel

Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Mr. Gramley, Economist (Domestic Business)
Mr. Solomon, Economist (International Finance)
Messrs. Boehne, Bryant, Chase, Davis, Green,
Kareken, Pierce, Reynolds, and Scheld,
Associate Economists

Mr. Holmes, Manager, System Open Market Account
Mr. Sternlight, Deputy Manager for Domestic
Operations
Mr. Pardee, Deputy Manager for Foreign Operations

Mr. Coyne, Assistant to the Board of Governors
Mr. Keir, Adviser, Division of Research and
Statistics, Board of Governors
Mrs. Farar, Economist, Division of Research and
Statistics, Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant,
Board of Governors

Messrs. Eisenmenger, Parthemos, Jordan, and
Doll, Senior Vice Presidents, Federal
Reserve Banks of Boston, Richmond, St.
Louis, and Kansas City, respectively
Messrs. Hocter and Brandt, Vice Presidents,
Federal Reserve Banks of Cleveland and
Atlanta
Mr. Keran, Director of Research, Federal
Reserve Bank of San Francisco
Mr. Sandberg, Assistant Vice President,
Federal Reserve Bank of New York

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, 1975; that it appeared that such persons were legally qualified to serve; and that they had executed their oaths of office.

The elected members and alternates were as follows:

David P. Eastburn, President of the Federal Reserve Bank of Philadelphia, with Robert P. Black, President of the Federal Reserve Bank of Richmond, 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;

Robert P. Mayo, President of the Federal Reserve Bank of Chicago, with Willis J. Winn, President of the Federal Reserve Bank of Cleveland, as alternate;

Ernest T. Baughman, President of the Federal Reserve Bank of Dallas, with Darryl R. Francis, President of the Federal Reserve Bank of St. Louis, as alternate;

Bruce K. MacLaury, President of the Federal Reserve Bank of Minneapolis, with John J. Balles, President of the Federal Reserve Bank of San Francisco, 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 29, 1976, 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 Nicoll	Assistant General Counsel
J. Charles Partee	Senior Economist

Stephen H. Axilrod	Economist (Domestic Finance)
Lyle E. Gramley	Economist (Domestic Business)
Robert Solomon	Economist (International Finance)

Edward G. Boehne, Ralph C. Bryant, Samuel B. Chase, Jr., Richard G. Davis, Ralph T. Green, John Kareken, James L. Pierce, John E. Reynolds, and Karl O. Scheld	Associate Economists
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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 29, 1976.

By unanimous vote, the action by Committee members on March 10, 1975, increasing from \$1 billion to \$2 billion the dollar limit specified in paragraph 2 of Authorization for Domestic Open Market Operations on System holdings of short-term certificates of indebtedness purchased directly from the Treasury, was ratified.

Mr. Coldwell noted that on March 10, when the Manager had recommended the increase in the limit in question, he had suggested that the higher limit might also be needed in the coming period. He asked whether it was the Committee's intention to retain the higher limit at this time.

Chairman Burns suggested that the Committee agree to leave the limit at \$2 billion for a period of one year from the date of today's meeting, unless it decided otherwise in the interim.

In response to a question, Mr. Holmes said he would recommend that the higher limit be retained at least through the month of April, in light of the outlook for the Treasury's cash position during that period. Since the higher limit might well be needed again later in the year, the Committee might choose to leave it in place for the time being. Alternatively, it could restore the prior limit when the immediate need for the increase had passed, and plan on taking further action if and when an increase again proved necessary.

Mr. Holland noted that there were no great difficulties involved in adjusting the limit from month to month, in accordance with changes in circumstances. While the issue was not a major one, he thought it was better procedure for the Committee to keep the limit in reasonably close relationship with the contemplated scale of operations.

Mr. Coldwell said he would prefer to retain the higher limit for a year, as the Chairman had suggested.

With Mr. Holland dissenting, the Committee voted to maintain the dollar limit specified in paragraph 2 of Authorization for Domestic Open Market Operations at \$2 billion for a period of one year from the date of this meeting, unless in the interim the Committee should decide otherwise.

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Before this meeting there had been distributed to the members of the Committee a report from the 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 19 through March 12, 1975, and a supplemental report covering the period March 13 through 17, 1975. Copies of these reports have been placed in the files of the Committee.

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

Recently, the extremely pessimistic atmosphere surrounding the dollar has lifted somewhat, and dollar rates are now away from their low points. Some of the worst fears of the market have not been realized, and the news has been a bit better.

Late in February, OPEC officials, concerned over the decline in the real value of their current dollar revenues, as well as of their dollar investments, began to discuss openly the possibility of seeking alternatives for invoicing their oil exports in dollars. With traders already sensitive to any sign of diversification by oil countries out of dollars and into other currencies, the mere hint of such a shift in invoicing was taken as highly significant by the market. This, combined with a newspaper report out of Washington on February 24 that certain U.S. Government spokesmen were unconcerned about the recent fall in the dollar, prompted a renewed sell-off of dollars which carried dollar rates back to, and in some cases below, the January lows. The Federal Reserve and other central banks resisted the decline, but did not try to hold the dollar rates at any particular level.

The OPEC meetings passed without agreement on a substitute formula, and indeed there were indications of growing strain on the OPEC cartel itself in the face of weak demand for oil. Even so, the markets remained rather thoroughly demoralized; even after the very

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encouraging U.S. trade figures for January were released on February 27, and the dollar improved a bit, a wave of speculative selling soon developed at the higher rate-- a wave which was countered forcefully by Desk action.

Since then the going has been easier. The market has taken note of the improvement in the underlying trade position of the United States and the slackening of inflation here. Moreover, the market has recognized that other countries are also suffering from declining production and rising unemployment, leading to a fall-off of interest rates abroad. In this regard, the fact that the latest discount rate cuts in Switzerland, Germany, and the Netherlands preceded ours defused any negative reaction in the exchange market to our own discount rate cut announced on March 7. Moreover, in recent public statements U.S. officials have been very careful to point out the dollar's underlying strength and to avoid the impression of "benign neglect."

As the dollar rates have recovered, the Desk's intervention has tapered off markedly and has been restricted to resisting any sudden sharp declines in dollar rates which threaten to trigger more generalized selling pressure. The dollar is currently nearly 4-1/2 per cent above its late-January lows against the Swiss franc and is up about 2 per cent against the German mark.

We are still at the mercy of potentially adverse events, however, and many market participants remain skeptical that the long-awaited turnaround for the dollar is immediately in prospect. Discussions with the market and with colleagues at European central banks indicate the general view that any attempt on our part to reverse our operations by buying foreign currencies or by European central banks' selling dollars right now, in order to reverse our recent interventions, could be very damaging to market psychology. Such actions could seriously undercut the chances for a basic dollar rally, which is expected by many in the market and by the central banks themselves. Current market rates are close to the average rates on our swap liabilities in marks, guilders, and Belgian francs, and the Swiss franc rate is such that our recent Swiss franc drawings could be covered at a profit. The timing of any such buying activity is crucial, however. If the current somewhat more buoyant tendency for the dollar continues, by the next meeting I would hope to be able to report at least some progress in clearing up some of our swap debts.

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Mr. Balles inquired about the implications, especially for oil prices in the United States, of recent decisions taken by certain Mideast countries to tie their currencies to the SDR in place of the dollar, and he asked whether shipments of oil to the United States were invoiced in dollars.

Mr. Holmes replied that, while he did not yet know all the details of the recent actions by the Mideast countries, he believed that shipments to the United States were still being invoiced in dollars. The currency changes by themselves would not affect prices of oil imported into the United States; such effects would follow if oil-producing countries shifted to quoting prices in terms of some currency other than the dollar or in terms of SDR's. In the exchange markets, the actions by the Mideast countries had been a source of concern; they had been taken as a sign of a growing tendency toward diversification in the asset holdings of those countries. But up to this point, the actions had not been a major factor in the markets.

Chairman Burns remarked that the issues involved in the new currency arrangements and their possible implications for pricing practices were of sufficient interest and importance to warrant a detailed staff analysis. He requested the staff to prepare such an analysis for distribution to the Committee at an early date.

Mr. Bryant commented that some work along those lines had already been started.

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Mr. Mitchell--with reference to a memorandum that had been prepared by Mr. Pardee at Mr. Bucher's request^{1/}--observed that, while he did not object to recent System operations in the foreign exchange market, he nevertheless thought they had been close to the border line of being inconsistent with the basic purposes set forth in the Committee's Foreign Currency Directive. Under the directive, intervention might be undertaken to lend support to the market under certain circumstances but not to attempt to establish whatever the underlying value of the dollar might be. He asked for Mr. Holmes' views concerning recent operations.

In response, Mr. Holmes commented that he endorsed the analysis contained in Mr. Pardee's memorandum. Intervention had been undertaken with a view to maintaining orderly market conditions rather than to supporting the dollar at any particular rate. Such operations could be defended. In his opinion, underlying strength of the dollar had been offset by outflows of domestic and foreign capital; if confidence could be restored, the underlying factors would cause the dollar to strengthen.

Mr. Pardee added that paragraph 2 of the Committee's directive contained specific language authorizing the kind of operations

^{1/} A copy of this memorandum, dated March 14, 1975, and entitled "Review of Factors Underlying Recent Dollar Decline and Implications for Federal Reserve Intervention Policies," has been placed in the Committee's files.

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that had been conducted. Thus, recent System intervention had been consistent with operations undertaken "A. To cushion or moderate fluctuations in the flows of international payments.... B. To temper and smooth out abrupt changes in spot exchange rates.... C. To aid in avoiding disorderly conditions in exchange markets...."

Chairman Burns commented that the concept of an orderly market was not precise and that the Committee's Foreign Currency Directive could be interpreted in different ways. It would be useful for the Subcommittee, consisting of the Chairman and Vice Chairman of the Committee and the Vice Chairman of the Board of Governors, to consider the issues that had been raised by Mr. Mitchell.

Mr. Coldwell observed that he had two additional questions concerning the System's foreign exchange operations, which he hoped the Subcommittee would consider as well. First, he wondered whether the over-all amount of money involved in market intervention might be approaching the limit that should be committed without direct authorization by the Congress. And second, he was concerned about an apparent inconsistency between the length of time that some of the System's swap drawings had been outstanding and the guidelines set forth in the Committee's Authorization for Foreign Currency Operations, which stated that such drawings "shall be fully

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liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorized a delay." He had reservations as to whether the reference to exceptional circumstances could continue to cover drawings that had been outstanding for nearly 5 years, and he suggested that a change be made either in the language of the Authorization or in the operations involving swap drawings.

Chairman Burns agreed that it would be useful for the Subcommittee to consider the additional two questions.

Mr. Bucher remarked that he shared the concerns expressed by Messrs. Mitchell and Coldwell, and he agreed that it would be useful for the Subcommittee to consider the issues. He felt that for some time the System's intervention in the market had been working against basic forces tending to depress the dollar. In view of the language of the Foreign Currency Directive, therefore, such intervention had made him uncomfortable.

Mr. Hayes said he agreed that it would be desirable for the Subcommittee to pursue the issues that had been raised. With reference to Mr. Coldwell's comment on the drawings that had been outstanding for nearly 5 years, however, a distinction existed between the drawings made just before the United States suspended convertibility and the drawings made in the more recent period. He certainly was in favor of liquidating the old drawings and did not foresee a long-term problem growing out of the recent ones. He also believed

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that a review of the Authorization and Directive was needed in light of changed circumstances in which the Federal Reserve was now operating.

Mr. Wallich commented that those instruments did need to be reviewed; they were no longer consistent with what he thought should be the objective--namely, not to operate on a large scale but rather to demonstrate that the System was aware of developments and would not turn its back on the nation's currency.

In response to a question by Mr. Mitchell concerning the meaning of his last phrase, Mr. Wallich said the United States had long been suspected of "benign neglect" with respect to its currency. The United States, to be sure, could be less concerned about some aspects of its currency than could a smaller country, but nevertheless, it had responsibilities to other countries that used the dollar and risked losing something if this country practiced benign neglect and allowed the dollar to find its own level in the exchange market without any intervention. Non-intervention was subject to the interpretation that the United States was not resisting fundamental trends, and that was fine. It was also subject to the interpretation that the United States did not care about the value of the dollar even that it was trying to gain a trade advantage by allowing that value to decline; neither interpretation was particularly desirable.

Mr. Holland remarked that he had long thought it was incongruous that the Committee had not changed its foreign currency instruments after the change from a fixed to a floating exchange rate system. That they had not yet been changed was a comment on how broad the language of the instruments was. However, the instruments ought to be revised to bring them more into line with current circumstances and to involve the Committee and the Subcommittee in foreign currency operations to a greater extent.

Mr. Broida observed that a staff committee had been reviewing both the Authorization for Foreign Currency Operations and the Foreign Currency Directive and hoped to have a report to the Committee in the near future.

Chairman Burns remarked that it would be desirable for the Subcommittee to review the staff committee's report before it was put before the full Committee.

Mr. Solomon commented that the International Monetary Fund, with the agreement of the United States, had adopted a set of guidelines for a floating rate system. He assumed that the staff committee, in reviewing the instruments, would take account of the IMF guidelines, which were not inconsistent with those now being followed by the System.

By unanimous vote, the System open market transactions in foreign currencies during the period February 19 through March 17, 1975, were approved, ratified, and confirmed.

The Chairman then called for the staff report on international developments.

Mr. Solomon made the following statement:

As is evident from various reports before the Committee, the rest of the world is also in an economic recession. Industrial output has been declining rapidly in most major countries. World trade in volume terms stopped growing in the fourth quarter of 1974. The slowdown or decline of imports into industrialized countries is hurting the exports of developing countries, and this in turn is bound to ricochet back, reducing the demand for exports of industrialized countries.

Quite apart from the obvious reasons to be concerned about losses of income and output in individual countries, there are three international reasons for concern about the current situation:

1. Individual countries may underestimate the need for countercyclical action by failing to take adequately into account the reduction in demand emanating from abroad. This was clearly a problem in 1974.
2. Growing unemployment and unused industrial capacity may lead to import restrictions as a means of protecting domestic employment. This is already happening in Australia and perhaps elsewhere.
3. Developing countries, many of which hold only limited amounts of international reserve assets, will be under severe financial strain as the result of declining export volumes and prices. This could retard development efforts and cause social and political instability.

The recent meeting of OECD's Economic Policy Committee^{1/} concluded that it would be up to the three major industrial powers--the United States, Germany, and Japan--to take the lead in putting the world economy back onto a reasonable growth path. The focus is on these three

^{1/} A report by Mr. Solomon on meetings of OECD's Working Party 3 and Economic Policy Committee on March 5-7 was distributed to the Committee on March 14. A copy is appended to this memorandum as Attachment A.

countries not only because of their importance in world trade but because each of them has experienced a more severe contraction than other countries, each of them has had an improvement in internal price performance, and each of them has less of a balance of payments constraint than most other countries.

Germany, which acted early to combat inflation, has also taken the lead in adopting stimulative fiscal and monetary policies. Despite some indications that an upturn in the German economy may soon occur, there is uncertainty as to whether the expansion will be sufficiently vigorous and sustained. Japan has done little thus far to adjust its economic policies. Though inflation has subsided and wholesale prices are falling, the Japanese authorities are concerned about the possible size of the wage contracts in the upcoming round of negotiations. Thus, Japan's expansion is likely to lag behind Germany's.

The economic performance of the United States will be importantly influenced by the nature and timing of fiscal policy measures as well as by the monetary policies pursued by this Committee.

I conclude with two observations. (1) Economic recovery and sustainable expansion of the U.S. economy are of great importance to the rest of the world. (2) If counter-recessionary measures are insufficient or too-long delayed, here and elsewhere, acute political pressures could lead to excessive stimulation later on. This, in turn, could lead to a repeat performance of the 1972-73 world expansion, which set off the explosion in prices of industrial raw materials with well-known effects. From the viewpoint of the three major countries and for the world as a whole, it would be far preferable that an early and steady economic expansion be set in motion.

Mr. Black asked Mr. Solomon whether one could infer from his statement that he did not anticipate further significant easing in economic policies on the part of European countries or Japan in the near future.

Mr. Solomon replied that there were no indications of much action to ease policies in the immediate future. The German

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authorities thought that they had already done a fair amount, and now they wished to wait and observe the effects. Italy and the United Kingdom--and France as well--had serious difficulties concerning wage-price developments, and they were counting on Germany to take the lead in expanding its economy, hoping that they in consequence could experience an export-led expansion. France, in particular, might then take some limited complementary actions. Some of the Scandinavian countries had taken stronger countercyclical actions, despite a falling off in their exports because of the decline in economic activity in Germany and elsewhere. They had been quite willing to live with the cyclical balance of payments deficits and to borrow in order to finance them.

Mr. Black then asked Mr. Solomon whether, in his view, a further decline in the Federal funds rate would have a significant effect on policy decisions in the other industrial countries.

Mr. Solomon replied that he thought not. As far as he knew, the Federal Reserve's policy stance was not inhibiting other countries from taking countercyclical actions.

Mr. Eastburn inquired whether cycles in business activity in the major industrial countries were essentially in synchronization.

Mr. Solomon said they were, although not perfectly so because Germany had acted to ease policies earlier than the rest. The upswing in 1972-73 also had been coincident. Not since 1957-58 had all industrial countries moved together, first up and then down.

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Mr. Holmes reported that two System drawings on the National Bank of Belgium, totaling \$31.8 million, would mature for the fifteenth time on April 17 and 24, 1975, having been outstanding since August 1971. He recommended that they be renewed for further periods of 3 months, if necessary, when they matured. The Account Management had proposed to the Subcommittee that the Treasury be asked to take over the long-term debt represented by those drawings.

Mr. Holland asked whether the Treasury had been approached as yet concerning the debt to the National Bank of Belgium.

Mr. Bryant replied that it had not. The Subcommittee first would have to consider the proposal.

Chairman Burns observed that if there were no objections from other members of the Subcommittee, he would ask Messrs. Holmes and Bryant to take the matter up with the Treasury. Messrs. Hayes and Mitchell indicated that they had no objections.

By unanimous vote, renewal
for further periods of 3 months
of System drawings on the National
Bank of Belgium, maturing on
April 17 and 24, 1975, was authorized.

Mr. Holmes also reported that six System drawings on the German Federal Bank would mature in the period from April 1 to April 24--five, totaling \$55.7 million, for the first time and one, amounting to \$29.6 million, for the second time. The German Federal Bank was eager to avoid an extension of the latter drawing beyond 6 months, although it probably would agree to the second

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renewal if the market situation did not favor repayment by the maturity date. Partial repayment had already been made, incurring an interim loss, and he planned to chip away at the remainder as soon as possible. In addition, six drawings on the Swiss National Bank, totaling \$19.4 million, would mature for the first time in the period April 8 to 23, and one drawing on the Netherlands Bank, amounting to \$3.2 million, would mature for the first time on April 1. He recommended renewal of all those drawings, if necessary.

Renewal for further periods of 3 months of System drawings on the German Federal Bank, the Swiss National Bank, and the Netherlands Bank, maturing in the period April 1 to 24, 1975, was noted without objection.

Secretary's note: A report by Mr. Wallich on the March meeting of central bank Governors in Basle was distributed during this meeting. A copy 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. Gramley made the following statement:

The recession in business activity that began last fall has deepened considerably further over the past month. Industrial production in February fell another 3 per cent, and declines were again widespread by industry categories. Since last September, industrial output has dropped by 12 per cent--a decline in 5 months that equals the total 8-month decline of the 1957-58 recession.

Employment also continued to drop in February, despite the stability in the unemployment rate. Since the peak in October, nonfarm employment (the payroll series) has been reduced by 2.3 million, with nearly three-fourths of the reduction occurring in manufacturing. As is the case with industrial production, declines in manufacturing employment during recent months have been substantially larger than in earlier postwar recessions.

The principal elements of weakness in economic activity now are the steep declines occurring in business investment in fixed capital and inventories. In the fourth quarter of last year the book value of business inventories rose at an annual rate of \$50 billion; this January a \$2 billion annual rate of liquidation occurred. Thus, inventory investment has dropped sharply, and drawing down of the physical volume of inventories is already under way. Declines in shipments of producers' durable equipment have also been substantial. In current dollars, shipments of nondefense capital goods have declined at a 20 per cent annual rate over the past 3 months, and in real terms the decline has been still larger.

Both categories of business investment are likely to display continued weakness in the months immediately ahead. Total new orders for durable goods are still declining, as are order backlogs. The major indicators of plant and equipment spending, moreover, indicate a continued retrenchment of real business fixed investment for at least the next quarter or two. But while activity in the industrial sector will probably fall further in the next few months, the staff believes that the steepest declines in industrial output and employment are now behind us.

This current recession is shaping up as the most severe of the postwar period, but the general pattern of cyclical developments is proving to be broadly similar to that of earlier postwar declines. We had assumed this would be the case when we first projected--some months ago--that the trough of this recession would occur around mid-1975. Accordingly, we have seen nothing in recent data to alter our general views of the outlook, and the staff's GNP projection in the current green book^{1/} looks similar to that of a month ago.

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

However, the probabilities that I would assign to the likelihood of a second half upturn are greater now than they were a month or two ago, for several reasons.

First, the prolonged decline in the physical volume of retail sales seems to have bottomed out. In real terms, retail sales rose somewhat in January, probably held about even in February, and appear to be running close to the February level in March. Second, as I noted a moment ago, outright declines in the physical volume of inventories have already begun, and in prior postwar recessions, the trough in general business activity has typically occurred about two quarters after inventory liquidation commences. Reductions in inventories seem to be occurring now on a wide scale. In January, for example, the decline in the book value of trade inventories was larger for general merchandise stores than for those in the automotive group.

Third, one can be cautiously optimistic that final sales will hold up well enough to permit an orderly reduction in excess stocks in the months ahead. Consumer spending, for example, may begin to respond to anticipated tax rebate checks soon after tax legislation is passed by the Congress and signed by the President. Furthermore, the magnitude of stimulus to consumer purchasing power may be larger than the tax package already passed by the House and incorporated in the staff's GNP projection. Also, there are some signs that the period of sharpest cutbacks in business plans for plant and equipment spending may now be over. And housing activity should, in the near future, show a moderate response to the improvement in mortgage credit supplies in process since last fall.

Easing conditions in credit markets are paving the way for a cyclical upturn in other ways also--such as the substantial rise in equity prices induced in part by the sharp declines, until recently, in short-term interest rates and diminishing concerns with the liquidity positions of financial and nonfinancial businesses. But in a variety of ways, trends towards easing conditions in financial markets have been disappointingly slow. Banks are still applying restrictive lending standards, judging by the latest survey of bank lending practices (taken in mid-February); long-term interest rates have backed up recently under the weight of a heavy volume of new offerings by corporations and municipal governments, and quality consciousness still prevails among financial investors.

Let me turn briefly to the outlook for prices, which the staff believes has continued to brighten over the past month or two. This adds a further note of optimism to the prospects for real activity.

Recent wage and price statistics continue to indicate a surprising degree of moderation in the current rate of inflation, and more slowdown may actually be occurring than the official indexes reveal. We look for a further moderation in the rate of wage increases over the course of 1975, and on into 1976. Moreover, in the highly competitive product markets likely to prevail over the next year or so, cost increases will be difficult to pass on. We are now projecting price increases--as measured by the fixed-weight deflator--to slow to around a 4-1/2 per cent annual rate by mid-1976, about 1 percentage point less than we expected a month ago. This projection implies a smaller recovery for corporate profits--though still a good recovery--and it depends partly on a better performance of food prices than we had been expecting earlier. World demand for agricultural commodities has slackened because of the world-wide recession; supplies of some individual food commodities have become more ample; and the farm-retail price spread seems unlikely to push up prices this year as it did last year. If harvests of major crops in the United States and abroad are reasonably good in 1975, retail food prices, on average, may rise only moderately over the next year or so.

In summary, the staff has become less uneasy about the economic outlook in the past month or so. The prospects for recovery in the second half of 1975 have improved; the prospects for further moderation in the rate of inflation have also improved. I would remind you, however, that we expect a substantial further rise in unemployment--to around a 9-1/2 per cent rate--before the bottom is reached. I would remind you, also, that the rate of economic growth the staff projects for the first year of the recovery--about 5 per cent--is anemic by postwar standards and would leave the economy far below full-production levels by the middle of 1976.

Chairman Burns remarked that at the last meeting he had made a brief comment on the special character of the current

recession, and he wished now to elaborate on that comment, partly because it had aroused the interest of members of the Committee and partly because it might serve as useful background for thinking about the current recession.

The Chairman observed that the recession was best viewed--and he believed it would be so viewed by later historians--as the culmination of a long economic wave. There had been many such long cycles in economic history: for example, one from 1921 to 1933; another from 1908 to 1921; and in the last century, one from 1879 to 1894 and one from 1894 to 1908.

The beginning of the current long wave, the Chairman said, might be dated in 1958 or in 1961; he would arbitrarily take 1961 as the starting point, although he could have chosen 1958 equally well. Since 1961 the economy had moved upward, except for a slight interruption in 1967 and a more significant interruption in 1969-70. Those interruptions of economic progress excited the interest of practicing economists, and also of political representatives, but he doubted that they would be noticed by economic historians concerned with large events. Putting monthly data aside and looking only at annual figures, total employment rose year after year starting in 1961. Disposable personal income per capita in real terms kept on rising year after year, and so also did consumer spending per capita in real terms. That

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sustained upward trend of the economy came to an end last year, and as he saw it, the economy now was in the downward phase of the long economic wave.

Continuing, the Chairman said that one need not be concerned with the interval from 1961 to 1964; that was a period of improvement, at times sluggish improvement, in the real economy, and it was also a period of remarkably stable prices. Starting in 1964, however, economic growth accelerated for a time. The price level then started to move up, and the rate of inflation accelerated more or less steadily until late 1974. He would not take the time now to demonstrate how a steady stream of budget deficits and the pace of monetary expansion had fed the inflation. His purpose, rather, was to comment on the special character of developments after 1965.

First of all, Chairman Burns remarked, there was a wave of corporate mergers and acquisitions. After running for a number of years at a rate of some \$2 billion a year, large acquisitions jumped to an aggregate of over \$3 billion in 1965 and in 1966, \$8 billion in 1967, \$12-1/2 billion in 1968, and \$11 billion in 1969. It was the great era of conglomerates; their spectacular formation tapered off rapidly after 1969.

The Chairman observed that that speculative merger phase was naturally reinforced, and to a degree made possible, by other speculative movements--notably by sharp increases in the

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volume of trading on the stock exchanges, by a run-up of prices of low-value common stocks, by emergence of "go-go" performance funds, and by generally rapid turnover of the portfolios of mutual funds. Once the speculative involvement in low-price common stocks cooled off, as it did by 1969, the interest of speculators shifted to high-grade securities, and the over-all stock market kept booming until 1972. New stock issues flourished, their volume more than doubling between 1968 and 1972.

The third speculative wave, and perhaps the one of largest consequence, Chairman Burns said, occurred in the real estate market. The country experienced a huge housing boom from 1970 to 1973. Merchant builders put up one-family homes ahead of demand, and the inventory of unsold homes kept increasing dramatically. Speculation was even more intense in the multi-family sector. By the first half of 1974 condominiums and cooperatives accounted for about a fourth of the completions of multi-family residential structures. The real estate investment trusts played a particularly large role in supplying high-risk construction credit for condominiums, for recreational building, and for other speculative types of construction. The assets of the REITs amounted to less than \$700 million as late as 1968, but they rose to over \$20 billion by 1973. Commercial banks became heavily involved in financing construction work during the 1970-73 boom by supplying credit on a massive scale to the REITs

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and by making other real estate loans. The speculative boom in real estate was not confined to residential structures. It extended also to speculation in land, to widespread building of shopping centers, and to construction of office buildings. By 1972 the vacancy rate in office buildings had reached 13 per cent, but the building of office structures still kept climbing.

By 1973, the Chairman observed, the economy was already operating at full capacity in a practical sense. Bottlenecks and shortages developed in numerous industries, industrial efficiency suffered, output per manhour began declining, difficulties in securing materials and supplies increased, and the rise in prices accelerated. Thus, a fourth type of speculation, speculation in inventories, got under way on a massive scale.

The Chairman noted that the entire period from 1965 to mid-1974 was, therefore, marked by a succession of overlapping speculative movements--first in buying up existing businesses, then in the stock market, later in the real estate market, and finally in the markets for industrial raw materials. Those speculative activities were nourished, of course, by rapid increases of indebtedness. Between 1965 and 1973, a period of just 8 years, the aggregate debt of individuals doubled and the indebtedness of corporations grew by nearly 150 per cent.

Chairman Burns remarked that in the early phase of the long economic wave--that is, from 1961 to 1965--sizable advances

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occurred in productivity, and corporate profits improved notably. However, the later part of the upward sweep of the long wave-- that is, from about 1965 to mid-1974--was characterized by a gradual weakening of the industrial sector of the economy, although exuberance continued, now in one and then in another speculative market. During that later phase, the trend of industrial productivity flattened out, corporate profits dwindled, the liquidity of corporate enterprises diminished, the capital position of the banking system eroded, Federal finances deteriorated, and the rate of inflation became progressively higher. The current recession was thus the aftermath of a protracted series of speculative developments. Those developments took place in the face of a weakening of the real sector of the economy.

The Chairman said the recession was deeper than any of the postwar period, but it also expressed the release of major corrective forces. The recession was causing much suffering to workers and financial losses to business firms. Those were deplorable facts. But the recession was also serving a salutary function; it was not to be viewed merely as a pathological phenomenon. In the first place, the recession was correcting the imbalances that had arisen between production and sales, between orders and inventories, and between industrial capacity and profits. Second, the recession was gradually restoring strength to the banking system. Third,

the recession was improving efficiency all around, by fostering better management, by concentrating production in more modern and more efficient installations, by weeding out less efficient workers, and by stimulating employees to apply themselves to their duties with greater diligence. And finally, the recession was wringing inflation out of the economic system, as was evidenced by the recent declines in wholesale prices and by the lower rate of advance in consumer prices.

Those corrective aspects of the recession were commonly ignored in day-by-day discussions, the Chairman observed, but Committee members could not afford to ignore them. They needed to recognize that a recession was a process which restored balance to an economy and which prepared the way for a new burst of prosperity. They also had to recognize, however, that a recession could degenerate into a depression which fed on itself and thus produced new maladjustments instead of correcting old ones. That, of course, constituted the rationale for stabilization policies, and it clearly justified Government measures to cushion an economic recession. In his judgment, however, it did not justify Federal deficits of \$80 to \$100 billion or more, which were now being widely recommended, and indeed were already being brought about. And in view of the accumulating evidence of the working of the corrective

process, it did not justify some of the more extreme monetary policies that were now being recommended to the Committee.

Mr. Black noted that the staff projected a rise in the saving rate in the third quarter of this year to a level that had been exceeded only for a short time just after World War II. Thus, consumers were expected to use a large part of their disposable incomes to reduce debt or to increase financial assets. In view of recent declines in consumer debt and of the probability that personal tax cuts would be concentrated among individuals who were likely to spend a large share of the funds, he inquired about the staff's rationale for such a high saving rate.

Mr. Gramley observed that the tax package passed by the House of Representatives--which was incorporated in the projections--would sharply increase disposable income in both the second and third quarters. The package included an \$8 billion rebate of 1974 taxes, and the staff had assumed that half would be paid in the second quarter and half in the third, raising disposable income by an annual rate of \$16 billion in each quarter. In addition, the package included \$8 billion of reductions in 1975 tax liabilities, which would be reflected in withholdings during the second half of 1975. Actually, withholdings would be reduced even more to compensate for part of the present rate of overwithholding; the total change in withholding rates would raise disposable

income by an annual rate of \$18 billion in the third quarter. Moreover, a cost-of-living adjustment for social security benefit payments was scheduled to take effect then. Altogether, the expansion in disposable income expected in the third quarter was enormous. The staff believed that consumers, even though they were not optimistic and were inclined to be cautious in their spending, by and large would spend the additional income. However, they would do so with a lag, so that the saving rate would rise sharply at first and then decline again by the end of the projection period.

Mr. Winn remarked that he was most concerned about prospects for business fixed capital investment and the implications for overall growth in the economy. The rise in the stock market, the improvement in consumer attitudes, and the better performance of prices all were positive in that respect, but he asked whether first- and second-quarter profits might not be so bad that programs for capital investment would be cut back further.

Mr. Gramley replied that deterioration in business attitudes and capital spending plans, in response to the performance of profits, was one possible development that might prevent activity from recovering in accordance with the staff projection. However, the staff had allowed for a sharp decline in corporate profits, and it had projected a decline in real business fixed investment that was even steeper than that in the 1957-58 recession--17 per cent

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from peak to trough, compared with 15 per cent in 1957-58. With respect to profits, it was significant that the moderation in the rate of inflation in this period was contributing to the decline in reported profits, just as the high rate of inflation earlier had contributed to the rise in profits; including the inventory valuation adjustment, profits were projected to decline less sharply. Further deterioration in business spending plans might be a more likely prospect if consumer spending turned down again in the second quarter. As of now, however, the prospects were reasonably good for an upturn in economic activity in the second half, and that would begin to have a favorable effect on profits.

Mr. Partee added that the staff had been surprised that the latest Commerce Department survey had not indicated greater weakness in capital spending in 1975, although publicly reported cancellations and postponements of expenditures in industries other than the utilities had been at a lower rate so far this year than in the latter part of last year. He would have expected more in the way of stretch-outs in capital expansion programs than seemed to be implied by the Commerce survey.

Mr. Sheehan remarked that the Commerce survey was not consistent with his own impression that businesses were actively cutting back their capital expenditures.

Mr. Partee commented that it was difficult to relate one's personal knowledge of business firms to the large scientific sample of the Commerce Department. It was possible that the reporting forms were being filled out by individuals in the firms who were not sufficiently up to date concerning the cancellations being discussed in the corporate board rooms. On the other hand, the survey might be saying that capital spending, although cut back substantially, was not going to collapse.

Chairman Burns observed that his conversations with businessmen of late had indicated a mixed picture. While a fair number had said they were reducing planned capital expenditures, quite a few had described their capital spending plans as firm and some had even indicated that they were rising. It would be helpful if the Reserve Bank Presidents would report any impressions of the capital spending situation that they might have obtained from their contacts with members of the business community.

Mr. Clay remarked that some indications of spending plans might be found in the recent announcements by certain large corporations that they were going to raise substantial sums of money in the capital market. Presumably, those funds would be used for some kind of capital expansion.

Mr. Sheehan commented that at least one of the firms in question was raising the funds primarily to deal with liquidity

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problems--particularly in the short run, because of their loans from banks--rather than primarily to finance capital expenditures. Several business economists for major corporations, in a meeting with the Board a month or 6 weeks ago, had used quite large numbers in speaking of the cuts in capital expenditures being made by their companies.

Chairman Burns remarked that in his opinion business sentiment had improved somewhat within the past 4 to 6 weeks.

Mr. Partee observed that a 150 point increase in the Dow-Jones average for industrial common stocks had had a considerable effect on attitudes.

Mr. Winn remarked that common stock prices could decline again if the profits figures proved to be very weak.

Mr. Francis commented that some firms in the St. Louis District recently had announced substantial increases in expenditure plans, while others had announced cutbacks. He felt that on balance the staff's projection of capital spending was about right.

Mr. Kimbrel observed that the conditions affecting capital investment differed quite a bit from one region to another within his District. New Orleans was almost a boom area, because of the presence of gas and oil exploration, ship building, and commercial construction. In Florida, expectations were for a good tourist season--even better than in 1973. In Southern Florida, almost all

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of the accommodations were sold out through Easter, and rental cars were available only with a lead time of 4 days to a week. It was expected that the citrus crop harvest would set a record, owing to the availability of labor to harvest the end of the crop. While it was reported that the overhang of unsold condominiums amounted to a 20- to 22-months supply, some new commitments to construct condominiums were being made, with the expectation that they would be ready for occupancy at about the time that the present large supply was exhausted. On the other hand, people in the textile industry in Georgia were anxious about their situation. New orders were beginning to pick up, but because of the possibility that the upturn resulted only from some earlier promotions and consequent reductions in inventories, there was uncertainty as to the duration of the improvement and the prospects for prices.

Mr. Clay, with reference to the Chairman's remarks concerning the salutary effects of recession, commented that one builder of large institutional structures in his area had reported that for the first time in 10 years worker productivity was high enough to enable him to earn a return on the labor input.

Mr. Morris expressed the view that there was greater uncertainty about business capital investment than about any other sector of the staff projection. This recession involved a new phenomenon,

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which he believed was consistent with the Chairman's analysis of long cycles: it was the first recession in his memory in which corporate decisions affecting capital investment plans were inhibited by balance sheet constraints. One major corporation, according to its chairman, was limiting its capital investment in 1975 to the volume that could be financed with internally-generated funds. No matter how attractive additional investment opportunities might appear to be, the company would not raise funds in the capital market or increase other borrowings. Like Mr. Sheehan, he had interpreted the bond offerings recently announced by certain large corporations as intended primarily to improve their liquidity positions. It seemed likely that a number of other companies whose securities were generally considered to be of high grade felt that their balance sheets precluded their going into the capital market--that it would be imprudent to extend themselves financially at this time. In earlier cycles, corporations had been willing to weaken their balance sheet positions in the interest of growth.

Chairman Burns commented that he agreed with the substance of Mr. Morris' remarks, but it was a matter of degree. In general, businesses sought to maximize profits during expansion phases; in recessions, motivation shifted to the maintenance of solvency. The shift this time had been greater than in earlier postwar recessions.

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Mr. Hayes remarked that the situation with respect to capital spending was mixed. While many businessmen certainly were proceeding cautiously, some were moving ahead without inhibitions. In part, the heavy capital market financing was for the purpose of funding short-term debt--which was therapeutic in view of the earlier piling up of such debt. Corporations were positioning themselves to proceed with capital spending projects whenever they saw a real pickup in consumer demand.

Chairman Burns commented that businesses needed a substantial volume of funds to finance capital investment projects already under way.

Mr. Wallich said capital spending decisions now being made--apart from those involving the purchase of automobiles, trucks, and the like--would affect outlays in 1976 at the earliest, and would have their major impact in 1977. He found it difficult to believe that the immediate situation--apart from financial considerations--could greatly influence decisions with respect to those years.

Mr. Baughman observed that, as was well known, boom conditions existed in the oil and gas industry in the Eleventh District, and the availability of equipment and labor was the only constraint on the rate of investment. Those conditions had

pervasive effects on the economy of the District, although there were some areas that were not enjoying a boom. Retail sales were stronger than in the rest of the country, and savings and loan associations were actively seeking borrowers. He would judge that recovery about in line with the staff projection was a widespread expectation in the District. However, it was also expected that after the middle of next year a vigorous inflationary thrust would be renewed. Concern was widespread that economic policies might be overly stimulative. Such expectations and concerns might be largely a result of the boom conditions peculiar to the District.

Chairman Burns suggested that the Committee now return to the discussion of the economic situation in general and to any questions regarding the staff presentation.

Mr. Hayes noted that in the staff projection the rate of inflation tapered off throughout the period to mid-1976. In view of the temporary nature of some of the price reductions associated with distress sales and special promotions, he asked whether some rebound in the rate was not to be expected when the pace of inventory liquidation slowed. Also, noting that the rate of increase in prices of services, with the exception of mortgage interest rates, had not moderated much, he asked whether the staff expected significant improvement in that area.

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Mr. Gramley replied that there were two major developments that made a rebound in the rate of price increase unlikely. The staff expected that the pace of advance in wages would slow further and that productivity would improve significantly once economic activity turned up. Together, those developments would result in several quarters of relatively small increases in labor costs per unit of output. Moreover, the consumer had become considerably more price conscious and was inducing producers to be a lot more competitive than they had been during the long period of inflation. Thus, he expected that the automobile producers would find it difficult to get prices of 1975 models back up or to raise prices on the 1976 models, and manufacturers of other goods would have much the same experience. Even so, the projected rate of increase of about 4-1/2 per cent in the fixed-weighted private deflator in the second quarter of next year was still substantial, but prospects had improved that the rate would slow that much.

Chairman Burns commented that he agreed, with one qualification: raw materials' prices would start to rise just about the time recovery in business activity got under way.

With respect to service prices, Mr. Gramley observed that some improvement was expected--also in association with some slowing in the rate of advance in wages--but the moderation was much less than in the commodity area. Service prices were expected to

be rising at an annual rate of 7 to 7-1/4 per cent in the second quarter of 1976, compared with a rate of about 8 per cent in the last quarter of 1974.

Mr. Partee added that the service category included such things as medical costs, utility rates, and college tuition, all of which were subject to strong upward pressures of costs, so the staff had not materially lowered the projected uptrend of service prices.

Mr. Hayes then remarked that in the New York District the problem with respect to municipal finance was especially acute; the situation in New York City was becoming critical and was a source of worry to everyone. It could become quite disturbing to markets in general.

Mr. Balles asked Chairman Burns how long he thought the downward phase of the current long cycle was likely to persist.

The Chairman replied that the very sharpness of the decline in activity led him to believe that there would be an upturn some time this year. Were it not for its sharpness, chances would be great that the recession would be drawn out for a long time.

Mr. Balles then noted that the staff projection in the green book was based on an assumption of growth in M_1 of about 6 per cent over 1975 as a whole, which apparently was consistent with alternative A^{1/} in the blue book.^{2/} He asked what the effect would be if the Committee followed alternative B or C rather than A.

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

^{2/} The report, "Monetary Aggregates and Money Market Conditions," prepared for the Committee by the Board's staff.

Mr. Gramley replied that, assuming alternative B rather than A, the level of real GNP in the second quarter of 1976--the last quarter of the projection period--would be a little less than 1 per cent lower and the rate of unemployment would be a couple of tenths of a percentage point higher. Under alternative C, real GNP would be about 1-1/2 per cent lower and the unemployment rate about .4 or .5 of a percentage point higher. In both cases, the price rise would be slower, but not markedly so, and interest rates, especially short-term rates, would be somewhat higher.

Mr. Kimbrel remarked that in his District he encountered a great deal of anxiety regarding the timing and the nature of Congressional action on tax reductions, and he asked Chairman Burns for his views on what might occur.

The Chairman observed that in his testimony before the Senate Budget Committee on March 13 he had indicated that budget deficits of \$45 to \$50 billion and \$80 to \$100 billion were shaping up for fiscal years 1975 and 1976, respectively. In his judgment, deficits of such size were virtually bound to put severe pressure on interest rates, particularly long-term rates, no matter what policy was pursued by the Federal Reserve. He had been discussing ways of dealing with the problem both with the President and with some key members of the Congress. The critical period was likely to be around next September. It was a subject for discussion later on.

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Mr. Wallich commented that, as he saw it, the sharp decline in economic activity last autumn was the result of developments in the preceding spring and summer--namely, very high interest rates, along with high rates of monetary growth. Now, the projected turnaround in activity near midyear would come about a half of a year after a period of lower interest rates and very slow monetary growth. From those developments, he drew certain conclusions regarding the relative effects of monetary growth and of interest rates, and he asked for Mr. Gramley's views.

In response, Mr. Gramley said he believed that a restrictive monetary policy had been an important contributing factor--but not the only factor--in the decline in economic activity. Because monetary policy affected activity with a considerable lag, however, its effects needed to be evaluated over longer periods of time. From roughly the beginning of 1973 to mid-1974 the real money stock had declined steeply, and interest rate changes and credit market conditions had also indicated developing restraint. With respect to the prospective upturn as well, monetary policy was not the only causal factor. Natural corrective forces were at work, and the projected upturn depended heavily on the prospective fiscal stimulus. Monetary policy would have some beneficial effects--especially in such markets as housing--even

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if it made no more positive contribution than to permit credit markets to ease.

Chairman Burns remarked that the fiscal assumption underlying the staff projection was based on the package of tax reductions passed by the House of Representatives. Larger tax reductions were bound to be enacted.

Mr. Wallich asked whether the staff attributed the prospective recovery more to fiscal than monetary stimulus.

Mr. Gramley replied that the fiscal stimulus was the more important. However, monetary policy was making a contribution by permitting a substantial decline in interest rates and an easing in credit market conditions, even though expansion in monetary aggregates had been limited.

Mr. Partee added that the assumed rebates of 1974 taxes and reductions of withholdings of 1975 taxes were the main causes of the projected expansion in consumption expenditures at annual rates of 9-1/2 and 10-1/2 per cent in the third and fourth quarters, respectively.

Chairman Burns remarked that increases in Federal expenditures beyond those incorporated in the staff projection probably were in the making. One Congressional committee after another, acting on its own and competing with other committees, was trying to remedy this recession. And a quiet but effective kind of

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competition was developing between the Congress and the Administration. The President had already made requests for funds in addition to the amounts proposed in his budget for fiscal 1976.

Mr. Gramley noted that the staff projection of Federal outlays incorporated the President's recent requests--namely, \$2 billion for highway and hospital construction, \$1.6 billion for public service employment, and \$400 million for the summer youth program. The staff also had assumed that far from all of the President's recommendations for rescissions and deferrals would be adopted by the Congress. Thus, the staff's projection of unified budget outlays in fiscal 1976 was \$10 billion above the Administration's figure. Moreover, the staff's projection did not include any expenditures for the Administration's energy program, which would amount to \$7 billion. Net of the energy program, the staff's projection exceeded the Administration's figure by \$17 billion.

Mr. Mayo asked what assumption the staff had made with respect to the size of wage increases in contract negotiations over the rest of this year.

Mr. Gramley replied that the staff had assumed that major collective bargaining settlements would average about 8-1/2 per cent for the whole of 1975. Thus, the settlements were still quite large. However, they constituted a fairly small part of total wage increases because there were relatively few new contract negotiations this

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year. Over the period from the second quarter of this year to the second quarter of next year, compensation per manhour was projected to increase 7.3 per cent; the rate of increase was expected to drop below 7 per cent by the end of the projection period.

Mr. Partee added that the figure for compensation per manhour reflected increases negotiated in major new contracts this year for about 2 million workers, a substantially smaller number than in recent years. It also reflected deferred advances provided for in existing contracts; increases resulting from the operation of escalator clauses; and advances in nonunion areas, particularly services and trade. In the nonunion areas, the high rate of unemployment had been assumed to limit the advances to an average of about 5-1/2 per cent, bringing the over-all average down.

Mr. Mayo then observed that the House and Senate differed on many proposals for tax reduction, and with the Easter recess imminent, he thought the fiscal stimulus might not come until later in the year. Moreover, there was uncertainty concerning the amount of fiscal stimulus that would be provided by the additional funds released for public works, in part because some State governments would not be able to come up with the matching funds required. There was also the problem that public works expenditures took

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so long to get under way that they really did not provide stimulus until recovery was already in progress and the stimulus unneeded.

Mr. Partee commented that Mr. Mayo had referred to well-known problems with public works programs. In the case of the road building program, the Office of Management and Budget had estimated that not more than half of the \$2 billion released by the President about a month ago could be spent in the next fiscal year. Furthermore, there were not many more projects on the shelf for which engineering designs were available, land and rights-of-way secured, and other preparations made. With respect to the timing of the stimulus from the tax cut, rebate checks were assumed to be mailed in volume before the end of the second quarter. If the stimulus were to be delayed until the autumn, the recovery in activity also would be delayed--perhaps until the fourth quarter.

Mr. Black--with reference to Chairman Burns' analysis of long cycles--noted that over the years the leading industrial countries had become more economically and financially integrated. He asked what implications the Chairman thought that might have for business cycles.

In response, the Chairman said the recessions that were peculiar to a given country tended to be minor, but those that synchronized in the leading industrial countries typically were more severe. The present recession was so deep in

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part because it was international in scope. The preceding boom also had been worldwide. The behavior of prices and of interest rates had been similar among the industrial countries, and he suspected that speculative developments of the kind he had described had occurred in other countries as well as in the United States.

Mr. Mitchell commented that at a recent meeting at the Cleveland Bank, several industrial representatives had reported that their export business had been very strong. He wondered whether U.S. exports were benefiting from the current situation of floating exchange rates, given the unique role of the dollar in the international system.

Mr. Wallich remarked that, according to one theory, it took about 2 years for a depreciation of a currency to have a significant effect on exports. In part because export volumes and prices did not respond promptly, the initial effects of a depreciation on the trade balance were likely to be perverse.

Mr. Hayes observed that a substantial depreciation of the dollar had occurred in mid-1973, and that might be contributing to the current strength of exports.

Mr. Eastburn asked whether it was correct to conclude that the projection of economic activity would not differ greatly if one assumed that the tax reduction proposals of the Senate rather than those of the House would eventually be enacted.

In response, Mr. Gramley said it was difficult to evaluate the Senate's proposals because of the provision for tax credits on purchases of new houses. However, the staff had estimated that the additional stimulus represented by the Senate's proposals would add less than 1 per cent to nominal GNP by the second quarter of 1976.

Mr. MacLaury asked what was implied for the level of short-term interest rates at the end of this year by the staff's assumption regarding the rate of monetary growth and its projection of nominal GNP.

Mr. Gramley responded that under alternative A--which had been assumed for purposes of the GNP projection--growth in M_1 would be at a 6 per cent annual rate in the fourth quarter, compared with a 13 per cent rate of growth in nominal GNP. In fact, growth in nominal GNP was projected to exceed growth in M_1 throughout the second half of this year and the first half of next year. The staff had assumed that short-term interest rates, following some further decline in the second quarter, would rise cyclically, as is typical of recovery periods when velocity increases. Treasury bill rates were assumed to approach 8 per cent in the fourth quarter, and to rise further to about 8-1/2 per cent by the middle of next year.

Mr. Axilrod added that even if the Federal funds rate were held at the alternative A level through the third quarter, the Treasury bill rate and other short-term rates would begin to rise because of the volume of Treasury financing in that period.

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 19 through March 12, 1975, and a supplemental report covering the period March 13 through 17, 1975. Copies of both reports have been placed in the files of the Committee.

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

Trading Desk operations since the last meeting of the Committee have been directed at producing a reserve climate that would encourage moderate growth in key monetary aggregates. To this end, reserves were provided through a variety of means in the early part of the interval, including outright purchases of \$692 million in Treasury coupon issues and Federal agency obligations, along with outright bill purchases and day-to-day repurchase agreements. In this effort, the Federal funds rate was gradually worked down to around 6 per cent midway in the period, from 6-1/4 per cent at the start.

Later in the period, Desk efforts were directed chiefly at absorbing part of the large release in reserves caused by the sharp rundown in Treasury cash balances at the Federal Reserve. This rundown proceeded to the point where the Treasury had to borrow a peak total of \$1,042 million directly from the System on March 12 through special certificates of indebtedness. The reserve absorption was accomplished partly through outright sales of Treasury bills to foreign

accounts and redemptions of some maturing bills, but mainly through use of matched-sale purchase transactions. While it was planned in the latter part of the period to encourage the Federal funds rate to ease down gradually to the 5-3/4 per cent midpoint of the range specified at the February meeting, the decline proceeded more quickly than intended--partly because of sharper than expected Treasury cash outflows--and most funds trading in the past week has been at rates in the neighborhood of 5-1/2 per cent.

Reserve targets were shaped against a rather satisfactory performance of the aggregates, except for the bank credit proxy. As the period unfolded incoming data pointed to a gradual strengthening in M_1 growth, with the most recent estimates around 7 per cent for the February-March period, well up in the desired range. Meanwhile, for the 2 months, M_2 is estimated to be growing at a rate a little over 9 per cent, slightly above the Committee's range. In contrast, because of weakness in CD's and Euro-dollar borrowings, the bank credit proxy is estimated to be declining slightly for the 2 months.

While Federal funds rates tended downward in recent weeks and economic news remained weak, some other rates have increased--responding to pressures of current and prospective market supplies of securities and to concern that the System's thrust toward ease was abating. The market in Treasury coupon securities weakened perceptibly after the Treasury's February 24 announcement of its plan to raise \$7 billion by mid-April by offering five coupon issues. The announcement followed by only a few days a \$3 billion sale of two short-term notes--making a total of \$10 billion in Treasury coupon issues to be sold in a span of several weeks. Two of the five issues announced on February 24 were bid for last week--a 6-year, 8-month note that went largely to dealers and a 14-month note that went mainly to banks and other investors. A 2-year issue is being bid for today, while a 15-year bond is to be auctioned on Thursday. The fifth coupon issue will be another short-term note.

The Treasury has made it clear that heavy additional sales will follow in the April-June period and on into the next fiscal year, given the enormous projected deficit. So far, sales have gone well, as dealers have been willing

to take on sizable inventories in anticipation of a continuing accommodative policy climate, although there have been occasional back-ups in yield including some fair-sized moves yesterday. Since the last meeting date, yields are up about 15 basis points in the 2-year area, 30-40 basis points in the 5-7 year area, and 25-30 basis points in the long-term sector. Customers have shown good interest in the shorter maturities and it remains to be seen whether they can be induced to take longer maturities on the scale the Treasury would like.

The bill market also has experienced additions to supply as the Treasury has added some \$400 to \$600 million to each weekly bill offering. Sizable foreign purchases and bank investment purchases have helped absorb these additions, and rates have shown little net change over the period. Yesterday, 3- and 6-month bills were auctioned at about 5.38 and 5.47 per cent, respectively, virtually unchanged from the rates in the auction preceding the last meeting.

Supplies of new debt issues also have been very large in the corporate sector, with a record volume expected for March, and there has been sporadic indigestion. The appearance of some rarely seen major industrial names among issuers of debt suggests that sophisticated market observers regard this as a good time to obtain long-term money before rates go higher. Utilities have also been heavy issuers, and high quality firms have had to pay about 30-35 basis points more than a month ago.

The tax-exempt sector has seen a rise in yields too, but has been especially notable for its heightened concern over quality following the failure of New York State's Urban Development Corporation to repay a maturing note issue, and New York City's difficulties in obtaining underwriter bids and final investor demands for its issues.

Looking to the period ahead, the reserve picture continues to be dominated by swings in Treasury cash balances. The rebuilding of such balances anticipated today and tomorrow should create a large reserve need for at least a week or two. Some of this can appropriately be met through purchases of Treasury coupon and agency issues. Another big rundown in Treasury cash balances is anticipated in early April, possibly requiring renewed use of the special borrowing facility and substantial use again of matched-sale purchase transactions to drain reserves.

Finally--a housekeeping note--we have added Goldman Sachs and Company to the list of dealers for System operations. This brings the number to a record 27, including 11 bank and 16 nonbank dealers.

Mr. Coldwell noted that the Desk had absorbed a substantial volume of reserves in recent weeks largely through frequent matched sale-purchase transactions. He wondered, first, whether the Desk viewed the reserves it had been withdrawing as representing transitory or permanent additions to the supply, and second, why the Desk thought it necessary to operate so persistently on the absorption side, even to the extent of producing a net reduction in total reserves over the period.

Mr. Sternlight replied that the operations in question had been a function primarily of the sharp swings in Treasury cash balances, which were regarded as a transitory phenomenon. The Treasury balance had been in the \$3 billion range at the beginning of the inter-meeting interval, but by March 12 the Treasury had drawn down its balance and in addition had borrowed over \$1 billion from the System. The huge volume of reserves released in that process had to be absorbed by the System if the Federal funds rate were not to decline to minimal levels. Indeed, as he had mentioned earlier, the rundown in Treasury balances had proceeded somewhat faster than expected, so that despite the operations in question the funds rate had dropped below the 5-3/4 per cent level the Desk had been seeking to maintain.

Mr. Coldwell asked whether market participants would have been misled about the System's policy stance if the Desk had not absorbed the reserves supplied temporarily by the rundown in Treasury balances.

Mr. Sternlight replied that market participants no doubt would have understood that the rise in excess reserves and the drop in the funds rate were caused by the reduction in the Treasury balance, and in that sense they would not have been misled. However, for a week or two the funds rate would have been far below the level the Committee had specified--perhaps as low as 1 or 2 per cent.

Mr. Axilrod added that under similar circumstances in the past the Desk had always entered the market to absorb reserves. Accordingly, participants undoubtedly would have interpreted a failure to do so now as a clear signal of a change to a policy of tolerating considerably lower interest rates.

Mr. Hayes remarked that Mr. Coldwell's question raised a fundamental issue, since it suggested a desire to discontinue the procedure the Committee had been following for some time of placing a constraint on fluctuations in the Federal funds rate. The Committee could, of course, operate in an entirely different way.

Mr. Coldwell commented that the Committee could take a longer view of the funds rate constraint, permitting the rate to fluctuate more widely over short periods.

In response to a question by the Chairman, Mr. Coldwell said he had reservations about the desirability of large-scale System operations on both sides of the market simply to smooth out transitory fluctuations. While he would agree that such operations did no real damage, he also thought that no significant damage would have been done if the transitory fluctuations had been permitted to occur.

Mr. Black asked whether, in light of the recent behavior of price indexes, the inflation premium in long-term rates appeared to be diminishing sufficiently to facilitate absorption of the projected huge volume of long-term borrowing.

Mr. Sternlight said the abatement of inflation appeared to have been a factor stimulating investor interest in long-term issues a month or two ago, when some longer-term rates had been declining. In his judgment, the recent backup in long-term rates in the corporate and Government markets reflected primarily the expectations of a heavy volume of debt issues and not of renewed inflationary pressures.

Chairman Burns observed that the extraordinarily heavy volume of corporate financing obviously had worked in the direction of raising interest rates. He also thought that in recent weeks market participants had become increasingly aware of the huge amount of Treasury borrowing in prospect; a few weeks ago they had been

thinking in terms of a budget deficit in fiscal 1976 of \$50 billion or so, but they had gradually come to realize that the deficit was more likely to be in the neighborhood of \$75 or \$80 billion. He would not attempt to assess the relative importance of those two factors in recent interest rate developments, and he suspected that no two market analysts would agree precisely on what weight to assign to each.

In response to the Chairman's question, Mr. Axilrod agreed that the factors the Chairman had mentioned--the prospective corporate bond volume and budget deficit--had been the principal causes of the recent upturn in long-term rates. He thought the abatement of inflationary expectations had been a favorable influence in the market, as Mr. Black had suggested; while it was difficult to prove, he believed that without the improvement in inflationary prospects, long-term rates would have been considerably higher than they were now. He noted in that connection that yields on corporate bonds were currently about 1-1/4 percentage points below their 1974 peak levels, even though the market had been absorbing a huge volume of new issues.

Mr. Holmes said he also thought the evidence of slackening inflation had been helpful to the bond market. On the other hand, he believed that the magnitude of the budget deficit in prospect had aroused fears in the minds of many that a new outburst of inflation might occur before the end of the year.

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Mr. Mitchell observed that three-fourths of the net increase in System holdings of securities since the last meeting had been in the form of coupon issues with maturities of more than one year. That was considerably higher than the relative importance of such issues in the System portfolio; of the total portfolio of \$85 billion, coupon issues with maturities of more than one year accounted for about \$37 billion, with the remaining \$48 billion consisting of Treasury bills and short-term coupons. He wondered whether, in light of the heavy volume of longer-term issues to be marketed, the Desk planned to enlarge the System's holdings of such issues to some specific percentage of the total portfolio, perhaps 50 per cent.

In reply, Mr. Sternlight said the Desk's purchases would depend on the availability of various types of issues at times when there was a need to supply reserves. He did not think the Desk would adopt any particular goal in terms of portfolio composition.

Mr. Eastburn asked whether one could assume that the Desk would also have objectives with respect to longer-term interest rates in mind in deciding whether to lean toward purchases of coupon issues in its reserve-supplying operations.

Mr. Sternlight replied that that would be one of the factors taken into consideration. There also would be other factors; for example, efforts customarily were made to avoid direct effects on the

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yields of issues with maturities similar to those involved in Treasury financings. However, it might be necessary to give that constraint less weight than in the past, in light of the frequency with which the Treasury would be coming to market.

In response to a question by Mr. Coldwell, Mr. Sternlight said his comments applied to agency issues also. He noted, however, that agencies' demands for funds in the market were now rather moderate, particularly in comparison with the Treasury's demands. During 1974 that situation had been reversed, and the System's holdings of agency issues had increased substantially.

Mr. Mitchell observed that dealers currently held a large volume of coupon issues. He wondered if they seemed anxious about their inventory positions.

Mr. Sternlight said he thought dealers might feel a little anxiety on that account. However, they were not distressed at this point, since they remained hopeful that an accommodative policy stance would foster a degree of market demand--particularly by commercial banks--that would lighten their inventory burden as time passed.

In reply to a question by Mr. Eastburn, Mr. Sternlight remarked that a Committee desire to have some effect on long-term rates presumably would call for Desk purchases of coupon issues in considerable volume. He might note, however, that while System

operations undoubtedly could make some contribution, he did not think they could have an effect of the magnitude that some observers evidently believed.

Mr. Wallich observed that econometric evidence did not support the proposition that Federal Reserve operations could have a fundamental effect on long-term interest rates.

Mr. Axilrod remarked that some analyses undertaken during the days of "operation twist" had suggested that shifts in System security holdings from bills to coupon issues had only a small impact on longer-term rates. As he recalled it, the effect was about 5 basis points for every billion dollars shifted.

Mr. Eastburn commented that the current situation might call for operations aimed not at reducing longer-term rates but at preventing the dramatic increases that might otherwise result from the flood of coupon issues coming to market.

Chairman Burns said it would be helpful to have a staff memorandum on the subject, summarizing past studies, analyzing past experience, and offering suggestions for the future. He thought the Committee might want to give some specific attention to that topic at its next meeting.

Mr. Coldwell said he hoped such a memorandum would deal not only with interest rate relationships but also with questions of supply in the market and System portfolio strategy, including

the possibility of Desk sales as well as purchases of coupon issues.

Mr. Holland commented that, in his judgment, a strong argument could be made for occasional sales of at least modest amounts of all types of instruments the System held so that it was not exclusively a buyer in any major category.

The Chairman suggested that the points just raised be taken into consideration in the staff study.

Mr. Morris noted that the Federal funds rate had been in the neighborhood of 5-1/2 per cent for the past 10 days or so. He asked about the likely market reaction to an increase in the rate to 5-3/4 per cent, the midpoint of the range suggested under alternative B.

In reply, Mr. Sternlight observed that market participants recently had seen the Desk act to absorb reserves when the funds rate was at the 5-1/2 per cent level, and so probably were still assuming that the objective lay in the 5-1/2 to 6 per cent area. Nevertheless, he thought there would be some disappointment in the market if the rate were actually to rise to 5-3/4 per cent, partly because some participants hoped to see a continued downdrift to levels below 5-1/2 per cent.

Mr. Bucher asked about the likely reaction if the funds rate stabilized at about 5-1/2 per cent for several weeks, as it might if the Committee adopted the specifications of alternative A.

Mr. Sternlight said he would expect such a development to have a neutral effect for a while. After some point, if the rate remained stable, there might be some disappointment. However, that was difficult to predict.

By unanimous vote, the System open market transactions in Government securities, agency obligations, and bankers' acceptances during the period February 19 through March 17, 1975, were approved, ratified, and confirmed.

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

I would like to add three points to the analysis presented in the blue book.

(1) For the first time in a couple of months, the monetary aggregates very recently have not fallen short of staff projections in the interim between Committee meetings. This gives me some confidence that we may be getting back to the place where the midpoint of the Federal funds rate range has more operational significance than at recent meetings. I would note, though, that an acceleration of income tax refunds did contribute to private deposit expansion in February, and we have also allowed for that in March.

(2) The patterns for the monetary aggregates and interest rates shown in the three alternatives depend in good part on the projected rebound of economic activity beginning in the third quarter. For example, the large transactions demands for money in the third quarter that would be associated with such a rebound limit the extent of the interest rate decline needed to achieve monetary growth rates for the February-September period under alternative A and enable the growth rates of alternative B to be achieved without further interest rate declines. If the Committee wishes to move toward the longer-run growth rates of alternative C, it appears to us that short-term interest rates would have to begin rising significantly now rather than later in the year.

(3) As a final point, I would note that the alternatives presented show more growth in the broader monetary aggregates relative to M_1 than was the case at the last meeting. For instance, alternative A reproduces the longer-run M_1 growth rates implicit in the specifications adopted by the Committee at the last meeting, but growth rates for M_2 and M_3 are about 1-1/2 percentage points higher, at an annual rate, in the second and third quarters. Alternative B, which has a slower longer-run M_1 growth rate, contains an expansion in M_2 and M_3 that is virtually the same as that implicit in the specifications chosen by the Committee at its last meeting. The reasons for this are two: (a) banks and thrift institutions have recently been experiencing larger net inflows of time deposits than expected; and (b) looking ahead, with the staff projecting less of an increase in prices, any assumed expansion in M_1 would be accompanied by a little more downward, or a little less upward, pressure on market interest rates and would therefore be accompanied by better time and savings deposit inflows than otherwise.

Mr. Bucher referred to the statement in the blue book that under alternative A a decline in the funds rate to about 5 per cent--the midpoint of the indicated range--would be anticipated over the next few weeks. He asked about the basis for that statement, given that the alternative A range of tolerance for growth in M_1 in the March-April period was 5 to 7 per cent and the current projection for M_1 growth in March was 7.2 per cent.

Mr. Axilrod replied that the funds rate range was predicated not only on current projections but on the likely course of developments over several months ahead. The longer-run targets for M_1 shown under alternative A in the current blue book were the same as those shown under alternative B in the previous blue book, and the midpoint

of the funds rate range was nearly the same; it had been lowered by one-quarter of a percentage point because of the reduced price pressures projected for the third quarter. He might add that while the Committee had adopted the longer-run targets of B at the February meeting, it had specified a higher range for the funds rate than shown under B in the previous blue book.

Mr. Partee added that the 7.2 per cent M_1 growth rate now estimated for March was not inconsistent with a March-April rate near the midpoint of a 5 to 7 per cent range, since M_1 growth was expected to slow in April.

Mr. Bucher said he understood that but was still not sure how the Desk would operate if the projections were realized. It seemed to him that if M_1 appeared to be growing over the next few weeks at a rate near or above the upper limit of the specified range, the Desk would be inclined to allow the funds rate to remain at the current 5-1/2 per cent level rather than to permit it to decline to 5 per cent.

Mr. Holmes indicated that, while the Desk would put a little more weight on actual developments in March than on projections for April, it would focus primarily on estimates of the 2-month average. If the 2-month average were at the midpoint of its range, under normal procedures the Desk would aim at a funds rate at about the midpoint of its range.

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Mr. Hayes remarked that the large banks in his District continued to be reluctant to invest in securities or to become more aggressive lenders because of their over-all loan loss position, quality of assets, and capital position. He wondered about the extent to which such reluctance was influencing the System's ability to expand the monetary aggregates.

In reply, Mr. Axilrod noted that in recent weeks banks had expanded their investments rather substantially; for example, during the week ended March 5 Treasury securities held by all weekly reporting banks increased by about \$1.1 billion, nearly twice the amount recorded in the comparable period a year ago. At New York City banks, however, the increase was only modestly larger than in the previous year.

Chairman Burns remarked that the substance of Mr. Hayes' question could be stated another way: would the banks use the reserves supplied by the System or would they permit excess reserves to pile up? He would expect the banks to use most of the reserves supplied.

Mr. Holmes observed that, so long as banks preferred to reduce debt rather than increase loans or investments, they would be reluctant buyers and eager sellers of Federal funds, and thus would tend to push the funds rate down below the levels desired by the Committee. It seemed to him that excess reserves could not be

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forced on the banking system as long as the Federal funds rate was positive.

Chairman Burns then called for the discussion of monetary policy and the Committee's policy directive.

Mr. Mitchell observed that he was uncertain about the appropriate course for monetary policy because of the uncertainty concerning the size of the fiscal stimulus. A budget deficit of as much as \$100 billion--which the Chairman had suggested might materialize--was stupendous. It left him wondering whether monetary policy should not focus simply on ensuring that the rate of inflation would continue to decline, with the objective of stimulating the economy put aside altogether. He could make a case for such a course, if he were certain that the fiscal stimulus would be that large.

Confronted with that dilemma, Mr. Mitchell said, it was easy for him to focus on the very short run and on the public relations problems confronting the System, which led him to want some further decline in short-term interest rates. Apart from the public relations effects, a decline in market interest rates relative to the Regulation Q ceilings would increase the attractiveness of savings deposits relative to demand deposits. While that would produce a wave of demands that the ceilings be reduced,

those demands could be resisted, and there were aggressive people in the thrift institutions who would keep the deposit rates up. Inflows of funds would increase further, and the banks and the other thrift institutions would thus be under pressures to take the sorts of actions that would bring down long-term rates. He had doubts that housing starts would rise as much as projected by the staff if mortgage interest rates were as high as 8-1/2 or 8-3/4 per cent. And he believed that the public utilities were delaying capital investments because of the current level of long-term rates.

Accordingly, Mr. Mitchell said, he favored a Federal funds rate constraint between the ranges shown under alternatives A and B. Specifically, he favored a range of 4-3/4 to 5-3/4 per cent, and he would move the rate down to 5-1/4 per cent in an effort to reverse the recent backing up of long-term rates. In the period immediately ahead, he would not permit the behavior of the aggregates to be a constraint on operations--even if the rate of M_1 growth in the March-April period rose to as high as 8 or 10 per cent, which was not being projected. With regard to the language of the directive, he would prefer to take monetary growth in February and so far in March as a base and to call for "somewhat more rapid growth in monetary aggregates over the months ahead than is currently being experienced." However, he did not feel strongly about the directive language.

Mr. Sheehan observed that at the February meeting--which he had had to leave shortly before the vote on domestic policy--the Committee had adopted the specifications for the aggregates shown in the February blue book under alternative B, including a target for the annual rate of growth in M_1 over the first 9 months of 1975 of 6 per cent. For the Federal funds rate, the Committee had chosen a range of 5-1/4 to 6-1/4 per cent, and at present the funds rate was about 5-1/2 per cent. In the current blue book, the 9-month M_1 target of 6 per cent was shown under alternative A, in association with a funds rate range of 4-1/2 to 5-1/2 per cent. While alternative A ordinarily involved an easing of policy, this time it represented a continuation of present policy, at least in terms of the longer-run target for M_1 . It was true that under A more rapid growth in M_2 was anticipated over the 9-month period than reflected in the February specifications, because market interest rates were expected to be lower.

The question in his mind, Mr. Sheehan continued, was whether the alternative A policy was easy enough. He thought the Committee should consider another alternative--which might be called "A prime"--involving a range of 4 to 5 per cent for the Federal funds rate. That might result in M_1 growth over the first 9 months of the year at a rate of 6-1/2 or 6-3/4 per cent, if the recovery in economic activity proceeded along the lines indicated

by the staff's GNP projections. In his judgment, however, those projections were over-optimistic; even though a strong fiscal stimulus was in prospect, recovery was not assured and all of the risks were on the downside.

Mr. Sheehan remarked that the Committee's objective should be to produce financial conditions conducive to economic recovery--in old-fashioned terms, to create a "tone and feel" in the market that would lead banks to become more aggressive lenders by providing reserves more aggressively. According to the staff projections, the unemployment rate would remain above 9 per cent and the rate of capacity utilization in manufacturing would not exceed 69 per cent over the coming four quarters. Free markets had been functioning surprisingly well recently, and the rate of inflation was coming down rather sharply. Under such circumstances the strong stimulus needed could be provided with little risk of regenerating inflationary pressures; monetary policy could err on the side of ease in the months immediately ahead with little danger of doing lasting damage, so long as the Committee followed appropriate policies next autumn.

As had been noted, Mr. Sheehan observed, longer-term interest rates were backing up, despite sharply lower rates of increase in prices of goods and services and a sharp reduction in inflationary expectations. In his view, longer-term rates

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were backing up not only because of very heavy offerings of corporate securities and the large Treasury financings in prospect but also because market participants now had the impression that the System would not ease policy significantly further. The Committee should make it clear by its actions that it was still pursuing an accommodative policy. Sustained recovery depended on an improved atmosphere and a greater availability of funds in the long-term markets, including the mortgage market. In the corporate sector, where profitability had declined and liquidity ratios had deteriorated, financial market conditions should be such as to encourage the long-term debt and equity financing that would permit the repayment of short-term liabilities and the rebuilding of working capital. If the Committee adopted alternative B or C and long-term interest rates rose further, many corporations would postpone financing operations and the recovery in economic activity would be further delayed.

Accordingly, Mr. Sheehan observed, he would like to assure that policy in the period ahead would not be too tight. He would retain the longer-run target of a 6 per cent growth rate in M_1 over the first 9 months of this year, along with consistent rates of growth for the other aggregates. To achieve that objective, M_1 would have to grow at an 8 per cent rate over the period from February to September. For the short run, he favored a lower range for the Federal funds rate and higher 2-month

ranges of tolerance for the monetary aggregates than those shown under alternative A in the blue book. Specifically, he favored a Federal funds rate range of 4 to 5 per cent, and ranges of 7 to 9 per cent and 10 to 12 per cent for M_1 and M_2 , respectively.

Chairman Burns observed that in making his earlier remarks on long cycles he had omitted a concluding comment in order to avoid deviating from the customary procedure of discussing the economic situation first and then monetary policy, and he would make that concluding comment at this point. By and large, the economists and politicians who now were advocating such far-reaching measures as budget deficits in the range of \$80 to \$100 billion and monetary growth rates of 8 to 10 per cent were the ones who had launched the economy on an inflationary wave in 1965. They were the people who in 1967 had become frightened and who had overreacted to the wavering of the economy at that time. They were the ones who had overreacted to the recession of 1969-70. They were the counselors who, in his judgment, had badly misled the country in the past.

Continuing, the Chairman remarked that he received an enormous amount of mail, and the great majority of letters arriving in recent weeks praised the Federal Reserve's monetary policy.

The Federal Reserve was now widely viewed as the one institution that is seriously concerned about the integrity of the country's money and that seeks to take a longer-range view of the nation's economic problems. In his judgment, the fiscal and monetary policies being advocated by some economists might, if followed, generate insistent demands for credit allocation before this year was over. The demands might become insistent because the Federal Government would be such a large factor in the debt market. Hence, interest rates might be rising appreciably, if the staff projections of economic activity proved to be valid. Since private borrowers might be crowded out of the market, it would be only natural on the part of concerned politicians and economists to urge credit allocation. If that happened, it might be the beginning of a decline of the nation's private economy.

The Chairman said the Federal Reserve had a great responsibility to protect the country at a time when many people were emotional about the subject of unemployment and recession. As far as he could see, budget deficits would persist for several years. A deficit of \$80 to \$100 billion was definitely in the making for fiscal 1976, and as things were shaping up, that deficit might be followed by other deficits in the neighborhood of \$50 billion a year. Consequently, the Federal Reserve had run out of good options and

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had no choice but to follow a moderate course. If he believed that the Committee could slow monetary growth after having stepped up the rate for a few months, he might well go along with the prescription to step it up for a time. But it would probably be very difficult to slow growth later; for the economy might still not be in recovery, or the recovery might appear to be so delicate, fragile, and uncertain that it would be hard to face up to a course that would bring about rising interest rates at that time.

Accordingly, the Chairman concluded, the Committee should stay on its present course, which was a responsible one. He would suggest a range of 5 to 6 per cent for the funds rate in the period until the next meeting. For the March-April ranges of tolerance for the aggregates, he would suggest the lower limits of alternative B and upper limits higher than those of alternative B; thus, he would suggest an upper limit of 7-1/2 or even 8 per cent for M_1 and corresponding upper limits for the other aggregates.

Mr. Eastburn remarked that the Chairman's comments concerning the dangers of over-reacting were well taken and should be borne in mind. It should also be borne in mind, however, that for several months the Committee had not achieved its objectives with respect to growth in the monetary aggregates. At recent meetings he had advocated alternative A, because the economy

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needed some stimulus and because shortfalls in monetary growth needed to be made up. It was becoming more difficult now to maintain that position, for two reasons: the economy was closer to a turning point, whenever it might occur, and at some time it would be necessary to forego the effort to make up for past shortfalls in monetary growth.

In considering the problem, Mr. Eastburn observed, three risks had to be weighed. First, there was the possibility that economic activity would recover more rapidly than expected. However, he believed it more likely that recovery would be slow and that the unemployment rate would remain high. Moreover, inflationary pressures were likely to lessen to a degree that many might find surprising. Accordingly, the main risk seemed to him to be of too little, rather than too much, expansion. Second, concern had been expressed at times in the past--by himself as well as others--that shortfalls in monetary growth would be followed by rebounds that were difficult to control. However, some recent analysis at his Bank indicated that there was no historical support for that concern. Thus, efforts to raise the rate of monetary expansion did not need to be held back now out of a fear of uncontrollable growth in the near future. Third, there was some concern that later in the year interest rates would rise sharply at a time when the unemployment rate was still high, generating awkward

problems for the System. However, projections of flows of funds--green book projections for the period through the second quarter of this year and others going beyond that period--suggested that private credit demands would not be very strong, and that the total of public and private demands for funds would result in only modest increases in interest rates later in the year.

Weighing all the risks, Mr. Eastburn said, he again favored the A alternative. At some time in the future, depending on the course of economic activity and the behavior of the aggregates, a shift toward a more moderate position would become necessary, but for the time being the rates of monetary growth under alternative A were still appropriate. He agreed with Mr. Sheehan that errors should be on the side of ease. And like Mr. Mitchell, he would raise the upper limit for the M_1 short-run range of tolerance shown under alternative A.

Mr. Bucher observed that, while he would not claim to have the best perspective concerning Congressional actions on taxes and expenditures, he had perceived in his nearly 3 years in Washington that the Congress seldom did what he anticipated and that the legislative process generally consumed more time than expected. Accordingly, in his view, there were serious questions as to whether the Congress would take actions that would have a major impact on economic activity before the autumn. Concerning the

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interaction between fiscal and monetary policies, he recognized the danger that System actions would be too accommodative and would thereby exacerbate the longer-term problems that would be created by overly expansive fiscal actions. However, he was more concerned about the danger of monetary policy being perceived as too restrictive, thereby encouraging Congressional action to bring about the overly stimulative fiscal policy that many Committee members were concerned about.

Chairman Burns remarked that the risk which concerned Mr. Bucher was within the realm of possibility. To the best of his knowledge, however, there was no evidence to support the view that the spending or tax-cutting propensities of Congress were being influenced at all by the reactions of Congressmen to the System's policy.

Continuing, Mr. Bucher said he wholeheartedly endorsed Mr. Sheehan's remarks. He would emphasize in particular the encouraging evidence that the rate of inflation was slowing, and it was likely that the price indexes were understating the degree of improvement that had occurred. He shared the concern about prospects for housing and for corporate capital spending in the event that the System did not provide additional accommodation in the form of lower long-term interest rates. With that in mind, he would tolerate acceleration in monetary growth--even to two-digit

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rates for a fairly short period of time--until some actual benefits became evident. Until such benefits materialized, every effort should be made to avoid a backing up of interest rates and to provide sufficient reserves to encourage expansion of credit.

With respect to the alternatives shown in the blue book, Mr. Bucher observed that in his opinion none represented a move toward further ease; he was not persuaded that even the alternative A specifications would bring about a reduction in interest rates or the provision of additional reserves. He agreed with the Chairman's suggestion to raise the upper limit of the 2-month ranges for the aggregates, but felt that it was necessary at the same time to reduce the range for the funds rate. Specifically, he favored the 4 to 5 per cent range of Mr. Sheehan's alternative "A prime." For the operational paragraph of the directive, the language of alternative B appeared to be the most appropriate for the policy action he favored.

Mr. Hayes said there was no question that recent Federal Reserve policy had been subject to unusually sharp public criticism as a result of the rather prolonged period of sub-normal growth of the monetary aggregates at a time when economic activity had been weakening pervasively and unemployment had been rising. To his mind, however, much of the criticism reflected public oversimplification

and overemphasis on the importance of the money supply as the measure of appropriate policy, and to some extent the Committee had contributed to that state of affairs through its own swing in recent years toward the monetarist concentration on the money aggregates.

Much of the aggregates' weakness, Mr. Hayes remarked, no doubt reflected the severity of the business decline itself, and the latter in turn was probably an inevitable result of the kind of excesses the economy had been developing in a period of overheating and severe inflation. He did not accept the thesis that the severity of the recession was attributable largely to too tight a monetary policy.

Continuing, Mr. Hayes observed that very real progress was at last being made in checking the pace of inflation, and that gave some leeway for further easing of policy. But he was far from convinced that the specter of serious inflation had really been banished from the scene, especially with the highly stimulative fiscal policy in prospect. Also there were a number of hopeful signs, including the tone of the red book,^{1/} suggesting that the economy might be beginning to generate the seeds of recovery. And he saw little merit in driving short-term rates so low that a very sharp increase would be inevitable later on when enormous deficit financing began to have real impact on the

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

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market. In view of the well-known lags involved, very active easing at present might bring about excessive growth of money just when the economy was beginning to recover anyway and when fiscal stimulus was providing a strong upward push. Also, he would hate to see the System ignore the perils of again weakening the dollar in the foreign exchange markets. Some improvement had occurred, but the dollar was still quite vulnerable, and there were perils in terms of revived domestic inflationary fears and lessened confidence in that important international vehicle for trade and investment.

Mr. Hayes said all of those considerations led him to suggest a very moderate approach to current policy formulation. The System could afford to edge a little further in the direction of ease. He saw no compelling reason to change the longer-range, December-June targets that were adopted last month. For the 2-month targets, he could accept alternative A for M_1 --or perhaps a range with an upper limit even higher than 7 per cent--and either alternative A or B for M_2 . He would add a 2-month target for the credit proxy of at least 5 per cent, hoping that banks would begin to expand loans and investments more than they had been. As for the Federal funds rate, he would be extremely cautious; like the Chairman, he favored a range of 5 to 6 per cent. For the near term, he would hold the rate around the current level of

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5-1/2 per cent unless the aggregates showed unexpected strength. He would prefer the language of alternative B. However, in recognition of the more buoyant behavior of the aggregates in February, the language of the directive might be modified slightly to call for, "...bank reserves and money market conditions consistent with more rapid growth in monetary aggregates over the months ahead than has occurred on average in the past several months."

Mr. Hayes added that since the last discount rate reduction had been in place only for the past couple of weeks, it seemed to him that another cut would be inappropriate for the immediate future. That picture could change if market interest rates were to drop substantially further in the next few weeks. Concerning a cut in reserve requirements, he was somewhat on the fence, having in mind, on the one hand, the desirability of encouraging bank credit expansion and mitigating the handicaps of System membership and, on the other hand, the reduction in System capacity to absorb Treasury securities.

Mr. Balles remarked that he would be opposed to accelerating growth in M_1 to a 10 per cent rate, as some economists were recommending. For some months, however, he had been concerned that over the period since last September there had been a cumulative shortfall in monetary growth from the Committee's targets. The substantial rise in unemployment since last summer and the

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decline in the rate of inflation permitted the Committee to make up for the shortfall to some extent, although a difficult trade-off question was involved. There were risks in letting interest rates fall too low, both because of the international repercussions and the resistance that might be encountered later on in the year to permitting interest rates to rise before the recovery was well under way. It also had to be recognized, however, that there were costs stemming from the cumulative shortfall in monetary growth. A simulation that had been done at the San Francisco Bank suggested that at the end of this year real GNP would be substantially lower and the number of persons unemployed would be about 500,000 greater than if M_1 had grown in accordance with the 5-3/4 per cent longer-term path adopted by the Committee in September.

In that connection, Mr. Balles observed, the absolute levels of M_1 were significant. At the January meeting the longer-run target under alternative C would have resulted in an M_1 level of nearly \$291 billion by June of this year. Actually, the Committee adopted the somewhat higher target of about \$292 billion under alternative B. At the time of the February meeting, the June level of about \$291 billion was associated with alternative B. Now, the Committee would have to adopt alternative A in order to

achieve that level in June. And as had been indicated earlier in response to his question, if the staff projection had been based on the longer-run M_1 growth rate of alternative B or C--rather than that of alternative A--the projected level of real GNP would have been lower by 1 and 1-1/2 per cent, respectively, in the second quarter of 1976, the last quarter of the projection period.

Accordingly, Mr. Balles said, he believed that alternative A would not be an overly stimulative policy at this time; adoption of that alternative would, in fact, merely reconfirm the targets that the Committee had adopted some months ago. If the achievement of the longer-run targets of alternative A required a decline in the Federal funds rate to a level within the alternative A range of 4-1/2 to 5-1/2 per cent in the period immediately ahead, he was prepared to accept that level.

Chairman Burns remarked that for some time Committee discussions had been unduly focused on M_1 . In his view, M_4 --which included currency in circulation and all deposits in all financial institutions^{1/}--was a more meaningful measure of liquidity than M_1 , particularly because of the rapid changes in financial technology. As indicated in the blue book, growth in M_4 had shown an impressive degree of stability; M_4 had grown 9.1 per cent in the calendar year 1974, 8.7 per cent in the 12 months ending in February 1975, and at annual rates of 7.9 per cent in the 6 months ending in February,

^{1/} Secretary's note: This measure was later redesignated as M_5 .

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9.2 per cent in the 3 months ending in February, and 8.9 per cent from January to February.

Mr. Bucher observed that in considering the importance of various measures of the money supply it was important to note that the proportion of time deposits with longer maturities had increased substantially; in the case of the nonbank thrift institutions, for example, time deposits with maturities longer than one year now accounted for more than half of the total. He wondered whether in view of the substantial--almost prohibitive--penalties for early withdrawal of such time deposits, they should be regarded as liquid assets available to meet transactions needs.

The Chairman commented that the issue of what to include in the concept of the money supply was debatable. In his view, the penalties for early withdrawal of time deposits were not prohibitive, and he believed that holders of certificates of deposit regarded them as virtually the equivalent of money.

Mr. Mayo said it was gratifying that, for the first time in quite a while, M_1 appeared to be growing in the latest 2-month period within its specified short-run range of tolerance. Nevertheless, it was too soon to feel relaxed about the rate of monetary growth. In that light, he favored alternative A, which continued the 6 per cent rate of growth for the period from December 1974 to September 1975 that was implicit in the longer-run targets

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adopted at the February meeting. The decline in the Federal funds rate associated with that alternative was modest. However, he would widen the range by raising the upper limit; thus, he would specify a range of 4-1/2 to 6 per cent, which had the same midpoint as the range suggested by Mr. Mitchell. There was no real danger that such a prescription would drive short-term rates down. The Committee could adopt alternative A without running a risk of over-stimulating the economy; adoption of alternative B would represent a premature move toward restraint. He believed that Congressional action on tax reduction was not imminent and that, as the situation developed during the year, fiscal policy would not be quite so bad as the Chairman had indicated.

Concerning the language of the directive, Mr. Mayo remarked that both alternatives A and B were acceptable with one amendment. For the final words "in recent months," he would substitute "on average in the past several months," as Mr. Hayes had suggested, or "during the past 6 months."

Mr. MacLaury remarked that, as Mr. Balles had observed, the longer-run targets under alternative C at the January meeting were associated with alternative B at the February meeting and with alternative A at this meeting. Because he gave a great deal of weight to the behavior of the aggregates, he felt that to favor alternative A today, as he did, was the same as favoring alternative C at the January meeting.

Continuing, Mr. MacLaury commented that he was wary of giving weight to definitions of money whose relationship to GNP over an historical period had not been adequately studied. Without the results of such study, he did not know how to interpret, for example, a 9 per cent rate of growth in M_4 . He felt limited to using the concepts of money that had been subjected to study.

Mr. MacLaury said he thought that the staff's projection of GNP was about right, and if it should be realized, GNP in the last quarter of this year would still be well below its potential. Consequently, he favored alternative A. He believed that the Committee would have come closer to achieving its targets for rates of growth in the monetary aggregates over the past 6 months if it had specified wider ranges for the funds rate. Accordingly, like Mr. Mayo, he would specify a range of 4-1/2 to 6 per cent for the period ahead. He would not move the rate down to the lower limit of the range unless the aggregates appeared to be growing at rates below the midpoints of their ranges. However, it was necessary to have the room to move down within the range if the aggregates appeared to be growing at rates below the midpoints.

Mr. Clay observed that in light of the continued weakness in the economy, a moderately stimulative monetary policy was appropriate over the coming months. Nevertheless, while encouraging economic recovery, overly expansionary policies that might

subsequently negate the lower rates of inflation gained in the current recession should be avoided. Considering recent shortfalls in the aggregates, a policy of fighting recession in the shorter term and inflation over the longer term would involve fairly large aggregate growth rates during the second and third quarters and lower growth rates thereafter. Specifically, policy should be directed toward bringing about aggregate growth rates indexed by 7.0 per cent M_1 growth over the period from February to September. A Federal funds range of 5 to 6-1/4 per cent for the period until the next meeting and a March-April range of tolerance of 4-1/2 to 7 per cent for M_1 appeared consistent with achieving that target. Alternative B fit his prescription quite well.

The meeting then recessed. It reconvened at 2:25 p.m. with the same attendance as at the morning session.

Mr. Morris said he thought monetary policy in 1975 should focus on two basic objectives: to create a monetary environment that could support a revival in economic activity, and--later in the year, after the upturn had occurred--to avoid an excessive monetization of the Federal deficit. It could be argued that those objectives were in conflict, in the sense that less monetary expansion now would provide more leeway for monetization of debt later. On the other hand, they were not in conflict in the sense that a more sluggish upturn in economic activity would lay the base for an even larger budget deficit than otherwise.

At this time, Mr. Morris continued, he felt that the Committee should give priority to the first objective. In his judgment, the lack of growth in total reserves and in loans and investments at commercial banks during the past six months supported the view that a financial environment conducive to economic recovery had not yet been created. Accordingly, he could not yet favor the policy of stabilizing short-term market rates that was implicit in alternative B. He would support alternative A, even though he was not as concerned as Mr. Sheehan was about the Federal funds range. Although the process had taken too long, the funds rate had finally reached a level where growth in the monetary aggregates could be expected with much less downward pressure on money market rates than had been necessary in the recent past. Therefore, he could accept a 4-1/2 to 5-1/2 per cent range for the funds rate. On the other hand, he strongly favored a wider range for the 2-month growth rates in the monetary aggregates than shown in the blue book. With an annual rate of increase in M_1 over the past 6 months of only 2.3 per cent, he saw no logic in instructing the Manager to limit M_1 growth in the March-April period to 7 per cent. He would suggest that the upper limits for M_1 and M_2 be raised to 9 and 12 per cent, respectively.

Mr. Francis said he was concerned about the proposal being made in many quarters, mostly outside the System, that M_1 be permitted

to grow temporarily at an 8 or 10 per cent annual rate. Rates of expansion in some of the monetary aggregates had been relatively low for the past two or three quarters, so that even the growth rates shown under alternative C--including the 6 per cent rate for M_1 from the first to the third quarter--would represent a substantial step-up and would probably be sufficient to accomplish the Committee's objectives. If M_1 were permitted to expand at a 2-digit rate for a time, the point at which it was desirable to return to a more moderate rate might well come in the third quarter, when it was likely that the Treasury's financing needs would be extremely heavy and interest rates would be under upward pressure. There would be serious difficulties in bringing about the needed slowing under such circumstances. Even if it proved possible then to reduce the rate of monetary growth by, say, 3 or 4 percentage points, the impact on the economic recovery would not be favorable.

Accordingly, Mr. Francis observed, he would favor starting from the present position, moving toward a 5 to 6 per cent rate of expansion in M_1 , and then holding to such a rate. For the March-April period, the ranges of tolerance for growth rates in the aggregates shown under any of the blue book alternatives were acceptable to him.

In response to the Chairman's request for his advice to the Committee, Mr. Partee remarked that he wished to emphasize a

few points, some of which had already been made by others. First, he would note that there remained some rather formidable obstacles to recovery in the economy; in particular, many industries were in poor shape and the financial structure of business was far from good. Although a recovery beginning around mid-year was still the most probable course for the economy, the Committee should keep in mind that that outcome was not assured and that some unwelcome surprises could emerge in the period ahead.

Secondly, Mr. Partee remarked, although conditions in the credit markets had improved, he would stress that they were not broadly supportive of a vigorous recovery. Large flows of funds into savings and loan associations had not yet been translated into a sizable increase in housing starts. For example, data on February housing starts that he had just received showed a 2 per cent decline from January--a small decline, but obviously not an increase. Nor had the volume of building permits been rising. Yields in the corporate bond market had been moving up recently, partly because of the heavy volume of new offerings and perhaps partly because of the large volume of Treasury issues in prospect. Moreover, lenders continued to be concerned about credit quality. The problems of over-building and over-extension of credit had developed over the past 8 to 10 years, and were not a consequence of recent monetary policy; nevertheless, they had to be taken into account.

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Finally, Mr. Partee continued, while the staff's projection of the unemployment rate might be somewhat off the mark, he would emphasize that a rate in the neighborhood of 9-1/2 per cent was in prospect by summer. A great deal of recovery would have to take place before unemployment was reduced to a level that would warrant concern about economic over-heating. He did not regard the 6 per cent rate of growth in real GNP the staff was projecting for the second half of 1975 as a "rapid" rate of expansion. Indeed, he would not consider a 10 per cent rate of expansion in real GNP, for a time, to be troublesome because, even at that rate, high unemployment and a large amount of unutilized resources would persist well into 1976. In sum, he thought the Committee should bear two considerations in mind in its policy deliberations today: in the short run, there was a need for some further easing in credit markets, and in the long run there was a large leeway for rapid economic expansion.

Mr. Kimbrel remarked that he was encouraged by indications in his District of returning confidence in the economy, availability of credit, reductions in inventories, and the prospect of some moderation in inflation. On the other hand, he was concerned about unemployment and the possibility of an overly stimulative fiscal policy that would reignite inflationary expectations. He would not want to see interest rates become too low because of the possible adverse impact on the already delicate situation in foreign

exchange markets and because of the need that would be created for rates to return to higher levels at a later time--perhaps at a time when the rise might thwart a tenuous economic recovery.

Accordingly, Mr. Kimbrel said, he favored the specifications of alternative B, with one modification--he would not want to see the Federal funds rate rise above 6 per cent nor fall below 5 per cent during the intermeeting period. As for the operational paragraph of the directive, he thought the reference to "more rapid growth in the monetary aggregates over the months ahead than has occurred in recent months" was rather nebulous. It seemed to him that most Committee members favored conditions consistent with moderate growth in the aggregates and he would have the directive state the Committee's aims in just those terms.

Mr. Black remarked that he had been impressed by the earlier comments of Messrs. Sheehan and Morris regarding the financial constraints inhibiting corporate investment. In his view, however, the best solution to that problem would be a corporate tax cut. As to monetary policy, he thought special caution was needed in any further move towards ease. He had welcomed the latest discount rate reduction, although he would have preferred an earlier reduction if international financial relationships had justified such action. At present, he would retain the 9-month 6 per cent M_1 target adopted at the last meeting, and he hoped that growth path could be maintained

beyond September without an abrupt reversal in money market conditions. Within that general policy framework, he hoped some restructuring of corporate debt could be achieved without significant upward pressure on long-term rates, although he was not optimistic in that regard.

For the immediate future, Mr. Black continued, he thought the Committee had to be concerned with the performance of the dollar in foreign exchange markets and hence with the relationships between domestic and foreign interest rates. It seemed to him that the international nature of the recession called for international coordination of economic policies, particularly monetary and credit policies. An overly accommodative monetary policy in the United States would not only lay the base for problems in the domestic economy further down the road, but would also jeopardize the position of the dollar in foreign exchange markets as well as the prospects for world recovery.

Accordingly, Mr. Black said, he would favor some cautious probing in the direction of further ease--a policy he hoped would be followed by other major industrial countries, especially Germany--and he would not allow any significant back-up in short-term interest rates. As for the alternatives presented in the blue book, he came out midway between A and B. In light of the slow growth in the aggregates during December and January, he

could accept March-April growth rates in M_1 and M_2 somewhat higher than 7 and 10 per cent, the upper limits of the ranges shown under alternative A. He believed, however, that such growth rates could probably be achieved without a decline in the Federal funds rate to the 4-1/2 per cent lower limit shown under alternative A. Specifically, he would favor a funds rate range of 5 to 6 per cent. He would strongly oppose allowing the rate to rise above 6 per cent, and assuming continued performance in the aggregates similar to that recorded in February and thus far in March, he would be cautious about moving the funds rate much below 5-1/4 per cent.

Mr. Black added that if the Committee should decide to seek a further decline in the funds rate, he would recommend consideration of another discount rate reduction--although he would be reluctant to take that move without prior action toward lower interest rates by other major industrial countries. For the wording of the directive, he leaned toward alternative A, but the wording suggested by Mr. Kimbrel would be satisfactory to him.

Mr. Winn expressed surprise that thus far in today's discussions no reference had been made to the unfolding developments in Cambodia and Vietnam, since those developments might well have a bearing on the economic outlook. In addition, he did not know just how to assess the implications of the huge Treasury financing in prospect. He noted that the draft directives submitted by the staff

contained no reference to forthcoming Treasury financings, even though the prospective volume of borrowing was substantially larger than at times in the past when such references had been included. He asked for Mr. Holmes' comments on that point, and also on the volume of Treasury issues the Federal Reserve System might have to absorb and on the likely course of interest rates on Treasury securities.

Mr. Holmes expressed the view that, given the current frequency of Treasury financing--with new offerings every week--the concept of even keel would have to be modified. The amount of Treasury debt the System would purchase would depend on the Committee's specifications for the Federal funds rate and reserves. In his judgment, some further back-up in rates on Treasury securities was in prospect.

Mr. Winn commented that such a rate back-up would concern him. Turning to short-run policy, he would be inclined to pay a little more attention to the aggregates; he hoped they would continue to behave in the recently encouraging fashion, because he would not like to see an aggressive move toward a lower Federal funds rate. He thought a range of 4-3/4 to 6 per cent for the funds rate would allow the flexibility needed to achieve the Committee's objectives. Unlike some other speakers, he would be prepared to support another discount rate reduction. He thought such

an action would have a beneficial psychological impact and would not have any adverse consequences. Moreover, even though it would follow the latest reduction rather closely, a further cut would not put the discount rate out of line with short-term money market rates.

Mr. Holland said he continued to believe that the Committee's fundamental policy objective should be the attainment of financial conditions that would facilitate recovery without fueling a resurgence in inflation. Of the various ranges for the funds rate suggested so far in today's discussion, he viewed the 4-3/4 to 5-3/4 per cent range proposed by Mr. Mitchell as a satisfactory compromise. He favored an upper limit of 5-3/4 per cent because he thought a backup to 6 per cent would have an adverse impact on financial markets; at the minimum, the Committee should review the situation again before agreeing on a 6 per cent ceiling. Also, he could accept Mr. Mitchell's lower limit of 4-3/4 per cent. However, he would be more comfortable with a 5 per cent lower bound, since he was somewhat apprehensive about penetrating that level. If a 5 per cent lower limit for the funds rate appeared to be constraining growth in the aggregates below the desired rates, he would urge that the Committee be consulted about the possibility of a reduction before the next scheduled meeting.

With respect to the aggregates, Mr. Holland continued, the short-run specifications of alternative A appealed to him. While he did not regard the short-run specifications proposed by Chairman Burns earlier as significantly different from those of A, he was troubled that the 4-1/2 per cent lower limit for M_1 growth suggested by the Chairman was below the lower limit adopted at the last meeting. He thought it would be undesirable to adopt a range which might imply that the Committee had lowered its target for M_1 growth, and consequently he felt a case could be made for retaining the 5-1/2 to 7-1/2 per cent short-run M_1 range adopted at the February meeting. With that exception, he could support the Chairman's recommendations for short-run specifications.

However, Mr. Holland observed, he had serious problems with the present formulation of longer-run targets. In sum, he thought they were too short run, too few, and too precise--both for System operations and for promoting public understanding of policy. He would point out that at its last meeting the Committee had agreed on growth rates of 4-1/2 per cent for M_1 and 7-1/2 per cent for M_2 for the first half of 1975. Those numbers were a consequence of the January shortfalls, and they were far too low to reflect properly the rates of growth in the monetary aggregates that the Committee members generally wanted to achieve over the longer run. Similarly, if current procedures were continued,

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the Committee today would employ a February-September period for expressing its targets, and in the process it would agree on numbers that were higher than most members would feel comfortable with for the longer run. For example, if the Committee chose the targets shown under alternative A, it would be agreeing on growth rates of 8 and 11 per cent for M_1 and M_2 . In light of the pending Congressional Resolution seeking more detailed and more timely information on monetary policy, he would recommend that the Committee's targets be formulated in a way that more clearly conveyed the views of its members. Specifically, at this point he would lengthen the time horizon to 9 months--including the weak January--which would yield targets of 6 per cent for M_1 and 10-1/4 per cent for M_2 under alternative A.

In addition, Mr. Holland observed, he would propose that the longer-run targets be stated in terms of ranges; as single figures, they conveyed an impression of far greater precision than the Committee aspired to or expected to achieve. Ranges of 5 to 7 per cent for M_1 and 9 to 11 per cent for M_2 would accurately reflect his own views on appropriate growth in those aggregates over the first 9 months of 1975. Finally, he would add M_3 to the family of longer-run targets because of the importance of that measure in terms of the liquidity positions of individuals and in connection with developments in the housing market. For M_3 he would suggest a range of 10 to 12 per cent for the 9-month interval.

With respect to the language of the directive, Mr. Holland said he favored alternative B with one modification. The staff's draft called for more rapid growth in the aggregates "than has occurred in recent months." He would replace that clause with "than occurred in the last half of 1974." Over that period, M_1 grew at about a 3 per cent annual rate, and M_2 , M_3 , and the credit proxy all grew at rates in the neighborhood of 5-1/2 to 5-3/4 per cent.

Chairman Burns said he also believed the way the Committee had been formulating its longer-run targets was rapidly becoming obsolete, in light of the Concurrent Resolution under consideration in Congress. The need for a new approach to the longer-run targets would be thoroughly discussed by the Committee at the next meeting. He thought Mr. Holland's remarks represented a useful introduction to the subject, but he would suggest that further discussion be postponed until the April meeting.

Mr. Coldwell remarked that his thinking had paralleled Mr. Holland's with respect to expanding the time horizon for specifying the longer-run targets. However, he had had in mind an April-to-December time frame, rather than January-to-December, because efforts to compensate for past shortfalls were not worthwhile; in his judgment the Committee should focus on the future.

Mr. Coldwell observed that he approached the question of today's policy decision with mixed feelings. While he did not

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think recovery was a certainty, his attitude--and the mood of the country--was somewhat more optimistic about that prospect than a month ago. The staff projection suggested that the unemployment rate would be around 9 per cent through mid-1976, and he suspected that if the projection were carried through the end of 1976, there would be little change in that rate. To him, a 9 per cent unemployment rate for so long of a period of time was totally unacceptable. On the other hand, it was beginning to appear that greater steps toward monetary ease perhaps should have been taken earlier, and he was concerned that some might now be reaching for the panic button. While M_1 had been growing recently, he was skeptical about the significance of that measure; he had not been greatly concerned about the shortfalls in M_1 earlier in the year, and he would not place much emphasis on high M_1 growth now. Of critical importance, however, had been the decline in reserves in the past month; he did not like that development at all.

Mr. Coldwell noted that at the past several Committee meetings he had argued for a steady reduction in short-term interest rates. He regretted that he had not persuaded the Committee to focus its efforts primarily on that objective. While a substantial decline in rates had been achieved, the decline in the Federal funds rate had been irregular.

As for his policy prescription, Mr. Coldwell continued, he would focus on reserve expansion without much emphasis on the particular rate of growth in M_1 . Specifically he would suggest the wide range of 5 to 9 per cent for M_1 growth in the March-April period, so that the Manager would not be required to take firming actions should money supply growth be on the high side. Similarly, he would not want the Federal funds rate to constrain reserve provision, and so he would propose a range of 4-1/4 to 5-1/2 per cent for that rate. He favored a 5-1/2 per cent ceiling on the funds rate because he placed the highest priority on avoiding a back-up in interest rates. He felt a Federal funds rate of 5 to 5-1/8 per cent would probably achieve the reserve target he had in mind--a level of about \$36-1/2 billion, according to his rough calculations. He hoped the Manager would move the funds rate down gradually from its current level over the next 2 weeks, and then stabilize the rate if adequate reserve growth were forthcoming but permit it to decline further if reserve expansion was not adequate. In general, he would urge that the Committee take care not to overreact late in the recession--and in his judgment, it was now becoming late in the recession.

Turning to the directive, Mr. Coldwell said that he could accept the wording of alternative B for the operational paragraph. He would suggest a few wording changes in the preceding background

paragraphs. First, following the statement that employment declined further in February, the staff's draft continued "However, the unemployment rate was unchanged, at 8.2 per cent, as the civilian labor force declined." He thought that sentence would be improved by striking the word "however" at the beginning and adding the word "sharply" at the end.

Chairman Burns asked whether there was any disagreement with that suggestion, and none was heard.

Secondly, Mr. Coldwell continued, he was uncomfortable with the statement indicating that "Since mid-February short-term market interest rates have changed little," in light of the substantial decline in the funds rate.

Chairman Burns asked whether it would not be more accurate to say: "Since mid-February, short-term market interest rates have declined a little."

Mr. Axilrod observed that the Chairman's proposed language was more accurate, in view of interest rate developments since the staff's draft had been prepared.

There was general agreement that the wording suggested by the Chairman should be employed.

Mr. Coldwell then commented that, as he had mentioned at the last meeting, he did not like the phrase "conducive to cushioning recessionary tendencies" in the description of the type of financial

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conditions the Committee sought to foster. Since the country was in a recession, he would prefer some such language as "conducive to combatting the recession."

Chairman Burns remarked that Mr. Coldwell's objective might be served by simply saying ". . .conducive to stimulating economic recovery."

Mr. Coldwell indicated that that would be satisfactory, and other Committee members agreed.

Mr. Wallich said he shared the view that the economy at present was at a late point in the recession and that there was a danger of overreacting, in classical fashion, at that point. The cycle now appeared more normal than it had earlier; the risk of a bottomless pit seemed to have disappeared. The main argument for active monetary stimulus now was that it might obviate the need to take excessive action later. He did not consider that to be a very effective argument.

It was true, Mr. Wallich continued, that conditions in financial markets were not yet of a kind that would be highly supportive of economic recovery. He had in mind in particular the situation with respect to bank lending practices. He would be happier if something could be done in that area without changing underlying financial conditions. It was also true that there was a great deal of slack in the economy. To him that suggested that

the ceiling set by capacity limits would not be reached for some time--perhaps not until 1977 or even later. If too much stimulus was supplied now, the expansion would be proceeding with considerable speed at that point. That also would be in accordance with a classical pattern which the Committee should try to avoid. It would be safer to stretch the recovery out over a longer period, despite the painfulness of continued high rates of unemployment.

Mr. Wallich observed that forthcoming Treasury financings would place great pressures on financial markets. He would prefer to be a little less accommodative now so that it would be possible to be more accommodative later in the year, when he expected that Treasury operations would be creating problems. With respect to international financial considerations, the dollar was now doing a little better in the exchange markets than earlier, so that domestic interest rates could be permitted to decline a bit without incurring the earlier risk of a revival of pessimistic attitudes toward the dollar. He agreed that international considerations should not be permitted to determine domestic monetary policy; priority had to be given to domestic considerations. At present, however, both domestic and international considerations argued for not moving too far in an easing direction.

As to specifications, Mr. Wallich remarked, the main question seemed to be whether the Committee should attempt to compensate for the January decline in M_1 . He thought the benefits

to be gained by doing so would not outweigh the costs. He would, however, want to avoid a significant back-up in interest rates, which would be troublesome. On the whole, he favored specifications somewhere between those of alternatives A and B. For the funds rate, he favored a range of 5 to 6 per cent and would like to see the rate move toward the lower end of that range. He would be troubled if the rate moved close to 6 per cent, and he hoped the Committee would be consulted before the Desk undertook operations directed toward that end. His computations suggested that the 2-month range specified for M_1 should be 4-3/4 to 6-3/4 per cent, but he could easily be persuaded that the end-points should be rounded out a bit--perhaps to 4-1/2 and 7 per cent. He favored alternative B for the language of the operational paragraph of the directive.

Mr. Wallich added that he hoped it would not be found necessary to reduce the discount rate again any time soon. He would consider such action highly undesirable from the international point of view.

Mr. Baughman said he was distressed to see another demonstration of the apparent impossibility of having fiscal actions taken in timely fashion. The problems that would face monetary policy down the road would be complicated if, as now seemed likely, fiscal action was too late and perhaps also too strong. It was

particularly distressing that the battle for timely action apparently had been lost once again, since fiscal policy appeared to have the potential for affecting the economy more quickly than monetary policy.

Since he was new to the Dallas Reserve Bank, Mr. Baughman continued, he had been visiting with many bankers in the Eleventh District. In those conversations he had found a universal attitude of conservatism with respect to lending policies, notwithstanding the fact that the economic environment in the District was good relative to that in the nation as a whole. The views expressed by bankers were consistent with the impressions he had gathered from a review of District banking statistics.

In his judgment, Mr. Baughman continued, it was likely that bank lending policies would have to be changed before the country would be able to move out of the recession. That would seem to call for a somewhat more liberal rate of reserve injections than had been the case recently in order to shorten the period over which current demands for liquidity--in both the financial and nonfinancial sectors of the economy--were satisfied. Within the framework of today's discussion, he thought the specifications of alternative A came closer to satisfying that requirement than the other alternatives.

Mr. Baughman noted that all of the alternatives for directive language included qualitative comparisons of the growth desired in

monetary aggregates "over the months ahead" with the growth that "has occurred in recent months." In his judgment, such statements conveyed relatively little information, and he would favor any of the proposed modifications that would clarify the Committee's intent.

Chairman Burns remarked that the range of views on policy at this meeting was wider than at any meeting he could recall; it was certainly wider than at any meeting in the past 6 or 12 months. The Committee was a deliberative body, and the views of some speakers might well have been influenced by comments subsequently made by others. Accordingly, it might be desirable at this time to determine whether anyone wanted to modify the position he had taken earlier or to raise any additional points.

Mr. Mitchell said he thought the discussion had revealed some degree of consensus on the desirability of setting the upper limits of the 2-month ranges of tolerance for the monetary aggregates at higher levels than those shown in the blue book under any of the alternatives.

The Chairman said he would attempt to extract a consensus in due course, after the members had been given an opportunity to comment further.

Mr. Black noted that he had originally expressed a preference for a Federal funds rate range of 5 to 6 per cent. After

hearing the discussion, however, he would not object to a range of 4-3/4 to 5-3/4 per cent.

Mr. Eastburn asked whether Mr. Axilrod would assess the chances that, if the Committee adopted the specifications of alternative A, the funds rate would have to decline to the lower limit of the range indicated--4-1/2 per cent--in order to achieve the growth rates in the aggregates shown under that alternative.

Mr. Axilrod replied that, as he had indicated earlier, he felt more confident than he had at other recent meetings that the midpoint of the ranges shown for the funds rate under the various alternatives had real operational significance. At the time of the January and February meetings he had suspected that the economy would prove to be weaker than suggested by the staff's GNP projections, which were taken as given for the purpose of developing the relationships set out in the blue book. Now he thought the midpoints of the funds rate ranges shown in the blue book represented the best estimates of the rates likely to be required to achieve the associated patterns of growth in the aggregates.

In reply to a question by Mr. Coldwell, Mr. Axilrod said he thought a 5 per cent Federal funds rate, the midpoint of the alternative A range, would be associated not only with the growth rates in the aggregates shown under A for the March-April period but also with the rates shown there for the longer run.

Mr. Hayes noted that he had expressed a preference for a funds rate range of 5 to 6 per cent. However, it was not inconceivable that the aggregates would be so weak as to suggest the desirability of a funds rate below 5 per cent. One possibility would be to authorize the Manager to reduce the funds rate from its present 5-1/2 per cent level to 5 per cent, but not to move below 5 per cent until the question had been reviewed by the Committee.

Chairman Burns said the following specifications appeared to him to be a reasonable compromise of the views the members had expressed: an intermeeting range for the Federal funds rate of 4-3/4 to 5-3/4 per cent, a 2-month range for M_1 growth of 5 to 7-1/2 per cent, and 2-month ranges for M_2 and RPD's as shown under alternative A in the blue book. As to the operational paragraph of the directive, the Chairman noted that several different modifications of the staff's drafts had been proposed in the discussion. If the Committee so desired, it could deliberate on each of those proposals in turn. His own suggestion would be that the Committee simply adopt the language of alternative B, which was the same as that agreed upon at the previous meeting.

After some discussion, there was general agreement that the language of alternative B should be adopted.

Mr. Hayes asked whether there was any disposition to include a 2-month range for the bank credit proxy among the specifications.

The Chairman noted that any such range would have to be improvised, since the staff had not worked out the short-run growth rates in the proxy that would be associated with particular growth rates in M_1 and M_2 . Accordingly, it might be best not to include the proxy among the short-run targets. More generally, the Committee would have to review carefully various questions relating to its targets, in light of the Concurrent Resolution now being considered by the Congress.

Mr. Holland noted that the Chairman had not suggested any longer-run targets for consideration by the Committee. He added that he would have no objection to the omission of such targets at this meeting.

Chairman Burns observed that any longer-run targets that might be adopted today would have no operational significance in the period between now and the next meeting, when the Committee would be reviewing its procedures. He doubted, therefore, that there would be much point in deliberating on longer-run targets today. However, that was a matter for decision by the Committee.

Mr. MacLaury said he agreed on the desirability of discussing the subject of targets at the next meeting. To his mind, however, the expectation that such a discussion would be held argued for following the customary procedure today, rather than for dropping the longer-run targets in advance of that discussion.

Chairman Burns said he thought Mr. MacLaury had made a valid point. Perhaps the best procedure would be for the Committee simply to reaffirm the longer-run targets it had agreed upon at the last meeting.

Mr. Mayo noted that in the blue book for the February meeting longer-run growth rates had been shown under each of the alternatives for a number of different periods, including the first 6 months and the first 9 months of 1975. He assumed that when the Chairman suggested reaffirming the longer-run targets adopted in February, he had in mind both the 6-month and the 9-month growth rates, which for M_1 were 4-1/2 per cent and 6 per cent, respectively.

The Chairman said that that had been his intention.

Mr. Broida remarked that some confusion on that score might have been created by the manner in which the staff had recorded the longer-run targets in the text of the draft memorandum of the discussion prepared for the February meeting and in the attached listing of specifications adopted then by the Committee. When the Chairman had set forth proposed specifications at the February meeting, he had referred to the longer-run targets "shown under alternative B." However, in preparing the draft documents for the meeting, the staff had interpreted the Chairman's

reference as applying to the 6-month growth rates, because prior to that time the Committee's practice had been to employ single periods of 6 or 7 months. It was planned to make corrections in the revised drafts that would be submitted for acceptance by the Committee.

It was generally agreed that such corrections would be appropriate.

Mr. Eastburn asked what approach the Desk would take to the funds rate if the Committee adopted the range of 4-3/4 to 5-3/4 per cent suggested by the Chairman.

In reply, Mr. Sternlight noted that the funds rate had recently remained in the 5-1/2 per cent area despite persistent efforts by the Desk to move it up to around 5-3/4 per cent. If the Committee agreed upon the suggested range, at the outset of the period the Desk would no longer attempt to move the rate above 5-1/2 per cent, assuming market forces were tending to hold it around that level. As the period progressed, if the aggregates were tending to grow at rates near the middle of their ranges, the Desk would gradually move the funds rate down to about the 5-1/4 per cent midpoint of its range.

Mr. Coldwell asked how the Desk would proceed if the growth rates of the aggregates appeared to be near the upper ends of their ranges.

Mr. Sternlight replied that under such circumstances the Desk would hesitate to reduce the funds rate below 5-1/2 per cent.

Chairman Burns remarked that Mr. Sternlight's comments were consistent with his own understanding of how the specifications should be interpreted.

Mr. Coldwell said he recognized that that was the manner in which the specifications had been interpreted in the past. It was for that reason that he had expressed a preference for a funds rate range with a midpoint closer to 5 than to 5-1/4 per cent.

The Chairman expressed the view that the range he had proposed was about as close to the Committee's consensus as one could come.

Mr. Bucher observed that he--and perhaps Mr. Coldwell also--would feel more comfortable if the upper limits for the 2-month ranges for the aggregates were set somewhat higher than the Chairman had suggested--perhaps at 8 per cent or above for M_1 . Even with such a change, however, he was not sure he could concur in the proposed specifications.

Mr. Holland remarked that he would be disturbed by upper limits for the aggregates as high as Mr. Bucher suggested.

Mr. Bucher noted that estimates of monthly growth rates in the monetary aggregates tended to fluctuate markedly from week to week. It was quite possible that within, say, the next two

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weeks the M_1 growth rate for March-April would be estimated at about 8 per cent. In that event, the Manager presumably would find it necessary to raise the funds rate above the current 5-1/2 per cent level.

Mr. Holmes said he thought there was enough sentiment today against moving the funds rate up from its present level to warrant an instruction to the Desk not to do so without prior consultation with the Committee.

Chairman Burns said he could assure the Committee that he would call for consultation if there was any appreciable back-up of interest rates.

Mr. Sheehan expressed the view that the best way to ensure against an increase in the funds rate was to set the upper limit of the range below the level the Chairman had suggested.

Mr. Mitchell remarked that he would prefer to raise the upper limits for the aggregates, or to have an understanding that if the aggregates were above their upper limits the funds rate would not be raised without prior consultation.

Mr. Hayes observed that he would have no objection to an upper limit of 8 per cent for the 2-month growth rate for M_1 .

The Chairman said he thought the point at issue was not likely to be a source of difficulty; he, for one, had been striving particularly hard to prevent a back-up of interest rates.

Chairman Burns then proposed that the Committee vote on a directive consisting of the general paragraphs as drafted by the staff, with the modifications the Committee had agreed upon earlier, and alternative B of the staff's drafts for the operational paragraph. It would be understood that the directive would be interpreted in accordance with the following specifications. The longer-run targets for the monetary aggregates would be the same as those adopted at the preceding meeting. The associated ranges of tolerance for growth rates in the March-April period would be 3-1/2 to 5-1/2 per cent for RPD's, 5 to 7-1/2 per cent for M_1 , and 8 to 10 per cent for M_2 . The range of tolerance for the weekly average Federal funds rate in the inter-meeting period would be 4-3/4 to 5-3/4 per cent.

With Messrs. Bucher, Eastburn, and Sheehan dissenting, 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 continuing to fall sharply in the current quarter. In February industrial production and employment declined substantially further. The unemployment rate was unchanged, at 8.2 per cent, as the civilian labor force declined sharply. Average wholesale prices of industrial commodities rose moderately again in February, and prices of farm and food products declined sharply further. The advance in average wage rates, although large, remained well below the increases of last spring and summer.

The foreign exchange value of the dollar declined in February, but it strengthened somewhat in early March, as short-term interest rates abroad fell further and as market attitudes toward the dollar improved somewhat. In January the U.S. foreign trade deficit was only moderately above the rate in the fourth quarter of 1974 despite a large bulge in recorded imports of oil. Net outflows of capital reported by banks continued large as foreigners withdrew deposits.

The narrowly defined money stock, which had declined sharply in January, expanded considerably in February, and broader measures of the money stock grew at substantial rates. Net inflows of consumer-type time and savings deposits were particularly large. Large-denomination CD's outstanding contracted in February and total bank credit showed little net change. Business demands for short-term credit remained weak, both at banks and in the commercial paper market, while demands in the long-term market continued exceptionally strong. Since mid-February short-term market interest rates have declined a little while longer-term yields have risen. Federal Reserve discount rates were reduced from 6-3/4 to 6-1/4 per cent in early March.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to stimulating economic recovery, while resisting inflationary pressures and working toward equilibrium in the country's balance of payments.

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

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

Chairman Burns then noted that in a memorandum dated March 11, 1975,^{1/} the staff had recommended that the lag with which the Committee's policy records were released be reduced from approximately 90 to approximately 45 days. He thought the Committee had leaned on the side of conservatism in maintaining a 90-day lag, and that there would be no significant loss in the effectiveness of the Committee's functions if the lag were reduced to 60 or 45 days. Personally, he preferred 45 days.

Before calling for discussion, the Chairman continued, it might be helpful if Committee members and Reserve Bank Presidents not currently serving on the Committee were informally polled on whether they were inclined to reduce the lag to 45 days.

Seventeen of the nineteen participants in the poll indicated that they were so inclined.

Chairman Burns then asked whether anyone preferred a lag of 60 to one of 45 days.

Mr. Coldwell expressed a preference for a 60-day lag.

Mr. Eastburn asked whether it might not be of interest to determine whether there was any sentiment for a 30-day lag.

In reply, the Chairman observed that, while he saw some merit in reducing the lag to 30 days, he would advise against such action at this time because a thorough analysis of its implications

^{1/} A copy of this memorandum, which was entitled "Proposed reductions in lag for FOMC policy records," has been placed in the Committee's files.

had not been made by the staff. It appeared that the Committee was prepared to reduce the lag to 45 days; he suggested that it do so now, without prejudice to the question of a possible further reduction at a later time. The staff might be asked to prepare an analysis of a 30-day lag for consideration by the Committee at an early meeting.

Mr. MacLaury remarked that, like the Chairman, he favored reducing the lag to 45 days but not to 30 days at this time. He hoped the decision to shorten the lag would be taken without prejudice to the question of the possible inclusion in the policy records of information on the Committee's longer-run targets. As the members knew, he favored publishing the longer-run targets.

Chairman Burns responded that he saw no relationship between the two questions. As he had indicated, he planned to call for a discussion of the desirability of publishing the longer-run targets at the April meeting of the Committee.

Mr. Coldwell observed that, to his mind, the questions were linked, since one might favor publishing the longer-run targets with a lag of 60 days but not with a lag of 45 days.

Mr. Balles remarked that it might be feasible to employ different lags for the publication of the short-run and longer-run targets.

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The Chairman commented that the Committee's debate on the question of publishing longer-run targets at the April meeting might take a form altogether different from its deliberations on that subject in the past, in view of the Concurrent Resolution on the conduct of monetary policy recently passed by the House of Representatives and the related resolutions approved yesterday by the Senate Banking Committee. He might note in particular that the Senate resolution called for the Board of Governors to consult semi-annually with the Banking Committees of the Senate and House about the objectives of the Board and the Open Market Committee with respect to ranges of growth in the monetary and credit aggregates over the upcoming 12 months. Such a resolution would, of course, have implications for the Committee's procedures.

Mr. Coldwell asked whether it would be feasible to postpone a decision on reducing the lag until the next meeting, so that the Committee could consider together the questions of the lag and of publication of the longer-run targets.

Chairman Burns replied that, while he saw some advantage in acting on the lag today, he thought it would be quite feasible to wait until the April meeting. The Committee might want to agree in principle today that the lag should be reduced, and to plan on taking formal action next month.

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Mr. Holland remarked that his willingness to reduce the lag to 45 days reflected a balancing of conflicting considerations, since he thought such early release might create problems from time to time. With respect to Mr. Coldwell's question, one possibility would be for the Committee to instruct the staff to proceed on the assumption that the policy record for today's meeting was to be released in 45 days, but to make no public announcement now. Since the April meeting would be held before that period had elapsed the Committee could review the matter again at that time in connection with its discussion concerning publication of the longer-run targets.

In response to a question, Mr. Broida said the staff had expedited processing of the policy records for both the January and February meetings to permit their publication in less than 90 days, should the Committee decide on that course. Specifically, it would be possible to release the January record next Monday, March 24--which would be approximately 60 days after the meeting date--and to release the February record in early April, about 45 days after the meeting date.

Mr. Hayes observed that he was prepared to vote today to reduce the lag to 45 days.

Mr. O'Connell said there was another matter on which he had planned to report to the Committee later in the meeting but

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which he might mention now since it was related to the question at issue. A formal request, under the Freedom of Information Act, had been received for the policy records--as well as the memoranda of discussion--for the meetings of the Committee held in January and February of this year. The request, which was from the Institute for Public Interest Representation of the Georgetown University Law Center, had been received on March 7, and under the law a determination as to whether or not it would be granted had to be made by March 21, 3 days from now. The nature of the response that would be made to the request for the policy records would, of course, be affected by the outcome of the discussion now under way. If the Committee agreed in principle that the lag should be reduced to 45 days, it might be desirable to act formally today, so that the requesting party could be so advised when the response was made.

Mr. Holland remarked that he concurred in Mr. O'Connell's view and accordingly withdrew his suggestion that the Committee defer final action on the lag until the next meeting.

Chairman Burns suggested that the Committee consider the nature of the response that should be made to the request Mr. O'Connell had described. As to the memoranda of discussion, he thought it was clear that the request had to be denied; he did not see how the

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Committee could possibly release those memoranda so soon after the meetings without destroying their usefulness. He asked whether there was any disagreement on that point.

Mr. Bucher said there was a question in his mind as to whether a lag as long as 5 years could be justified from a legal point of view. However, he would be prepared to rely on the opinion of the Committee's General Counsel.

Mr. O'Connell said he believed a credible case could be made for withholding the memoranda of discussion for a reasonable period of time. He did not address the question of whether 5 years was a reasonable period.

Mr. Coldwell asked for Mr. O'Connell's opinion regarding the lag for the policy records.

Mr. O'Connell replied that in his judgment a court of law might well find that the present 90-day lag was an unreasonable period for deferring the availability of the policy records.

Chairman Burns expressed the view that the request that had been received for the January and February policy records strengthened the case for acting today to reduce the lag, rather than deferring formal action for a month.

Mr. Broida observed that a decision to reduce the lag to 45 days could be implemented by amending Subsection 271.5(a) of the Committee's Rules Regarding Availability of Information in the manner

indicated in the Appendix to the staff's memorandum. One possible procedure would be to vote today to amend the Rules in the suggested manner, effective Monday, March 24; to announce the decision on that date, indicating that the new lag would be employed beginning with the policy record for the February meeting; and to simultaneously release the record for the January meeting.

After discussion, the Committee agreed that that procedure would be appropriate. Mr. Coldwell said he planned to dissent.

With Mr. Coldwell dissenting, the Committee voted to amend subsection 271.5(a) of the Rules Regarding Availability of Information as indicated below, effective March 24, 1975:

SECTION 271.5 - DEFERMENT OF AVAILABILITY OF
CERTAIN INFORMATION

(a) Deferred availability of information. - In some instances, certain types of information of the Committee are not published in the Federal Register or made available for public inspection or copying until after such period of time as the Committee may determine to be reasonably necessary to avoid the effects described in paragraph (b) of this section or as may otherwise be necessary to prevent impairment of the effective discharge of the Committee's statutory responsibilities. For example, the Committee's domestic policy directive adopted at each meeting of the Committee is published in the Federal Register approximately 45 days after the date of its adoption; and no information in the records of the Committee relating to the adoption of any such directive is made available for public inspection or copying before it is published in the Federal Register or is otherwise released to the public by the Committee.

Mr. Broida then observed that it would be helpful in connection with the pending request for the release of the memoranda of discussion for January and February of this year if the Committee would formally reaffirm its intention that the memoranda of discussion for individual meetings were not to be made available to the public until the Committee had authorized their transfer to the National Archives. Although it had been the Committee's practice in recent years to authorize such transfers of the memoranda for a full calendar year shortly after the close of the fifth following year, such action would not bind the Committee to any particular lag. It would, however, make it clear that the staff was not authorized to make the memorandum for a meeting available to the public unless the Committee had made a specific decision to transfer that memorandum to the Archives.

Mr. O'Connell concurred in Mr. Broida's suggestion.

By unanimous vote, the Committee reaffirmed its intention that the memoranda of discussion prepared for individual Committee meetings are not to be made available to the public until after the Committee has authorized their transfer to the National Archives.

The Chairman then observed that a memorandum from Mr. Broida, entitled "Recommendations regarding Committee's information procedures,"^{1/} had been distributed on March 17, 1975. Before turning

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

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to those recommendations, it might be helpful if Mr. O'Connell would comment generally on the implications for Committee procedures of the new amendments to the Freedom of Information Act.

Mr. O'Connell noted that some issues relating to the amendments to the Freedom of Information Act that became effective on February 19, 1975, had been discussed at the FOMC meeting on January 21, at which time the Committee had approved certain revisions of its Information Rules to conform to the provisions of the new amendments. The amendments introduced more rigorous, specific, and time-conscious provisions for responses to requests for information than contained in the original Act. Congress clearly intended the amendments to make information in the hands of Federal agencies more accessible to the public; indeed, the Attorney General had characterized the amended Act as "very much pro-public."

To illustrate the character of the amended Act, Mr. O'Connell continued, he might note that if an agency failed to respond to a request within the time limits specified, the requesting party was deemed to have exhausted his administrative remedies and could immediately take the matter to court. Under another provision, if a court should find that circumstances surrounding the withholding of requested information raised questions whether agency personnel acted arbitrarily or capriciously with respect to the withholding,

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the Civil Service Commission was required to determine whether disciplinary action was warranted against the officer or employee primarily responsible for the withholding, and the administrative authority of the agency was required to take the disciplinary action recommended by the Commission.

Mr. O'Connell observed that he expected an increasing number of requests for information of the Committee, including some made primarily to test the statute rather than because of any inherent interest in the information asked for. Where such requests were denied--and the denial affirmed on agency appeal--it was likely that the requesting party would sue in Federal Court for a reversal of the decision. It was important that the Secretary be in a position to respond promptly to requests for information, in a manner consistent with the Committee's intent. For that reason, he concurred in the recommendations contained in Mr. Broida's memorandum.

In the ensuing discussion, Mr. O'Connell responded to questions regarding the implications of specific provisions of the amended Act.

Chairman Burns then asked the Secretary to summarize the recommendations in his memorandum.

Mr. Broida said the recommendations were intended to ensure that the Committee conformed closely to the letter and spirit of the Freedom of Information Act and that the staff and the Committee

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communicated clearly and efficiently with respect to the Committee's intent as to the manner and timing on which information concerning specific Committee actions should be made available to the public. The proposal was to place a symbol next to every agenda item which involved possible action by the Committee indicating the staff's recommendations regarding the handling of information on that action, should it be taken by the Committee. The symbols might indicate, for example, that information concerning the action should be promptly published in the Federal Register, announced by press release, made available for public inspection in the Board's Public Information Office, or some combination thereof; or that the information should be withheld until the policy record for the meeting was published. The procedure should be efficient since there would be no need for Committee discussion unless a member disagreed with the staff's recommendation in a particular case. In effect, it involved a "consent calendar" approach.

Mr. Broida noted that symbols of the type proposed were shown on the copy of today's agenda attached to his memorandum. If the Committee concurred, the proposed procedure could be begun with today's meeting, on the basis of those annotations. He might note that some items were marked "open" because of uncertainty at the time the symbols were entered regarding the nature of the action that

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might be taken. Those items included one on which the Committee had already acted--the Manager's recommendations with respect to foreign currency operations. The Manager's recommendations had in fact been limited to the renewal of certain swap drawings, and there would appear to be no reason to defer release of information concerning the Committee's action on that matter. Accordingly, he would recommend that information concerning that action be promptly placed in the Board's Public Information Office.

In response to a question by Mr. Eastburn, Mr. Broida said he thought it would be consistent with the proposed procedure for a member to raise a question regarding the recommended handling of information on a Committee action at any time before adjournment of the meeting at which the action was taken.

Mr. Mitchell asked whether the agenda for a past meeting would itself be available for public inspection under the provisions of the Act.

Mr. O'Connell said he thought it probably would be. However, the statute did provide for certain exemptions, and if the listing of any particular item fell within one or more of those exemptions, it could appropriately be deleted before such an agenda was made available for inspection.

Mr. Mitchell then noted that there were no symbols on the annotated agenda for items involving Committee discussions and staff reports. He asked about the proposed handling of such items.

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Mr. Broida replied that the procedure he had described was concerned with information concerning actions of the Committee, essentially as recorded in the action minutes and in the so-called "action paragraphs" of the memorandum of discussion. The rest of the memorandum of discussion consisted of staff reports and the deliberations of the Committee that preceded actions. In accordance with the Committee's intent, reaffirmed earlier today, the staff would plan to deny requests for information concerning such reports and deliberations until the Committee had authorized transfer of the memorandum of discussion for the meeting in question to the National Archives.

After some further discussion, the Committee agreed that it would follow the procedure recommended in Mr. Broida's memorandum of March 17, 1975, beginning with today's meeting.

Mr. Broida then said he had one further suggestion, relating to information regarding the tentative meeting schedule for a calendar year which the Committee customarily considered in the latter part of the preceding year. In the past, the staff had declined to provide information on dates of meetings other than the forthcoming one, on the grounds that meeting dates were tentative until confirmed by the Committee at the immediately preceding meeting. He would suggest that in the future the staff provide requested information regarding forthcoming meeting dates, insofar as those

dates were shown in the tentative schedule, with appropriate qualifications--such as that meeting dates were subject to change and that special meetings might be called at any time. It might also be desirable to indicate that it had been the Committee's recent practice to hold most of its meetings on the third Tuesday of the month.

No objection was raised to that suggestion.

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 each year.

Secretary's note: On February 28, 1975, certain continuing authorizations of the Committee, listed below, had been distributed by the Secretary with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the March organization meeting to give members an opportunity to raise any questions they had concerning them. 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. List of Treasury Department officials to whom weekly reports on open market operations may be sent.
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.

5. Resolution relating to examinations of the System Open Market Account.
6. Regulation relating to Open Market Operations of Federal Reserve Banks.
7. Rules of Organization, Rules Regarding Availability of Information,^{1/} and Rules of Procedure.

Chairman Burns noted that it had been planned at this meeting to review the authority for lending securities from the System Open Market Account under paragraph 3 of the Authorization for Domestic Open Market Operations, to consider a staff committee report recommending an amendment to paragraph 1(b) of the Authorization to authorize System operations in finance bills, and to consider recommendations by the Manager for certain changes in the guidelines for System operations in agency issues. In view of the lateness of the hour, he proposed that those items be deferred until a later meeting.

No objection was raised to that suggestion.

By unanimous vote, the Authorization for Domestic Open Market Operations shown below was reaffirmed:

AUTHORIZATION FOR DOMESTIC OPEN MARKET OPERATIONS

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

^{1/} As recorded above, an amendment to Section 271.5(a) of the Rules Regarding Availability of Information was made at this meeting.

(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;

(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 \$1 billion;

(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.

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, or, under special circumstances, such as when the New York Reserve Bank is closed, any other Federal Reserve Bank, to purchase directly from the Treasury for its own account (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate charged on such certificates shall be a rate of $1/4$ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed \$2 billion.

3. In order to insure the effective conduct of open market operations, the Federal Open Market Committee authorizes and directs the Federal Reserve Banks to lend U.S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

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

AUTHORIZATION FOR FOREIGN CURRENCY OPERATIONS

1. 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 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	3,000
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:

FOREIGN CURRENCY DIRECTIVE

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 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 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.

The meeting then proceeded with attendance limited to Committee members and Reserve Bank Presidents not currently serving on the Committee and the following: Messrs. Broida, O'Connell, Partee, Axilrod, Holmes, Sternlight, Pardee, and Coyne. In addition, Mr. Rippey, Assistant to the Board of Governors, joined the meeting.

During this session Chairman Burns commented on legislation relating to the Federal Reserve now under consideration in Congress, and Mr. Rippey reported on the status of the Senate and House Concurrent Resolutions relating to the conduct of monetary policy. The Chairman expressed the hope that the members would study the Resolutions carefully in preparation for the discussion of questions relating to the publication of the Committee's longer-run targets that was planned for the April meeting.

It was agreed that the next meeting of the Committee would be held on Monday and Tuesday, April 14 and 15, 1975.

Thereupon the meeting adjourned.


Secretary

ATTACHMENT A

Robert Solomon
March 13, 1975

Report on Meetings of OECD's Working Party 3 and
Economic Policy Committee, March 5-7, 1975

The WP-3 discussions focused on a) the over-all current account deficits of the OECD area with the rest of the world, b) the distribution of these deficits among member countries and c) the position of the U.S. dollar in foreign exchange markets.

a) There was general agreement that the OECD area's current account deficit realized in 1974 and projected for 1975 was considerably less than earlier estimated. The 1974 deficit was put at about \$34 billion and the 1975 deficit at \$28 billion. Most of the improvement was related to the general cyclical weakness, which had a depressing effect on both volumes and prices of imports from non-member countries, including oil imports. Exports to OPEC countries have been increasing rapidly. The better OECD position for 1975 was likely to be reflected in balance of payments difficulties for non-oil developing countries.

b) The distribution of the projected deficits among OECD countries implied only little progress, if any, towards a diminution of the large imbalances that currently exist. Some improvement was seen for Italy and Denmark. But improvement was also projected for countries whose external positions were already relatively favorable, e.g., Netherlands, Belgium, and Japan. The OECD Secretariat also foresaw a further increase in the surplus position of Germany (to a current account surplus of \$12 billion) but the German representative argued

strongly that a small reduction in the surplus was more likely (and the Federal Reserve staff is inclined to agree with this judgment). The United States is likely to have a current account deficit of \$5 to \$7 billion, a not excessive share of the total OECD deficit. On the whole, financing of the prospective deficits in 1975 was viewed with equanimity, except for some doubts regarding the U.K. and the Danish positions.

c) During the discussion of the foreign exchange position of the U.S. dollar, the Swiss representative outlined the severe difficulties that the Swiss export and tourist industries were confronting at the present exchange rate, though he failed to note that some of these difficulties may be a reflection of world recession rather than of an overvalued exchange rate. The U.S. representatives reviewed recent developments and, according to Chairman Emminger's sum-up, "re-assured" other members of the working party that the U.S. attitude was not one of benign neglect. U.S. monetary policy was not criticized for being insufficiently stimulative. Instead two or three representatives expressed a concern that U.S. short-term rates ought to be regarded as an instrument of foreign exchange management. But others stressed that recent exchange rate movements have a number of causes, only one of which is interest rate differentials. Finally, there was widespread agreement with the proposition that this is not the time to return to exchange rate targets or zones.

* * * * *

The discussions in the EPC focused largely on the economic position and policy stance of the United States, Germany, and Japan. In all three of these countries activity had declined rather more than expected, price performance had been better than expected, and the external position was relatively strong.

Alan Greenspan presented a relatively favorable picture of the prospects for an upturn in the U.S. economy and expressed his well-known concerns about future financial strains. The reactions around the table were mixed: some doubts were expressed about the timing and sustainability of the U.S. upturn and about Greenspan's concern over the future effects of financing deficits. The German delegate observed that the present uncertainty as to the timing and extent of U.S. policy was unsettling.

The discussion of Germany acknowledged that the Government had adopted significant fiscal action--involving a fiscal stimulus estimated to be about 2-1/2 percent of GNP--as well as an easier monetary policy. While foreign orders for German products had fallen, domestic orders may have turned up again. Germany has less of an inventory overhang than other countries and the major question was not whether activity would turn up but whether the domestic expansion would be sufficiently strong and sustained to restore prosperity in Germany and permit some of its trade partners to improve their balance of payments positions.

Economic activity in Japan has fallen sharply--industrial production has dropped more than in any other major country--and the rate of price advance has moderated strikingly. The Government has adopted a number of selective and unannounced measures of a stimulative nature but its general stance is to hold off on major policy actions until the spring wage negotiations (beginning mid-April) are completed. The Japanese representatives stressed the persistence of inflation expectations, despite the recent price performance. They also believe that Japan's future growth potential will be less than in the past, perhaps 5-7 percent instead of 10 percent.

The meeting was summed up by its chairman with the statement that there was a diversity around the table in the degree of concern over the economic prospects and policies of the three major countries, but that most representatives tended to give present policies the benefit of the doubt without being fully convinced.

ATTACHMENT B

Henry C. Wallich
March 18, 1975

Report on Basle Meeting - March 10, 1975

The Governors' meeting (in effect the G-10) dealt principally with the following topics: (1) Swiss entry into the Snake, (2) economic conditions including the position of the dollar, and (3) gold.

(1) Leutwiler (Switzerland) explained the Swiss desire to join the Snake as a result of their recent unhappy experience in seeing the Swiss franc driven up. Intervention to hold it down had already added SF 2 billion to the monetary base, and while slightly more than half of this liquidity had been neutralized the target rate for the monetary base for all of 1975 was being approached by this expansion. Operating within the Snake, instead of in dollars, would probably be less expansionary.

Klasen (Germany) welcomed Swiss adherence. He seemed undisturbed by the prospect that adding another strong currency to the Snake might give the Snake a further upward bias. He said that he had overestimated the danger to German exports from a rise in the D-Mark.

Clappier (France) was not enthusiastic about Swiss entry into the Snake. He pointed out that a country in France's position, with a payments deficit, could not well join a group of currencies in the stronger economic condition. (The French have been trying to move the franc more or less in line with other Snake currencies, in the hope of eventually being able to join. Swiss entry and the resulting upward bias, as well as the implicit demonstration of strength on the part of the Swiss, creates a political problem for the French.)

In response to a question I commented that the joining together in a common float of currencies in similar economic conditions might have advantages but that attempts to bring together currencies in differing economic conditions would probably create problems.

(2) The discussion of economic conditions suggested a fair degree of confidence. Conditions in many countries are weak, but for the most part there is a belief that they can be turned around. This is particularly true of Germany and Japan. Klasen referred to the German discount rate cut as having been made in coordination with the Federal Reserve cut. The German reduction was justified, he said, in terms of the weakness of German conditions.

Carli (Italy) saw a considerable improvement in the Italian position and announced the approximate suspension of the import deposit scheme. He admitted that this might weaken monetary control.

De Strycker (Belgium) complained quite strongly about the weakness of the dollar and urged that the U.S. use interest rate policy to avoid its falling further. Intervention alone, he said, was not sufficient in the face of what he called fundamental factors.

I described the position of the dollar as cyclical. Our current account had tended to improve as a result of recession, but this effect was outweighed by the adverse impact upon the capital account of declining interest rates. Without offering predictions, I invited attention to what might happen if interest rates in the U.S. should rise as a result of heavy Treasury financing.

The discussions in the EPC focused largely on the economic position and policy stance of the United States, Germany, and Japan. In all three of these countries activity had declined rather more than expected, price performance had been better than expected, and the external position was relatively strong.

Alan Greenspan presented a relatively favorable picture of the prospects for an upturn in the U.S. economy and expressed his well-known concerns about future financial strains. The reactions around the table were mixed: some doubts were expressed about the timing and sustainability of the U.S. upturn and about Greenspan's concern over the future effects of financing deficits. The German delegate observed that the present uncertainty as to the timing and extent of U.S. policy was unsettling.

The discussion of Germany acknowledged that the Government had adopted significant fiscal action--involving a fiscal stimulus estimated to be about 2-1/2 percent of GNP--as well as an easier monetary policy. While foreign orders for German products had fallen, domestic orders may have turned up again. Germany has less of an inventory overhang than other countries and the major question was not whether activity would turn up but whether the domestic expansion would be sufficiently strong and sustained to restore prosperity in Germany and permit some of its trade partners to improve their balance of payments positions.

Economic activity in Japan has fallen sharply--industrial production has dropped more than in any other major country--and the rate of price advance has moderated strikingly. The Government has adopted a number of selective and unannounced measures of a stimulative nature but its general stance is to hold off on major policy actions until the spring wage negotiations (beginning mid-April) are completed. The Japanese representatives stressed the persistence of inflation expectations, despite the recent price performance. They also believe that Japan's future growth potential will be less than in the past, perhaps 5-7 percent instead of 10 percent.

The meeting was summed up by its chairman with the statement that there was a diversity around the table in the degree of concern over the economic prospects and policies of the three major countries, but that most representatives tended to give present policies the benefit of the doubt without being fully convinced.

Governor Hoffmeyer (Denmark) welcomed Governor Wallich, representing the Federal Reserve, for the discussion of the common intervention approach under consideration by the EC central banks. Mr. Heyvaert (National Bank of Belgium), who had outlined this scheme to representatives of the Federal Reserve in Washington on March 3-4, then presented the essential elements of the plan to the meeting.

He said that the first objective is to maintain order in the exchange markets through intervention by the central banks, without, however, opposing fundamental trends in exchange rates. A second objective of the EC plan is to promote cohesion within the group. Third hallmark of the EC plan is "concertation" which relates to both the close daily consultation among EC banks and to the joint operations they may have. The plan sets forth a specific formula for intervention, limiting daily movements to no more than 1 percent, but this guideline is not considered precise or rigid. Mr. Heyvaert stressed the need for a maximum flexibility in this regard. In defining the difficult concept of a "fundamental tendency", he suggested that the persistent movements of rates in one direction or a persistent accumulation or decumulation of reserves be the main criteria. Mr. Heyvaert noted that the Europeans all generally consider the daily fixing rate to be the basis for calculating the percentage daily swing, but the closing rate in New York could also be used.

My Heyvaert closed by saying cooperation between the EC group and the Federal Reserve was considered indispensable for the success of the plan, particularly because dollar intervention was

under consideration. Moreover, the European central banks would not want their operations to interfere with foreign exchange intervention by the Federal Reserve.

Governor Wallich responded by discussing the formal aspects of the plan, its purposes, and operating matters. With respect to the formal aspects, Governor Wallich emphasized that the U.S. could not be considered a formal participant in the EC plan but he understood that the Federal Reserve had been asked to cooperate with the EC group. He urged that there be no press statement or communique emerging from these discussions and they be kept strictly confidential. On that basis, and on our understanding of the plan, it fits within the Federal Reserve's own procedures as worked out in early February with the Bundesbank and Swiss National Bank.

Turning to purposes, Governor Wallich said that different central banks seem to have different expectations from the scheme, with differing emphasis on salient points. The "orderly markets" objective of the scheme is an attractive feature to us. At times, this may require forceful intervention, but there may be different attitudes as to the scale of operations. Also, he finds that some of the G-10 governors would like to see the scope of the Federal Reserve intervention operations broadened, to include more currencies, or the Federal Reserve to be perhaps more active to avoid any sense of "benign neglect" on the part of the U. S. authorities. He said he hoped that Under Secretary Bennett's comments to the OECD last week had relieved concerns on the question of "benign neglect". Cohesion

received different emphasis from different people. Governor Wallich said he saw some advantages of greater cohesion of European currencies but was concerned with the different circumstances of different currencies. A rigid structure of currency relationships might not be validated by the market. It might be useful to have strong currencies linked together but formal arrangements between strong currencies and those of countries with severe payments problems could lead to difficulties. He stressed that, as far as the Federal Reserve was concerned, no pegging of exchange rates is intended.

Turning to operating aspects Governor Wallich noted that the EC central banks had in mind a 1 per cent limit on daily fluctuations, which seemed to be an appropriate order of magnitude since it would be only an indication and not a hard and fast rule and since there was ample flexibility to allow smaller or greater movements under particular circumstances. Governor Wallich also cited the trade-off between the scale of operations and the need for prompt reversal, since larger amounts of intervention may build up to larger accumulative totals unless reversed more promptly. He added that the term "concertation" does not lend itself readily to a precise English definition and we think in terms of close consultation procedures which are largely already in force between the Federal Reserve and the European central banks. These procedures and technical points, such as the basis for calculating the day-to-day exchange rate movements, could be discussed further.

On this understanding of the EC plan, Governor Wallich said that the EC Governors could expect cooperation from the Federal Reserve. Governor Wallich said that he thought we could work fruitfully together to achieve the broader principles and objectives of the EC plan. The Federal Reserve would at least not act counter to the objectives of the EC central banks.

Governor Richardson (Bank of England) also urged that the agreement be maintained strictly confidential, given its very sensitive nature to the markets.

Governor Hoffmeyer then asked what differences there may be among the various G-10 governors as seen by Governor Wallich. Governor Wallich repeated that these related to the degree of cohesion within the group, the degree of forcefulness of intervention, and the possibilities for broadening the scope of Federal Reserve operations as in dealing in more currencies.

With respect to the scope of Federal Reserve operations, Vice President Emminger (Bundesbank) said that on several occasions when the Federal Reserve was intervening in marks, the mark was low in the snake, if not actually pushed to the floor. The Bundesbank had drawn this to the attention of the Federal Reserve and had asked that we intervene in both guilders and Belgian francs, which in fact was done. On that basis, Dr. Emminger thought the Federal Reserve should consider broadening its operations to currencies other than the Deutsche mark, particularly when the Deutsche mark itself was at

low levels vis-a-vis other European currencies. Governor Wallich said he understood this point, but noted that the market in New York for some of the other currencies may be rather limited, making it difficult to operate effectively in those currencies.

Hoffmeyer asked if we would be willing to intervene at the request of any of the countries within the EC, and Governor Wallich responded that there are in effect bilateral swap arrangements between the Federal Reserve and the countries involved. Whether we operate or not depends on the limitations of the foreign exchange market, and on the arrangements, such as the 50-50 risk sharing, we may have with the central bank in question.

Zijlstra urged that there not be a formal arrangement for dealing in other currencies. He prefers spontaneous phone calls between the central banks to organize such an intervention as needed.

Klasen of the Bundesbank agreed that the links should not be too formal. Consultation is the best approach, with ample conversations among the central banks to determine what is proper. Some would like the scheme to be very precise but there is the need to be flexible.

Governor Wallich asked about the reversibility of operations. Emminger responded, again citing the Bundesbank's experience, noting that with the possibility of reversal in mind the 1 percent rule should be suspended under certain circumstances. Over the past three months the Federal Reserve had tried the 1 percent rule. In practice, it has been applied on days that the dollar has declined, but when

the dollar has risen, the System has allowed uptrends to exceed 1 percent. But the System has to decide each time, based on a feel of market conditions. As far as full reversal, one cannot say a priori what the timing may be. Last year, there had been substantial intervention in dollars, as it declined from February through May, during which the Bundesbank increased its reserves by DM 5 billion. Nevertheless, there had been a complete reversal by August with a reduction in German reserves of a similar order. Last spring the Federal Reserve could not have forecast the timing and magnitude of the outcome.

Governor Wallich agreed with these considerations but asked more specifically about shorter-term reversibility. Zijlstra commented that it depended on the trade-off between reserves and exchange rates, whether the central bank wanted to have an effect on the rate or not. Klasen suggested that the governors avoid being too theoretical. It was sufficient to talk about orderly exchange market conditions and not to set objectives for short-term exchange rate policy.

Zijlstra agreed that all hypothetical questions cannot be answered now and that it would be better to act on the basis of a spirit of cooperation between the EC and the Federal Reserve. It's important to gain experience with these procedures and to then review that experience as necessary. Governor Wallich concurred.

ATTACHMENT C

March 17, 1975

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 18, 1975

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that real output of goods and services is continuing to fall sharply in the current quarter. In February industrial production and employment declined substantially further. However, the unemployment rate was unchanged, at 8.2 per cent, as the civilian labor force declined. Average wholesale prices of industrial commodities rose moderately again in February, and prices of farm and food products declined sharply further. The advance in average wage rates, although large, remained well below the increases of last spring and summer.

The foreign exchange value of the dollar declined in February, but it strengthened somewhat in early March, as short-term interest rates abroad fell further and as market attitudes toward the dollar improved somewhat. In January the U.S. foreign trade deficit was only moderately above the rate in the fourth quarter of 1974 despite a large bulge in recorded imports of oil. Net outflows of capital reported by banks continued large as foreigners withdrew deposits.

The narrowly defined money stock, which had declined sharply in January, expanded considerably in February, and broader measures of the money stock grew at substantial rates. Net inflows of consumer-type time and savings deposits were particularly large. Large-denomination CD's outstanding contracted in February and total bank credit showed little net change. Business demands for short-term credit remained weak, both at banks and in the commercial paper market, while demands in the long-term market continued exceptionally strong. Since mid-February short-term market interest rates have changed little while longer-term yields have risen. Federal Reserve discount rates were reduced from 6-3/4 to 6-1/4 per cent in early March.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to cushioning recessionary tendencies and stimulating economic recovery, while resisting inflationary pressures and working toward equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPH

Alternative A

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

Alternative B

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

Alternative C

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

March 18, 1975

Points for FOMC guidance to Manager in implementation of directive		Specifications (As agreed, 3/18/75)		
A. <u>Longer-run targets (SAAR):</u>	Jun. '74- <u>Jun. '75</u>	Dec. '74- <u>Jun. '75</u>	Dec. '74- <u>Sept. '75</u>	
M_1	3-3/4%	4-1/2%	6%	
M_2	6-3/4%	7-1/2%	8-1/2%	
Proxy	6%	6-1/2%	8%	
B. <u>Short-run operating constraints:</u>				
1. Range of tolerance for RPD growth rate (March-April average):				3-1/2 to 5-1/2%
2. Ranges of tolerance for monetary aggregates (March-April average):		M_1		5 to 7-1/2%
		M_2		8 to 10%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):				4-3/4 to 5-3/4%
4. Federal funds rate to be moved in an orderly way within range of toleration.				
5. Other considerations: account to be taken of developments in domestic and international financial markets.				
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.				