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 and Wednesday, February 17 and 18, 1976, beginning at 4:00 p.m. on Tuesday.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Baughman
Mr. Coldwell
Mr. Eastburn
Mr. Holland
Mr. Jackson
Mr. MacLaury
Mr. Mayo
Mr. Partee
Mr. Wallich

Messrs. Balles, Black, 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
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Mr. Holmes, Manager, System Open Market Account

Chairman Burns observed that, as the members were aware, the United States District Court for the District of Columbia had ruled orally against the Committee in a suit that had been brought under the Freedom of Information Act. It was possible that the Court's final written order would require, among other things, that the Committee make its policy decisions public on the day of their adoption. Should that part of the Court's order concerning policy decisions refer only to the domestic policy directive, he would recommend that the Committee comply with the spirit as well as the letter of the order and make public at the same time the short-run ranges of tolerance adopted for the aggregates and for the Federal funds rate. He would also recommend that the Committee petition the Congress for explicit authority to determine a period no longer than 45 days during which the directive could be withheld.

The Chairman remarked that the Court also had ruled that segregable statements of fact in the Committee's memorandum of discussion must be made available on demand. In his view, that would not do anyone any good and it would not do the Committee any harm. However, there was the possibility of other suits and other adverse rulings leading to much more prompt release of the entire memorandum. In the interest of preserving uninhibited deliberation on the part of the members, the Committee should give serious consideration to ways of dealing with the problem. To assist in that process, he proposed to appoint a subcommittee.

After discussion, the Committee agreed with the Chairman's recommendations and with his proposal to appoint a subcommittee. Thereupon, the Chairman designated Messrs. Coldwell (Chairman), Mayo, Partee, and Winn as members of the Subcommittee on the Memorandum of Discussion.

The following then entered the meeting:

Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. Gramley, Economist (Domestic Business)
Messrs. Boehne, Davis, Green, Kareken, Reynolds, and Scheld, Associate Economists

Mr. Pardee, Deputy Manager for Foreign Operations
Mr. Sternlight, Deputy Manager for Domestic Operations

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

Mr. Leonard, First Vice President, Federal Reserve Bank of St. Louis

Messrs. Eisenmenger, Parthemos, Balbach, and Doll, Senior Vice Presidents, Federal Reserve Banks of Boston, Richmond, St. Louis, and Kansas City, respectively
Messrs. Brandt and Keran, Vice Presidents, Federal Reserve Banks of Atlanta and San Francisco, respectively
Ms. Tschinkel, Adviser, Open Market Operations, Federal Reserve Bank of New York
Mr. Hall, Economist, Federal Reserve Bank of Cleveland

Chairman Burns then called for a discussion of the Committee's procedures in setting its 2-month ranges of growth for the monetary aggregates. He noted that the staff had recently concluded a study of alternative methods for making seasonal adjustments in the money supply series. The results of the study had important implications for the short-run ranges of growth that were specified by the Committee at each meeting.

Over the past 3 years, the Chairman continued, the width of the ranges for both M_1 and M_2 had varied from 2 to 5 percentage points; these were ranges for growth rates over 2-month periods calculated at an annual rate. The average width of the ranges adopted for M_1 had been about 3 percentage points and that for M_2 a little under 3 percentage points. Over the same period the staff had almost invariably proposed a range of 2 percentage points for both M_1 and M_2. However, in its memorandum of February 10, 1976, to the Committee,[1/] the staff was now recommending a range of 4 or 4-1/2 percentage points for M_1 and 3 or 3-1/2 percentage points for M_2.

The Chairman added that the staff had made a related recommendation, namely, that the range adopted by the Committee

1/ A copy of the memorandum, entitled "Seasonal and other uncertainties in the money supply and operating implications," has been placed in the Committee's files.

be viewed as a true zone of indifference for the inter-meeting period. That recommendation could be interpreted in strict form, with the entire range being viewed as a zone of indifference, or in qualified form, with the Manager permitted to begin shading his operations as either limit of the range was approached.

The Chairman then asked for Committee discussion of the staff recommendations. He remarked in reply to a question that he was using the term "zone of indifference" to mean the same as the expression "range of tolerance" employed in the staff memorandum. It was his impression that the term "zone of indifference" might be a little clearer.

Mr. Leonard indicated his support of the proposal to broaden the 2-month range for M_1 to 4 or 4-1/2 percentage points, and said he would also want to view the wider range as a true zone of indifference. However, he believed that in setting its monetary growth objectives for longer periods of time, such as 6 months, the Committee should use a significantly narrower range or perhaps a specific growth rate.

Mr. Wallich remarked that each member of the Committee would probably have a preference for a particular growth rate within the wider range, even though that member might not be greatly disturbed if the rate fluctuated toward either end of the range. Accordingly, he did not think the notion of a zone of indifference quite reflected the way the members viewed the short-run aggregates.

The Chairman said he agreed that individual members might prefer specific growth rates. Unfortunately, the errors involved in measuring short-run rates of growth were so large that when the Committee specified a 2-month range of 4 to 8 per cent, for example, one could not really distinguish a 4 per cent rate from an 8 per cent rate. Thus, the issue was not whether the Committee wanted a narrower range or even a specific growth rate, but how to take into account the very imprecise techniques for measuring growth in the short run.

Mr. Wallich observed that given such a degree of uncertainty about short-run rates of growth in the aggregates, one's instincts would be to seek some other standard for guiding System operations.

The Chairman commented that one choice available to the Committee would be to stop using the monetary aggregates in its instructions to the Manager, but he doubted that the Committee would favor that alternative. Over time periods longer than 2 months, monetary growth rates could be measured with greater precision, and while members held different views of the relationship between money and economic activity, and between money and prices, he thought every member agreed that some significant relationships existed.

Mr. Black asked whether viewing the entire range specified for an aggregate as a zone of indifference might not require moving the Federal funds rate in larger steps than had been customary and whether that would have some implications for financial markets.

Mr. Axilrod said he would not anticipate a need for any change in Committee instructions with regard to the size of movements in the Federal funds rate. To be sure, adoption of a zone of indifference would lead to a less prompt response to the incoming data on the monetary aggregates. However, that need not require larger changes in the funds rate than occurred under current procedures.

Mr. Black agreed that the Committee would not necessarily change its approach to the Federal funds rate, but he thought there would be a tendency to suggest somewhat larger moves when the limits of the zone of indifference were reached or exceeded.

Mr. Axilrod said he would assume that as the limits were approached or reached, the Manager would move the Federal funds target a little--perhaps by 1/8 percentage point or so. If the aggregates moved outside their ranges, the Manager would begin to use the available range for the funds rate more actively. For example, he might move the funds target by 1/4 percentage point in one week and by an additional 1/4 percentage point in the following week. In his view the Manager's response would be essentially the same as at present, except that it would take somewhat larger deviations from the expected rates of growth in the aggregates to initiate the process.

Chairman Burns said his response would have been the same as Mr. Axilrod's. He asked Mr. Holmes for his view.

Mr. Holmes indicated that he too agreed with Mr. Axilrod's interpretation. Larger deviations from the midpoints of the ranges specified for the aggregates would be required to activate Desk operations to move the funds rate, but then the response would be about the same as before. If the Committee wanted the Federal funds rate to move in larger steps, it would have to instruct the Desk accordingly.

Mr. Jackson said he supported the concept of broader ranges for growth in the aggregates in the short run. If the Committee adopted something like the staff's proposals, he believed the staff should present policy alternatives in the blue book that differed more substantially one from the other than they had in the past. For example, the spread between the upper limit of the alternative A range and the lower limit of the alternative C range was only 5 percentage points in the current blue book, and since a range of 4 percentage points was proposed for each alternative, the three ranges overlapped to the extent of 3 percentage points.

The Chairman remarked that the staff proposal for widening the short-run ranges did not represent a major departure from past Committee practice. As he had indicated, the average range for M_1 had been 3 percentage points over the past 3 years, and in recent months the range had been 3 or 4 percentage points.

Mr. Partee commented that a zone of indifference was clearly justified by the imprecision of the statistics. Recalling his own experience in having to decide on appropriate seasonals, he could well understand how a variety of seasonal adjustments might be made from a scatter diagram representing the short-run behavior of the monetary aggregates. He doubted, however, that the zone of indifference should be as wide as the staff memorandum purported it to be. The staff had used nine alternative seasonal adjustment procedures in its analysis, and he believed there should be some basis for choosing among them. The nature of the statistical series in question led him personally to prefer a moving seasonal adjustment procedure to a constant seasonal correction technique. In that connection it might be noted that one of the procedures making use of constant seasonals accounted for nine of the twelve extreme observations in the monthly growth rates calculated for 1975. The monthly growth rates based on that seasonal adjustment technique varied from a decline of 10.9 per cent to an increase of 19.2 per cent. He could only conclude that the technique produced essentially unstable results. His impression--which would need to be confirmed by careful calculations--was that the appropriate zone of indifference, based on seasonal adjustment procedures that he regarded as reliable, might be closer to 2-1/2 percentage points than to the 4 or 4-1/2 percentage points suggested by the staff.

Mr. Axilrod said his recollection was that if the two extreme results for each set of nine calculations of seasonals were left out, the range between the high and the low estimates for the 2-month growth rates would average around 2-1/2 percentage points. At the moment, he did not have the calculations at hand.

Mr. Partee said that the calculation just referred to by Mr. Axilrod was consistent with his impression that an appropriate zone of indifference should be narrower than the one suggested by the staff.

Mr. Holland commented that the staff memorandum was useful in flagging one possible source of error in the data for the monetary aggregates. There were other potential sources of "statistical noise" as well.

The Chairman commented that Mr. Holland had made a good point. Even if, as Mr. Partee had suggested, the alternative seasonal calculations covered too wide a range, the Committee still had to take into account other sources of error in setting the width of a zone of indifference.

Mr. Holland said he had wrestled with the problem of establishing appropriate zones of indifference and had concluded that relatively wide ranges should be set for the first week or two following each Committee meeting. The zones of indifference should be narrower--possibly 3 percentage points instead of 4--later during the inter-meeting period. The rationale for his proposal was the need to take account of a series of weekly deviations, which he would regard as much more significant than even a sizable deviation in a single week. An individual week's number could be a "sport" for all sorts of reasons. Indeed, work done for the Subcommittee on the Directive suggested that close to 75 per cent of individual weekly deviations from trend were reversed in the subsequent week. In short, the weekly numbers were largely independent observations.

Mr. Holland added that another consideration leading him to make his proposal was his belief that a start should be made in moving the Federal funds rate in the period between Committee meetings, if evidence began to accumulate that the aggregates were deviating from their expected rates of growth. The Committee had a record of being laggard in adjusting monetary policy to unfolding developments, and in his judgment it was desirable to continue the current procedure of allowing the Manager to alter his operations during inter-meeting periods.

The Chairman commented that Mr. Holland had made a significant point but that he might be overstating his case. Even if the Committee were to adopt a strict 4-1/2 percentage point zone of indifference for M_1, the Manager would still have to move the Federal funds rate fairly frequently between meetings. Of course, the rate adjustments would not be as frequent as under the rule proposed by Mr. Holland.

Mr. Holland indicated that he would be willing to tolerate an occasional false start in order to diminish the risk of delaying a needed turn in monetary policy. He did not think the damage would be very great, and indeed a "zigzag" or two that tended to keep the market guessing had not always been regarded as bad.

The Chairman said he found Mr. Holland's suggestion very interesting, but he wanted to make a factual point. Estimates of current rates of monetary growth were actually projections that were subject to a considerable margin of error. For example, fairly firm figures on January rates of growth had become available only in the past week and even those figures might be revised to some extent.

Mr. Axilrod noted that the staff would normally anticipate a revision of up to $200 million in the figure for the January level of M_1 that had been published on February 12.

Mr. Coldwell commented that the Committee should perhaps look only at past monthly figures instead of relying on staff projections.

The Chairman noted that Mr. Coldwell had pointed to one possibility. Another approach, which the staff was exploring actively, would be a procedure under which known figures received the greatest weight and projections for subsequent weeks were given progressively diminishing weight. He asked Mr. Axilrod about the status of the staff's work on this project.

Mr. Axilrod indicated that the project was taking a fair amount of time, partly because it was felt desirable to extend the data base for the study back several years. Also, the staff wanted to experiment with a number of rules of thumb to see if they could improve their projections. In effect, the staff was using such rules now, but they were purely intuitive in nature.

With reference to his earlier comments on seasonal adjustments, Mr. Axilrod then said that if the two extreme calculations produced by the nine alternative seasonal adjustment techniques were dropped, the difference between the high and the low growth rates of individual months would average about 3-1/2 percentage points. For 2-month periods the average would be about 2 percentage points--rather than 2-1/2 percentage points, as he had indicated before.

The Chairman observed that dropping two extreme calculations was not equivalent to dropping two alternative methods of calculation.

Mr. Partee said he agreed with the Chairman's observation and suggested that a desirable procedure would be to drop the two methods that produced the most extreme results.

Mr. Mayo remarked that he was reminded of the Chairman's warning to the Committee some time ago against placing too much emphasis on the short-run ranges of tolerance for the monetary aggregates. He feared the Committee was falling into that trap again today. The staff's analysis of seasonal adjustment procedures had underscored the imprecision of the measurement of rates of monetary growth in the short run. The Committee was seeking a solution to that problem by broadening the zones of tolerance for those measures. As the Chairman had observed, one could not distinguish a 4 per cent rate of growth for M_1 in the short run from an 8 per cent rate. That sort of imprecision led him to question the value of 2-month operating ranges. He wanted to retain the monetary aggregates as guides to operations, but he wondered whether the Committee should not be thinking in terms of 3-, 4-, or even 6-month ranges. The Committee was committed, for better or for worse, to 1-year growth ranges for the aggregates, but to associate unduly short-term operating ranges with the latter only served to create problems for the Committee. He found it frustrating to try to solve those problems by broadening the zones of tolerance to encompass all sorts of short-run aberrations.

The Chairman said he understood Mr. Mayo's frustration. A possible solution would be for the Committee to maintain narrower ranges of tolerance--say, 3 percentage points for M_1--but to lengthen the period to which those ranges would apply, as Mr. Mayo had proposed. The difficulty with such an approach was that more guesswork would be involved for the Desk. Under the current procedure the Desk started out with at least some data for 2 or 3 weeks of the 2-month period and had to rely on projections for the remaining 5 or 6 weeks. If the period were lengthened to 3 months, the number of weeks to be projected would be that much larger.

Mr. Mayo said he had in mind going in the other direction and being guided more by recent history than by projections.

Mr. Jackson suggested that a period of 3 months might include 6 weeks of past data and 6 weeks of forward estimates.

Mr. Balles said he thought the idea of relying more heavily on past experience had merit.

The Chairman commented that such an approach might be an improvement, but he would want to study it carefully before reaching a definite opinion. He asked Mr. Axilrod whether the staff had made any studies bearing on the question.

Mr. Axilrod replied in the negative. He added that lengthening the period would tend to affect Desk operations in the same way as widening the ranges of tolerance.

Mr. Mayo said his concern with the Committee's procedures had been increased by the repeated shortfalls in recent months from the Committee's short-run ranges. He wondered if the Committee was not tending to overlook such shortfalls even though it had a 1-year range for growth in mind. One had the impression that the Committee was wandering in all directions.

Mr. Axilrod commented that even though a 4 per cent rate of growth might not be distinguishable from an 8 per cent rate over a 2-month interval, the staff was not suggesting that a series of 4 per cent rates was indistinguishable from a series of 8 per cent rates. For example, if a 4 per cent rate of growth was indicated for two successive policy periods in which the Committee had set a 4 to 8 per cent range, the Committee would probably decide to lower the Federal funds rate in order to move back toward its longer-run path for M_1.

Mr. Mayo said his major concern was to achieve the Committee's longer-run objectives for the monetary aggregates. It had been argued, quite persuasively in his opinion, that the only proper basis for judging the Committee's performance with respect to the aggregates was in terms of growth over the long run. Perhaps the erratic nature of the seasonals made wider ranges necessary for the short run, but solving the problem in that way would lead critics to argue that those ranges were becoming so wide as to be meaningless. It would be inferred, erroneously, that the Committee was now less firmly committed to its longer-run ranges for the aggregates.

Chairman Burns said there might well be criticism of that sort. Indeed, one already heard it now and then. However, monetary policy would be judged fundamentally on the behavior of financial markets and the general economy. There had been little criticism of the Federal Reserve during his testimony at a recent Congressional hearing. An important reason was that the economy was doing better; another was that the judgment of System officials on velocity had proved to be right in contrast to that of people outside the Federal Reserve. Perhaps the most important reason was the fact that interest rates had moved down. It was fashionable for System critics to speak about the monetary aggregates, but what some of them really wanted was lower interest rates.

Mr. Holland remarked that Mr. Mayo had provided the Committee with a compromise proposal that could help to overcome some of the reservations that had been expressed around the table. Adding the prior month's data to the 2-month period currently used for the short-run ranges would smooth seasonal aberrations and make it possible to keep the ranges of tolerance fairly narrow.

Mr. Partee observed that 2 of the 3 months in the proposed period for the ranges would already be determined. The Committee would therefore have little scope to affect average growth rates over the 3-month period.

Mr. Balles referred to Mr. Mayo's suggestion and asked Mr. Axilrod whether the staff had considered using moving averages of past weekly data to establish a relatively reliable basis for changing the Federal funds rate. He noted that research conducted at the Federal Reserve Bank of San Francisco suggested that a 3-month moving average of past weekly observations might provide a helpful benchmark for judging the short-run behavior of the monetary aggregates in relation to the Committee's longer-run ranges for those aggregates. He would not propose that the Committee adopt such a procedure without testing it thoroughly, but like Mr. Mayo and others, he thought current weekly data were too unreliable to provide a basis for corrective action by the Desk. The approach he had in mind would imply a belated adjustment in the Federal funds rate when the aggregates were clearly getting off target, but he felt a tardy response was preferable to a wrong response.

Mr. Axilrod said that the Board staff had not studied the possibility of using moving averages based on past weekly data or the related approach outlined by Mr. Mayo, but he thought it would be desirable to undertake such studies. In particular, it would be useful to investigate the length of the period required for a string of shortfalls or overshoots to be significant in the sense of overwhelming the erratic elements in the series. He would note, without intending any normative conclusion, that the approaches in question would have the effect of diluting the influence of the latest data.

Chairman Burns left the meeting at this point and was absent for the remainder of the afternoon session, during which Mr. Volcker presided.

Mr. Balles commented that widening the short-run ranges would help to take account of the uncertainties in the weekly data. However, it would contribute nothing in the way of systematic procedures for moving growth in the aggregates back toward its longer-run path after a deviation had occurred. He wondered, therefore, whether it might make sense for the Committee to take account of deviations when it adopted 2-month ranges. Given the current shortfall in M_1, for example, his staff had calculated that the upper limit of the range for M_1 should be set at 12-1/2 per cent to get that aggregate back to its longer-run path. The lower limit of the 2-month range might be set at the bottom end of the longer-run range--that is, 4-1/2 per cent.

Mr. Axilrod observed that the Committee might wish to consider a number of approaches along the lines suggested by Mr. Balles. One possibility, which was discussed in the staff memorandum, would be to shift the entire short-run range in the appropriate direction when a deviation had occurred. For example, under present circumstances the Committee could decide to set the M_1 range at a relatively high level to make up for the short-fall in recent months.

Mr. Baughman said he wanted to endorse further investigation of the suggestion made earlier by Mr. Holland. The proposal was generally consistent with others that had been made, and it also had the advantage of keeping the contemplated zone of indifference within a reasonable dimension. He believed it would be a mistake for the Committee to adopt and attempt to defend a relatively wide zone of indifference with respect to measures of such significance for monetary policy.

Mr. Wallich said he too was troubled by the proposal to adopt a relatively wide zone of indifference. He did not believe individual policymakers were really indifferent to possible outcomes within such a zone, although they might be prepared to tolerate them. For example, if one's preference was for an 8 per cent growth rate within a 4 to 8 per cent range, an outcome of 4 per cent would lead to a preference for a higher growth rate than otherwise in succeeding months. The converse would, of course, be true for one who had preferred a 4 per cent rate in the first instance. In this situation it would become increasingly difficult for people whose preferences lay at opposite ends of the 4 to 8 per cent range to reach agreement at succeeding meetings.

Mr. Wallich added that a relatively wide range might be appropriate for a period of special uncertainty with regard to the behavior of the monetary aggregates. However, the need for such a range was not a permanent condition. Indeed, one would expect that uncertainties, such as the current ones relating to the demand for money, would be reduced over time and that use of a narrower range would again be feasible. In sum, the Committee might temporarily adopt a wider range, implying more emphasis on the Federal funds rate, but such a procedure should be regarded as a makeshift.

Mr. Eastburn commented that to a considerable extent the issue before the Committee was a technical one. However, a policy issue also was involved, in that the Committee had to weigh the risks of excessive or inadequate movements in the Federal funds rate. If the weekly data were interpreted too literally, the Committee would be making some false starts, as Mr. Holland had pointed out, and would have to backtrack. However, the risk on the other side seemed greater to him since past experience suggested that movements in the Federal funds rate had often been inadequate or tardy. Accordingly, he believed that whatever specifications and whatever ranges of tolerance were adopted, there should be more leeway, rather than less, for the Federal funds rate to be moved in the future.

Mr. Morris said he agreed with Mr. Eastburn. The proposed widening of the short-run ranges, in association with a policy of not moving the Federal funds rate until the limits of the wider range were approached, seemed to him to be a formula that would encourage a more sluggish response in monetary policy. Quite clearly, the Committee's main problem in the past had never been a tendency to move the Federal funds rate in an erratic manner. Since a consensus in favor of the staff proposal had not emerged, and there was dissatisfaction with the current procedure, he thought the Subcommittee on the Directive should be invited to come up with an alternative proposal.

Mr. Volcker commented that the staff proposal seemed to involve a fairly simple change in current procedures that would take into account the uncertainties associated with seasonal adjustment techniques. However, in its discussion the Committee had complicated the issue by raising a number of other questions about the conduct of monetary policy. He could understand the restiveness of Committee members about broadening the short-run ranges, but he thought the Committee could do little about the instability of the data that had been documented in the staff paper. In that connection he believed it was important to note that a series of 4 per cent rates of growth was significantly different from a succession of 8 per cent rates, as Mr. Axilrod had observed.

The problem that the Committee was grappling with, Mr. Volcker continued, was how to take account of the short-run instability in the data in working toward longer-run objectives. The Committee had to decide when a deviation in monetary growth from the longer-run path had lasted long enough to justify remedial actions; it had to recognize that a premature reaction to a deviation could cause trouble in the future, both because the data were subject to revision and because monetary policy actions affected developments with a lag. A number of mechanical approaches had been proposed to resolve the Committee's problem and they needed to be studied further.

Mr. Jackson inquired whether the Committee might have less of a problem with the data if it considered seasonally unadjusted figures. The Committee's current practice was to use data that were seasonally adjusted and expressed at annual rates. He could see an advantage from a public relations point of view in publishing adjusted data, but he wondered whether the operational process might not benefit from the use of unadjusted data.

Mr. Jackson added that errors could arise because the staff might be wrong in its basic forecast of the aggregates, and errors arising from seasonal adjustment techniques were superimposed on those. If his understanding of staff procedures was correct, it seemed to him that the Committee should stop at the first source by using the staff's actual projections before seasonal adjustment.

Mr. Axilrod commented that errors in the staff's basic projections would affect the seasonally unadjusted as well as the adjusted data. Thus, regardless of which data were used, the problem would remain the same. The Committee would still have to decide how much weight should be given to incoming figures, how prompt the reactions to them should be, and indeed what value should be assigned to the staff projections, which were themselves highly uncertain. One of the benefits of widening the short-run ranges was that it would reduce the extent to which the Desk reacted to what were essentially staff guesses as to the future. The problem might be solved in a variety of ways, and the staff would be looking into the suggestions that had been made.

Mr. Partee observed that it was difficult to communicate in terms of seasonally unadjusted data. For example, an increase of $500 million in the money stock would mean a different thing at one time of the year than at another. It was hard to adjust monetary data for seasonal influences, but the Committee had to cope with that problem. Department stores approached the problem by looking at sales on a year-over-year basis, but they also took into account the special effects of key dates such as those of Easter and Christmas.

Referring to the proposal before the Committee, Mr. Partee said he would be willing to see a wider range for growth in the aggregates in the short run, but as he had suggested earlier he did not think the Committee should establish a zone of indifference as wide as 4 or 4-1/2 percentage points; a range of a couple of percentage points seemed about right to him. When growth in the aggregates appeared to be outside such a zone, the Desk should begin to react, and of course, it should do so more vigorously if the aggregates continued to fall beyond the zone of indifference as time went on.

Mr. Volcker said that his 6 months of experience on the Committee suggested to him that the most important feature of the staff recommendations was the widening of the short-run ranges of tolerance for the aggregates--in effect, widening the zones of indifference--so that deviations in growth rates from the midpoints of the specified ranges did not necessarily trigger changes in the Federal funds rate. In the past, the Committee had contemplated operations in that manner at times but it had not at other times, such as at the last meeting.

Mr. Axilrod commented that until the last meeting or two, and for a period of some 2 years before then, a deviation from the midpoint of more than about 1/2 percentage point would have triggered a move in the Federal funds rate.

Mr. Volcker remarked that use of a wider zone of indifference would make quite a difference in Desk operations, regardless of whether or not the ranges for the aggregates were widened.

Mr. Coldwell said he could not support a wider range of tolerance with a zone of indifference within that wider range.

Mr. MacLaury said he could not recall any instance when the Committee had been led astray by the mechanistic linking of the Federal funds rate to the midpoint of the ranges for the aggregates. It was possible that a close examination of the record might reveal an instance or two when the Committee had decided to backtrack, but he still felt that the Committee was fighting a nonproblem in its effort to avoid gyrations or "wrong" movements in the Federal funds rate. In that connection he had a good deal of sympathy for Mr. Mayo's suggestion, or perhaps some refinement of it. He could live with a zone of indifference of a couple of percentage points, which Mr. Partee had recommended in preference to a wider zone, but he did not see why the Committee should make a substantial change in its operating techniques when it was dealing with a nonproblem and when it was going to investigate a number of alternatives to a wider range.

Mr. Volcker said he was not sure a nonproblem was involved, but he also did not see any need to reach a decision at this time. The staff would work on the suggestions that had been made around the table, and a decision could be reached later on the various alternatives. It was recognized that particular observations might not be very meaningful, and accordingly it had been suggested that the Committee use observations for a longer period of time, involving both back data and projections. Such an approach might also be combined with a zone of indifference that was narrowed over the course of an inter-meeting period.

Mr. Holland noted that the Stage II Report of the Subcommittee on the Directive was on the agenda for today's meeting. Since the time had come to recess until tomorrow morning, he would distribute some comments that he had prepared to introduce the subject. Committee members might find them helpful when they returned to the matter at a later meeting.[1/] Also, some Committee members might wish to attend a special briefing session with staff specialists after the meeting ended tomorrow.

Mr. Volcker remarked that the Committee had not gotten to another item on today's agenda regarding the weight that should be given to disparate movements in M_1 and M_2. He did not feel that there was enough time to

1/ A copy of Mr. Holland's prepared comments, dated February 17, 1976, has been placed in the Committee's files.

discuss the issues that were involved, but he understood that Mr. Holland had a proposal to make for future Committee consideration.

Mr. Holland said he wanted to put a compromise proposal before the Committee. He would suggest that the two aggregates be weighted on a 50-50 basis. As he interpreted the Committee's past discussions of this issue and the Manager's operational response, there had been a tendency to attach more weight to movements in M_1 than to those in M_2. The evidence reviewed by the Subcommittee on the Directive did not suggest, however, that M_1 should be weighted more heavily than M_2. He was proposing not a strictly arithmetic procedure but a flexible approach where the central tendency would be to value movements in M_1 and M_2 on a 50-50 basis.

The meeting then recessed. It reconvened at 9:30 a.m. the following morning with the same attendance as at the beginning of the Monday afternoon session except that Mr. Eisenmenger was absent and the following were present:

Mr. Zeisel, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Gemmill, Adviser, Division of International Finance, Board of Governors

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on January 20, 1976, were approved.

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 January 20 through February 10, 1976, and a supplemental report covering the period February 11 through 17, 1976. 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:

> Exchange rate relationships have undergone a severe test since the last FOMC meeting. Mainly, the testing has been of the European snake alignment, with pressures reminiscent of those which have forced countries to withdraw from that arrangement in the past. On January 21, the Italian authorities decided they could no longer hold the lira at previous levels in the face of continuing strong selling pressure. They pulled out of the market completely and the lira has dropped by up to 12 per cent in occasionally disorderly trading. Although the lira was not tied to the snake, the Bank of Italy had been intervening to maintain a close relationship with other European currencies, and the sudden drop in the lira altered competitive relationships in Europe substantially.
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> In particular, the Italian action triggered heavy selling pressure on the French franc, a currency historically subject to surprise devaluations and currently subject to rumors of a cut in the exchange rate. The French authorities considered the pressure to be purely speculative and responded with vigorous intervention, mainly in dollars, to resist the erosion of the franc with respect to the D-mark and other snake currencies.

Some of the immediate flows from francs went into marks, setting off--as the mark rose--the kind of two-way speculation which has been a characteristic of the EC snake at times of uncertainty. A similar speculative dumping of Belgian francs in favor of Dutch guilders came on the heels of rumors that the margins between Benelux currencies would have to be widened to 2-1/4 per cent from their present 1-1/2 per cent.

At first, the dollar was in a fairly neutral position. Further evidence of an economic recovery much stronger here than abroad helped reinforce the market's favorable assessment of the outlook for the dollar, and traders took in stride such news as the cut in the Federal Reserve discount rate and publication of a smaller U.S. trade surplus for December. When the dollar did come under occasional selling pressure in New York in late January and early February, we were able to avert broader unsettlement by modest intervention out of our mark balances. Through the first week of February the dollar had declined by about 1 per cent, and we had intervened on three occasions, selling $42.4 million worth of marks. In fact, our intervention was generally taken favorably by the market.

While the dollar itself was basically strong, it could not, because of its role as an intervention currency, avoid the pressures arising from the snake difficulties. As you know, the dollar is the main vehicle for moving large blocks of funds from one currency to another, and although the outflow from French francs initially came into dollars, these dollars were in turn sold for German marks. The Bank of France recognized that its dollar intervention was occasionally pushing the dollar rate down--even against the franc--and increasing the total supply of dollars in the market place. The French in fact hoped to intervene directly against marks and, thus, relieve some of the pressure on the dollar. The German Federal Bank, however, mindful of its own domestic monetary targets, was reluctant to create additional mark liquidity through substantial exchange intervention. Thus, as the speculative pressures mounted, the market realized that the German Federal Bank was not intervening as strongly as the French on the other side; the balance of market forces turned in favor of the mark, prompting a generalized demand for marks. Vigorous French denials of devaluation rumors and German denials of revaluation rumors had, if anything, a perverse effect on market psychology, as such denials quite often do. Of course, this is a familiar story to people in the market.

The situation was deteriorating rather rapidly by the time of the Basle meeting, on February 9, and after further bilateral discussions that day, the German Federal Bank and the Bank of France agreed that they would coordinate intervention in each other's currencies as well as in dollars. Operations under that agreement were very heavy over the following 3 days, raising the Bank of France's intervention in dollars during the period since the last meeting of this Committee to \$1.6 billion. The combined intervention in marks and francs in a few days came to \$390 million equivalent. At the same time, in rather frantic market activity, there was substantial intervention by the Belgians and the Dutch in their respective currencies. And there was also support, mainly by the Germans, of the Danish kroner, which was at the bottom of the snake.

Meanwhile, for our part, the Federal Reserve responded rather forcefully to avoid a spillover of speculative pressures on the dollar. The dollar dropped off a further 2 per cent against the mark through February 11, and we sold an additional \$115 million in marks, including \$81 million drawn on the swap line with the German Federal Bank. We also sold \$19.6 million of Dutch guilders drawn under the swap line with the Netherlands Bank; and the Swiss themselves were intervening in New York, but for their own account. The dollar has since recovered to about 1-1/2 per cent above last week's low, and since Friday we have already accumulated some \$16 million of marks, which we can use to repay our swap debt.

As you know, the Bank of Italy drew \$250 million under the swap arrangement. These funds have not been used, since the Italians have been out of the market, but they do figure importantly in the Bank of Italy's plans for intervention when it does return to the market. They have not yet set a date for this resumption of intervention but feel an obligation to get back into the market once the new government has been sworn in and has weathered a vote of confidence. They have made it quite clear that they intend to operate in the market more flexibly than in the past in order to conserve their cash reserves. Just recently they have gained agreement in principle from the EC Finance Ministers for an oil facility borrowing of about $700 million, with the possibility that this may be available before the end of March. In view of that possibility, they have asked if we would agree to a further $250 million swap availability, bringing the total to $750 million, repayable out of the proceeds of the EC as well as the IMF borrowing. Their point, which I think is well taken, is that a substantial package will lend a creditable influence on the exchange market when they do resume operations. Moreover, the more they have in hand and can show to the market, the less they may have to use. This appears to me to be a reasonable request--subject to approval by the Chairman once fully satisfactory information about the availability of take-out credit becomes available.

In other operations, on the basis of our program of regular purchases of Belgian francs, we repaid a total of $40 million during the period. Although the franc was caught up in the speculative storm and was quite weak against the guilder, the dollar-franc rate is still not favorable to accelerating our purchases. We have also arranged to purchase some $13 million worth of Swiss francs from the Swiss National Bank in connection with an IMF oil facility transaction and its own need for foreign currencies. We will add these francs to our balances for the time being, but eventually we will use them to repay on the swap debt.

Chairman Burns remarked that the most important part of Mr. Holmes' report probably was the Bank of Italy's request that the System make available an additional $250 million on the swap line, with the take-out provisions indicated. He asked whether members of the Committee had questions on that or on other aspects of Mr. Holmes' report.

Mr. Partee inquired whether Mr. Holmes anticipated that any drawings that the Italians might make on the swap line would be repaid within 3 months.

Mr. Holmes replied that the Italians expected to have funds available by the end of March with which to repay drawings on the swap line. Whether they repaid immediately or not would depend on circumstances. If by then they had drawn only modest amounts on the swap line and did not immediately draw funds on the EC oil facility, it would be reasonable for the System to allow the drawing to remain outstanding for the normal period of 3 months before seeking repayment. Whenever the Italians drew on the EC facility, the debt to the System would be the first to be repaid.

Mr. Pardee added that it was preferable to link repayment of Italian drawings on the swap line to funds made available from the EC oil facility rather than from the IMF. The IMF might establish terms under which funds, while available for more than 3 months, would be drawn in several tranches.

Mr. Coldwell--noting that the System itself had some debts on swap lines that had been outstanding for a long time--asked why take-out provisions should be required for any funds made available to the Italians at this time. He also asked whether in the future similar take-out provisions would be required for drawings by other central banks.

Mr. Holmes replied that in the normal course of events such take-out provisions would not be required. In the current case, however, the Germans and the Swiss were making gold-collateral loans to the Italians, and he felt that more than the ordinary provisions should be made for repayment of Italian drawings on the System.

Mr. Pardee commented that the Federal Reserve had always made it a point to consider what funds might be available to a foreign central bank to repay a drawing on the System. In viewing the current case, it was significant that the Italians had drawn all the funds from the IMF that were available to them; the $450 million SDR loan being discussed was a new credit. In that light, he thought it was appropriate to have specific take-out provisions to ensure that the drawings were short-term.

Mr. Holland remarked that the swap facility was intended to be a source of short-term credit; ordinarily, repayment was contemplated after some expected event, such as a turn-around in the exchange rate or an improvement in a country's ability to earn foreign exchange. In the present case, one could not look forward to any such event with much confidence, and therefore, the System needed to look to the medium-term credit facilities being made available to the Italians to assure that it would not become a medium-term lender. While it was true that the System itself was subject to criticism for having used swap drawings as medium-term credit, two wrongs did not make a right. The System should pay off its long-outstanding debts and take steps to keep drawings by other countries on a short-term basis.

Mr. Holmes observed that it was a basic feature of the philosophy of the swap network that IMF borrowings or some other form of credit would serve to repay a swap drawing if market factors did not bring about an improvement in the borrower's reserve assets.

Chairman Burns remarked that two points about the Italian request needed to be kept in mind. First, as Mr. Holmes had noted, the Germans and the Swiss had made gold-collateral loans to the Italians. Second, it was possible that the Italian authorities wished to underline the seriousness of their country's situation in order to help in handling domestic political problems.

Mr. Pardee commented that the Italians themselves had suggested the provisions. Moreover, they had indicated that they had been responsible for the tough language in the pledge made in connection with the SDR loan from the IMF.

Mr. MacLaury observed that no precedent would be set; U.S. Government loans to the United Kingdom--made at times when sterling was under pressure--had carried more or less explicit understandings that the British would draw on the IMF if necessary to make repayment.

Mr. Volcker remarked that he did not think those understandings had been formalized.

Mr. Pardee commented that there had been an exchange of cables in the present case, in contrast with earlier experience.

Chairman Burns asked whether members of the Committee had any objections to proceeding in the manner indicated by Mr. Holmes, and no objections were heard.

Mr. Partee asked what reasons the System might have for intervention in the foreign exchange market when there were disturbances that affected other currencies, such as the recent movement of funds from the French franc to the German mark.

In response, Mr. Holmes observed that at times during the period since the last meeting heavy French intervention exerted downward pressure on the dollar, which continued in the New York market after the European markets had closed. The System intervened in the New York market for the purpose of maintaining orderly conditions on days when the dollar was declining at a fairly rapid pace. On those occasions, activity in the New York market was greater than usual, as Europeans placed orders after their own markets had closed. As a result, System intervention--while not massive--was fairly large. Given the European central banks' efforts to maintain some measure of stability in the markets, he felt that it was desirable for the System to support those efforts in the New York market. Had the System not intervened on days of strong pressure, the Europeans would have faced more serious problems upon the re-opening of their markets the next morning.

Mr. Partee remarked that in the circumstances that Mr. Holmes had described, it appeared that System intervention had been substituted for intervention by the German Federal Bank. In his view, that underscored the need for caution. He asked why the Germans had not intervened more forcefully.

Mr. Holmes agreed that to a large extent System intervention had substituted for German intervention. Nevertheless, he thought intervention was appropriate in the spirit of cooperation that the central banks were attempting to maintain. As he had noted in his statement, the German Federal Bank had not intervened more heavily because it had been reluctant to create additional mark liquidity.

Mr. Pardee commented that the German authorities would not intervene in the New York market, and they did not feel responsibility for the dollar.

Mr. Partee observed that the Germans needed to improve their instruments for dealing with their liquidity problem. Given the circumstances, he understood the point of view behind System intervention. However, he presumed that if exchange rates were floating freely, the dollar would have risen against the franc by about as much as it would have declined against the mark. The System had felt it necessary to intervene in the New York market, because of the heavy sales of dollars by the French.

Chairman Burns remarked that the Germans had instruments to deal with their liquidity problem, but like others, they also had to cope with political problems. With respect to operations in the recent period, the Germans probably would have felt that the System was not being cooperative if it had stayed out of the market entirely. The Germans had intervened rather frequently in the past, either at the request of the U.S. authorities or on their own initiative in expectation of a request. As a matter of fact, it would not surprise him if the Germans felt that the System's intervention in the recent period had been inadequate. He asked Mr. Holmes if the Germans did feel that way.

Mr. Holmes said he thought they did not in this particular case. More generally, however, there was a continuing debate with the Europeans concerning the sharing of the burden of intervention.

> By unanimous vote, the System open market transactions in foreign currencies during the period January 20 through February 17, 1976, were approved, ratified and confirmed.

Chairman Burns observed that the Committee, as the members knew, had a Subcommittee which was authorized to act on its behalf when it was necessary to enable the Federal Reserve Bank of New York to engage in foreign currency operations before the Committee could be consulted. The Subcommittee consisted of the Chairman and Vice Chairman of the Committee and the Vice Chairman of the Board. During the past year Mr. Wallich--who dealt with many of the System's problems in the foreign currency area--had helped the Subcommittee a great deal. Therefore, it would be proper and more efficient to have Mr. Wallich as a member of the Subcommittee empowered to act in that area, and he was now proposing that to the Committee. An amendment to the foreign currency authorization would accomplish that objective, and a proposed amendment had been distributed to the Committee.[1/]

Mr. Coldwell asked whether the proposed Subcommittee had the same title as the old one or whether a new subcommittee was being proposed.

Mr. Broida replied that the Committee's rules of procedure named a Subcommittee having the composition indicated by the Chairman, and the foreign currency authorization in its present form referred to that Subcommittee. The proposed amendment to the authorization would establish a new subcommittee, to be known as the "Foreign Currency Subcommittee." It would include the members of the existing Subcommittee and might include one or more additional members of the Board.

Mr. Holland asked why the proposed amendment referred to "other members" rather than "other member" of the Board, if the intention was to establish a four-man subcommittee.

1/ The proposed amendment to the foreign currency authorization was appended to a memorandum from Mr. Broida to the Committee, distributed on February 17, 1976, and entitled, "Procedure for adding Governor Wallich to FOMC Foreign Currency Subcommittee." A copy has been placed in the files of the Committee.

Chairman Burns said he would guess that the staff had intended to make provision for those occasions when more than one Board member on the proposed Subcommittee was absent.

Mr. Holland observed that the proposed amendment empowered the Chairman to designate alternates to serve on the Subcommittee in the absence of Board members. To establish a four-man Subcommittee, the language of the amendment should specify "such other member of the Board," rather than "such other members."

Mr. Coldwell commented that he did not understand why it was proposed to create a new Subcommittee rather than to make provision for expanding the existing one to include Mr. Wallich. He would suggest that the Committee abolish the original Subcommittee and have only the new one.

Chairman Burns said he would not want to abolish the old Subcommittee without some deliberation. He recommended that the Committee vote on the amendment to the foreign currency authorization with the change proposed by Mr. Holland.

> By unanimous vote, paragraph 6 of the Authorization for Foreign Currency Operations was amended to read as follows:

> The Foreign Currency Subcommittee 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. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). All actions taken by the Foreign Currency Subcommittee under this paragraph shall be reported promptly to the Committee.

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 observed that after his introductory remarks Mr. Zeisel would present the highlights of the new GNP projections. Then he (Mr. Gramley) would comment on policy alternatives.

Mr. Gramley then made the following introductory remarks:

> Data coming in over the past month continue to indicate a good rate of economic recovery in early 1976. Retail sales last month held close to their strong December levels, and there has been further evidence of strengthening in consumer demands for durables. Furniture and appliance sales have continued to record good gains, and domestic auto sales

in January and early February have increased further. Industrial output last month rose an additional 0.7 per cent--with advances once again widespread by industry category. And conditions in the labor market improved substantially in January, although part of the large increase in employment, and the decline in unemployment, may have reflected difficulties of seasonal adjustment.

More impressive than these statistical measures of further recovery, however, is the marked strengthening that seems to have taken place over the past couple of months in consumer and business confidence. True, a boom-like atmosphere has not yet developed, and business plans for fixed capital outlays are still being made quite cautiously. But surveys of consumer attitudes have shown marked improvement; stock prices have risen dramatically, and the qualitative evidence in this month's red book[1/] points clearly to greater optimism in the business community.

The staff has tried to take this new atmosphere into account in its current GNP projection, which extends the forecast through mid-1977. As for monetary policy, we assume a 6 per cent growth rate of M_1--the midpoint of the long-run target range. We also assume some further downward shift in the quantity of M_1 demanded relative to GNP, at given interest rates--although less downward shift than in the recent past. Short-term interest rates are projected to rise gradually over the projection period, but we would expect little change in long-term rates from present levels.

For fiscal policy, we have assumed budget outlays for fiscal 1977 about $15 billion higher than what is incorporated into the Administration's budget--but still below the current services budget. The deep cuts proposed by the Administration in such areas as health care, social services, and welfare seem unlikely to be accepted by the Congress; furthermore, estimates of sales of oil leases (a negative expenditure) seem over-optimistic, and the allowance made in the budget for the effects of rising interest rates on debt service costs seems to the staff inadequate. If the expenditure level recommended by the Administration is not adhered to, however, the President may resist tax cuts beyond the extension of the Revenue Act of 1975. We have therefore excluded from our

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

projection any tax reductions in mid-1976, and we have included the 1977 tax increases for social security and unemployment insurance that are in the budget.

Our fiscal assumptions would imply a budgetary posture a little less restrictive than that proposed by the Administration. The high employment deficit would be diminishing over the course of 1976, and a surplus would develop early next year. The swing toward surplus from now through mid-1977 amounts to around $20 billion.

Mr. Zeisel made the following statement on the new GNP projection:

The improved tone of the economy, and of financial markets generally, over recent months has led the staff to revise upward its projection of real activity.

Real GNP growth is now projected to average around 5-1/2 per cent, annual rate, over the next six quarters. This would mean a rise of 5.3 per cent from 1975 to 1976 on a year-over-year basis, about three-quarters of a percentage point more than in our last projection. Possibly more important, the projected rate of real GNP increase now has a slight upward tilt as we move into 1977. With this more rapid rate of growth, we are now projecting a drop in the unemployment rate to around 7-1/4 per cent by year-end and to about 7 per cent by mid-1977.

The recent strength of demand for autos and other consumer goods indicates a larger gain in personal consumption expenditures for the first quarter than we had been anticipating. We now expect real consumer outlays for goods to rise at about an 8-1/2 per cent annual rate this quarter. We also anticipate a sizable rise in the rate of inventory investment, as businessmen begin to rebuild depleted stocks. In retail trade, the strength of sales appears to have resulted in an unintended reduction of stocks in both November and December. Inventory-sales ratios in most retail lines are very low--as they are also in nondurable goods manufacturing--and we expect a shift to inventory accumulation to help raise first-quarter growth in real GNP to around a 6-1/2 per cent annual rate--rather than the 4-1/2 per cent rate we were projecting last month.

We anticipate that improved consumer markets will contribute to a stronger rate of growth in upcoming quarters as well. The projected strength in consumer demand derives both from increased real spendable incomes and from a rising tendency to spend out of those incomes. The major surveys report a significant strengthening under way in consumer confidence--and with good reason. Fewer job layoffs, increased rehiring, rising real incomes, and improved wealth positions have all contributed to more ebullient attitudes and rising spending propensities. We are projecting a decline in the rate of saving from the current 8-1/4 per cent to about 7-1/4 per cent by the spring of next year. This downtrend in the saving rate is consistent with that in earlier recoveries.

Inventory investment is also expected to provide more support to economic growth over the next year. We now have inventory accumulation rising to a rate of over $20 billion in the first half of 1977. At that level, inventory investment would total slightly over 1 per cent of GNP, somewhat above the long-term average. Even so, the ratio of total stocks to final sales would drift down slightly later this year and level off in the first half of 1977. The inventory-sales ratio remains above its level in recent, previous recoveries, however.

Among other sectors of demand, both residential construction and business fixed investment are expected to contribute to growth, although at somewhat less than the average rate in previous postwar recoveries. Although housing starts have shown no increase in the past two months, sales of both new and existing homes have been strong, and a number of factors suggest continued improvement in housebuilding over the next several quarters: outstanding loan commitments at S&L's are now at a 2-1/2 year high; mortgage interest rates have edged down; new and existing home sales have strengthened; and recently the rental vacancy rate has dropped sharply.

The rise in residential construction will probably contribute less to the over-all rate of expansion in activity as the year goes on, but as that occurs, gains in plant and equipment spending will probably be picking up. True, the advance indicators suggest only a modest increase in capital spending over the near term. But with consumer demand strengthening, profits and liquidity improving, and financial markets highly accommodative, we expect upward revisions in plant and equipment spending plans to develop--which should build considerable momentum in the growth of business fixed investment toward the end of 1976 and into early 1977. The anticipated revival of real capital spending is not quite as strong as the recovery from the 1957-58 recession--but hopefully it will prove to be longer-lasting. One determining factor in that prospect will be how well we do in holding down the rate of inflation. Our present staff view is that the additional strength of activity we are now projecting is not expected to affect the price outlook significantly. The degree of recovery in our forecast will still leave us a long way from conditions that could be characterized as excess aggregate demand, and we see no reason for expecting widespread shortages of industrial materials by mid-1977. Costs, therefore, are likely to continue to be the dominant factor driving prices, and with a year of strong wage bargaining in the offing, we don't foresee much improvement on the price front. It appears to us that costs and prices will be rising in a range of 5-1/2 to 6 per cent throughout the next year and a half, rather close to the recent rate.

Mr. Gramley made the following comments on policy alternatives:

We thought it might be of some interest to the Committee to consider the possible consequences of a more expansive fiscal policy than assumed in our base projection. Specifically, what would happen if the higher level of expenditures assumed in the staff projection was accompanied by the additional $10 billion of tax cuts at midyear 1976 proposed in the budget, and also if Congress refused to go along with the $8 billion (annual rate) of additional social security and unemployment insurance taxes scheduled for January 1, 1977?

The additional fiscal stimulus would, according to our quarterly econometric model, add about 0.6 per cent to the level of real GNP by the second quarter of 1977, and take about two-tenths off the unemployment rate. It would also add a couple of tenths to the underlying rate of inflation--as measured by the fixed-weight price index for gross private product, adjusted for the direct cost and price effects of the lower tax rates for social security and unemployment insurance. Interest rates would be pushed up somewhat--about 1/4 of a point for Treasury bills.

These estimates may understate the probable effects on the real economy of the additional fiscal stimulus assumed. They may also underestimate the price effects. But I am inclined to believe the general thrust of what the model seems to be telling us--namely, that in an economy operating well below capacity levels, and operating under a relatively tight fiscal rein, a moderately larger stimulus would not have earth-shaking effects on the economic performance.

Chairman Burns remarked that on the basis of the assumptions made by the staff, the high employment deficit would diminish during 1976 and a surplus would occur in the first half of next year, as Mr. Gramley had noted. However, the projected decline over the four quarters of 1976 was only about $5 billion, which was not large enough to have significance. As he interpreted the quarterly numbers, the high employment deficit would be approximately constant throughout 1976 and a surplus would emerge in early 1977. Some other projections of the high employment budget position that he had seen conformed more precisely to the pattern of a level deficit this year and a rise into surplus next year.

Mr. Gramley commented that on the basis of the staff projection for the four quarters of this year alone it would be difficult to argue that a significant degree of fiscal restraint would develop. However, over the whole projection period--the six quarters through the second quarter of 1977--the trend toward fiscal restraint was clear, although most of it would develop in the first half of 1977.

In response to questions by Messrs. Holland and Partee, Mr. Gramley observed that under the alternative policy assumptions he had described, the pattern of the high employment budget position would be quite different. There would be a high employment deficit throughout the projection period, at a level close to that in the fourth quarter of 1975. For calendar year 1976, therefore, the deficit would be about $14 billion, compared to $7-1/2 billion in the base projection. For fiscal 1977, there would be a high employment deficit of about $10 billion compared to a surplus of about $7-1/2 billion in the base projection.

Chairman Burns asked whether the calculation of the high employment budget was based on the conventional assumption of a 4 per cent rate of unemployment. If it was, then the position would look quite different if 5 or 5-1/2 per cent were assumed.

Mr. Gramley replied that a 4 per cent unemployment rate had been assumed. In his view, more significance should be attached to the change in the budget position over time than to the level of the deficit or surplus at any one time.

Mr. Black asked about the assumptions for productivity and wage rates underlying the projection for prices.

Mr. Gramley replied that over the projection period compensation per manhour in the private nonfarm economy was assumed to advance at an annual rate of around 8-1/2 per cent. Productivity was assumed to improve at a rate of around 3 per cent, resulting in a rise in unit labor costs at a rate of about 5-1/2 per cent. The assumed rate of improvement in productivity was a little higher than in the last projection, reflecting somewhat stronger growth in real GNP.

Mr. Volcker commented that the staff projection of business fixed investment seemed high, and he asked how it compared with Commerce Department figures.

In response, Mr. Gramley observed that in the staff projections, plant and equipment expenditures for 1976 were considerably higher than those suggested by the Commerce

Department's first survey of business capital spending plans for the year: the staff projections suggested a rise of about 8 per cent in current dollars from 1975 to 1976, compared to an increase of 5-1/2 per cent in the Commerce survey. In the staff projection, moreover, expenditures gained strength as time went on. He thought that it was reasonable to assume increasing cyclical strength over the course of 1976; continuation of business fixed expenditures at a 5-1/2 per cent rate in nominal terms was not consistent with the strength developing in consumer expenditures.

Mr. Leonard noted that the staff's latest GNP projection was based on an assumption of a 6 per cent rate of growth in M_1. While he viewed both the monetary assumption and the GNP projection as reasonable, they did raise a question about the velocity of money; they implied that the rise in velocity would remain strong throughout 1976 and would continue to exceed the increases characteristic of comparable phases of past cyclical upturns in GNP. In contrast, velocity of M_2 so far in this recovery had followed a more-or-less normal cyclical pattern. In light of the recent behavior of the velocity of M_1 and of M_2, his enthusiasm for M_1 had declined and that for M_2 had increased; in fact, he was beginning to long for something in between. Perhaps serious consideration should be given to building a new money supply series containing M_1 and those time and savings deposits that people apparently were beginning to view as money--such as corporate savings aocounts.

Mr. Leonard added that the recent weakness in interest rates was often taken as evidence of the decline in the demand for money. While the weakness in rates could be explained that way, it could also be traced to a lack of demand for bank credit rather than for money, and the two were different.

Chairman Burns remarked that the staff was working industriously on a measure of the money supply along the lines suggested by Mr. Leonard.

Mr. Gramley commented that the staff would be delighted if it found a better measure of the money supply. As Mr. Leonard had indicated, the staff projection did assume a further downward shift in the money demand function such that the rate of increase in the velocity of M_1 over the projection period remained rather high. Staff estimates of GNP and money supply growth for the current quarter implied an increase in M_1 velocity at an 8 per cent annual rate. Throughout the remainder of the projection period, M_1 velocity increased at an average annual rate of about

4-1/4 per cent--which was rather high for that stage of a cyclical upswing in economic activity.

Continuing, Mr. Gramley observed that there had been an aberration in the behavior of the velocity of M_2 as well as of M_1, although it was not so great. M_2 velocity had increased at annual rates of 8.0 and 5.6 per cent in the third and fourth quarters of last year, respectively, and the staff projected an increase over the period to the second quarter of 1977 at a rate of 2-1/4 per cent. That also was high; there had been no secular increase over the past 10 years, although there had been some earlier. With respect to Mr. Leonard's final comment on the explanation of the recent weakness in interest rates, if the demand for money had not shifted downward, the quantity of money demanded at any given level of GNP would be a great deal higher than it has been. One had to accept the conclusion that the demand for money had declined.

Mr. Partee noted that the staff projection included a considerable recovery in housing starts to an annual rate of 1.8 million in the first half of 1977. In light of the special problems affecting multi-family housing, he asked whether the projection implied a rather full recovery in single-family housing.

Mr. Gramley replied that the latest projection--like those for some time past--suggested continuing weakness in multi-family starts and a rather good recovery in single-family starts.

Mr. Zeisel added that starts of single-family units were projected to reach a rate of 1-1/4 million in the second quarter of 1977--a substantial recovery, but one that left the rate still below earlier peaks. Multi-family starts were projected to rise from a current rate of about 340,000 units to a rate of about 550,000 in the second quarter of next year; the rate then would be only about half that in 1972-73. The more restrained recovery in the multi-family sector would tend to dampen expansion in residential construction activity later this year.

Mr. Baughman asked whether the staff projection of consumption expenditures was buoyed by the increase in wealth owing to the recent rise in stock prices.

Mr. Gramley replied that the recovery in the stock market had done much to restore consumer wealth, and that was a significant factor in the staff's judgmental projection. In that projection, however, it was difficult to assign weights to any particular influence. He would add that consumer confidence was being bolstered by other forces: the improvement in employment and a growing expectation among the public in general that the rate of inflation would not return to earlier highs were also significant.

In response to a question by Mr. Wallich, Mr. Gramley remarked that real rather than nominal wealth entered into the quarterly econometric model.

Mr. Baughman observed that managements of major oil companies were reported to be restructuring their enterprises so as to be able to break them up, should legislation be passed which would require that. He was surprised that management people would take that possibility so seriously. Such a development would surely have an adverse impact on the expansion in economic activity, which seemed to be developing well at present. He wondered whether anyone else had reason to believe that such a possibility should be taken seriously.

Mr. Wallich remarked that he would regard the possibility more as a structural problem, because of the need for oil exploration and development, than as a threat to the over-all expansion in activity.

Chairman Burns commented that he would not take the possibility seriously for this year but would for the longer run. In any case, it was not entirely clear to him that breaking up the major companies in the oil industry would have adverse economic effects. A friend of his who had sat on the board of one of the country's giant corporations had told him repeatedly that he and several colleagues on that board had become firmly convinced by their extensive studies that breaking up the company would be beneficial to the shareholders.

Mr. Morris noted that the staff anticipated a substantial rise in short-term interest rates by the fourth quarter of this year in association with its GNP projection, but the rise in rates apparently did not have a dampening effect on housing activity during the projection period. He asked Mr. Gramley to comment.

Mr. Gramley said there was a great deal of uncertainty with respect to short-term interest rates. How much they might rise depended on the behavior of the demand for money in relation to income, and past projections had been bad. Concerning the impact on housing, the fear of heavy disintermediation that had been so strong in the latter half of 1975 had by and large been moderated by more recent developments; the volume of outflows of funds from the thrift institutions anticipated in response to a rise in short-term market rates was not so large now as it had been some months ago. In addition, the institutions were sufficiently liquid that the anticipated increase in rates was not expected to have much impact until after the projection period; during the projection period, housing starts were expected to level off but not turn down.

Mr. Morris remarked that the Boston Bank's examination of corporate savings accounts suggested that most of the inflow in recent months represented funds coming out of money market instruments. Deposits of that kind were likely to flow out of the thrift institutions long before short-term interest rates reached levels as high as suggested by the staff projection.

Mr. Axilrod commented that only since about the second week of January--when the Treasury bill rate had dropped below the Regulation Q ceiling on deposit rates--had most of the funds flowing into corporate savings accounts come out of market instruments. Over-all, inflows of time and savings deposits other than large-denomination CD's were at an exceptionally high rate recently. The blue book[1/] projections suggested that the pace of inflows would drop sharply in the spring and in the second half of this year.

Mr. Jackson said he had heard that a surprising amount of the inflows of funds into time and savings deposits other

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

than large-denomination CD's had been going into time certificates rather than into savings accounts. He asked whether the staff had information on that point.

Mr. Axilrod replied that the bulk of the total inflows had been going into time certificates. However, the share going into savings accounts had been increasing more rapidly than the staff had expected it would.

Mr. Partee observed that since the first of the year there had been a remarkable improvement in attitudes about economic prospects. That was noticeable in every outside meeting he had attended recently, and it was particularly noticeable in a recent session the Board had had with a group of business economists. It was also evident in the latest red book, in which almost every District report had referred to excellent retail sales, and many had called attention to excellent sales of durable goods. Given the widespread improvement in attitudes, he believed that the staff projection surely could be achieved. In fact, the projections of growth in the latter part of this year might be too low: inventory accumulation could be higher; consumption could grow at a somewhat faster rate; and more strength could develop in plant and equipment expenditures than had been projected.

While he felt that the economic outlook was quite good, Mr. Partee continued, he--like Mr. Leonard--wondered about the implications for the velocity of money. He had some doubt that the projected increase in velocity was consistent with the projected rise in interest rates. In part for that reason, he thought that the pattern of developments over the period through the first half of 1977 might differ somewhat from that suggested by the staff projection: compared with the projection, growth in real GNP might be more rapid in the second half of this year and less rapid in the first half of next year. The resulting deceleration in the rate of growth would be occasioned by what in effect would be tighter monetary conditions than those projected by the staff.

Mr. Balles observed that he agreed with the thrust of Mr. Partee's remarks regarding the outlook, but there were two major soft spots in the economic situation on the West Coast that made him a little less bullish than people from other parts of the country might be. In California, drought had adversely affected agriculture, which was the State's leading source of income. And the aerospace industry was sick. Reports from the industry indicated that orders for private aircraft were down sharply, backlogs were declining, and activity this year would be about half that of last year. One company reported that its work force would be cut by 5,000 people this year. Price competition was severe, and companies were being forced to choose between protecting their market share and protecting their profit margins. The airlines were having difficulties, because they could not get increases in fares and costs of fuel and labor were rising. On the other hand, defense business still appeared to be good, and the business community expected the Alaskan pipeline to be of long-term benefit to the District.

Chairman Burns remarked that he was somewhat surprised by Mr. Balles' statement concerning new orders in the aerospace industry. Yesterday, he had met with executives of a major company who had expressed optimism about their orders, although he would have expected their orders to slump badly and their outlook to be gloomy. Perhaps they were not being realistic about their situation.

Mr. Winn commented that merchants in the Cleveland District reported that the higher-quality and higher-priced items were selling better than items in other parts of their lines. Sales of old homes were strong, as noted in the supplement to the green book[1/], and that was contributing to the home repair and modernization business. There too, consumers appeared to be

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

buying products at the top of the line. The combined cost of the home and the modernization exceeded the price of new homes. It was also interesting that sales were not especially related to family formation; many sales were to single people. Finally, the mobile home business appeared to have picked up suddenly.

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 January 20 through February 10, 1976, and a supplemental report covering the period February 11 through 17, 1976. 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:

> Desk operations in the period since the last meeting of the Committee maintained a steady climate of reserve availability, with Federal funds rarely straying by more than a few basis points from 4-3/4 per cent. Taken in isolation, the performance of either M_1 or M_2 might well have caused the Desk to seek different conditions of reserve availability, but as one measure (M_1) was rather weak and the other (M_2) quite strong in relation to the Committee's indicated ranges, the net effect was a decision to make no change.
>
> Reserves were added through outright purchases of $321 million in Treasury coupon issues early in the interval, and later through purchases of $360 million of bills in the market and about $1,220 million of bills from foreign accounts.

Yesterday, the Desk bought about $335 million of coupon issues for delivery tomorrow. The heavy sales of bills by foreign accounts were largely an outgrowth of the fairly turbulent foreign exchange market about a week or so ago. Midway through the period, the Desk arranged to redeem $200 million of maturing bills at a point when it appeared that reserves would be overabundant for a time. Temporary reserve needs were, as usual, met through extensive use of short-term repurchase agreements, while matched sale-purchase agreements were used to effect temporary withdrawals.

With the Federal funds rate firmly anchored around 4-3/4 per cent, most other interest rates registered little net change over the period. There was some tendency for rates to decline early in the interval, nurtured by market expectations that slow growth of M_1 would encourage the System to become more accommodative. These expectations faded as the period unfolded and the Desk was observed to be on a steady course. The publication of largely positive news on the economy and the Chairman's testimony on growth objectives for the aggregates, including comments that put greater weight on M_2, also encouraged the market to conclude that no further easing was imminent. Against this background, rates tended to back up somewhat--although there is no general expectation of a near-term tightening of money market conditions. At the latest weekly bill auction, held last Friday because of the holiday on Monday, 3- and 6-month bills were auctioned at 4.85 and 5.17 per cent, up about 7 and 13 basis points from the rates just before the last Committee meeting.

In the coupon market, attention was centered on the Treasury's refunding offering announced January 27--especially the 7-year, 8 per cent notes. By pre-announcing an attractive 8 per cent yield, in contrast to the auction-determined yields generally employed in recent financings, the Treasury generated an enormous interest in these notes. Some of this interest came from speculators who were seeking a quick profit based on the Treasury's pricing, but the great bulk of subscriptions seemed to be from genuine investors--including individuals, and banks for their own portfolios and for trust accounts. The Treasury had initially announced a $3.5 billion sale, and an intention to award subscriptions up to $500,000 in full, but when the total subscriptions of $29 billion were analyzed, it was learned that a $10 billion issue would have been needed to meet the demand for subscriptions up to $500,000. Rather than enlarge the issue this much, the Treasury gave full allotments only up to $200,000, and no more than $200,000 on larger subscriptions. Even after this cutback, the total size was $6 billion. A number of major market participants were quite disappointed at receiving no percentage allotment on their large subscriptions--feeling that their long-term association with Treasury underwritings was not adequately recognized. The new notes have been trading at a premium of about 1/2 to 1-3/4 points--closing yesterday near the higher figure, which puts the yield around 7.70 per cent.

Following the great outpouring of demand for the 7-year notes, interest in the 3-year note and 25-year bond auctioned on February 5 was comparatively restrained. Sizable amounts went to dealers, and both issues subsequently traded at somewhat higher yields than the 7.05 and 8.09 per cent established in the auctions. Contributing to the heavy feeling in the reopened bond issue was the enlarged supply and higher rates that developed for corporate issues in the latter part of the period, following some price improvement earlier.

State and local government issues also registered little net change in price over the interval. Concern over quality continued to cast a shadow over the market, although the crisis atmosphere of recent months seemed to abate somewhat. Prospects for handling the financing needs of several New York State agencies brightened when the State Comptroller indicated a willingness to invest State employee pension funds in their issues under certain conditions. The mid-February financing need for the State agencies seems to have been met with less

> visible difficulty than in other recent months. Another favorable development was the agreement by savings banks in New York to provide some long-term financing to the State's Urban Development Corporation. As for the State's own needs, which run to some $4 billion to meet a seasonal cash drain in the next few months, it is noteworthy that a distinguished committee including former Federal Reserve Chairman Martin has been named by the State Comptroller to verify and attest to the State's creditworthiness. On the less encouraging side, recent reports indicate that New York City's budget gap is $300 million greater than had been anticipated just a few months ago--thus intensifying the need for drastic remedial action and raising questions about the underlying viability of the City's 3-year budget balancing plan. Meanwhile, smaller crises come and go, such as the failure of Yonkers to repay maturing debt when due last Friday. Arrangements were made to meet that city's obligations by yesterday, but it is perhaps noteworthy that the rescue operation in this case proved to be slightly "after the last minute" rather than "by the last minute." This does not help to rebuild investor confidence.

In response to a question by Chairman Burns, Mr. Sternlight observed that the failure of the rescue operation for Yonkers to be put together until just after the due date was of some significance in that it tended to heighten the atmosphere of uncertainty.

Mr. Jackson asked about the rationale for buying coupon issues on some occasions rather than Treasury bills.

Mr. Sternlight replied that, in providing reserves on a longer-term basis, the Desk typically sought to purchase some Treasury coupon and Federal agency issues, which could be bought thoughout the maturity range. Just how such purchases were divided between the two types of issues depended on their availability in their respective markets.

Mr. Jackson then asked whether the premium existing on the Treasury's new 8 per cent, 7-year note resulted in part from the liquidation of short positions by some market participants who had been caught by the allocation system.

Mr. Sternlight said that was quite likely.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period January 20 through February 17, 1976, were approved, ratified, and confirmed.

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

> The three policy alternatives[1/] before the Committee are each geared to the longer-run growth ranges for the aggregates that were adopted by the FOMC at its last meeting. Given the staff's long-run projection of GNP growth, and the assumption that there will be only a modest further downward shift in the demand for money, these longer-run growth ranges appear to involve rising interest rates in the course of 1976. However, only one of the shorter-run alternatives--alternative C--looks to a significant tightening of the money market and of credit conditions between now and the next Committee meeting. Alternative B contemplates unchanged money market conditions, and alternative A involves a modest easing.

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

Each of these short-run approaches has advantages and disadvantages, given the longer-run outlook for a cyclical rise of interest rates. A tightening of the money market in the weeks immediately ahead would enable the Committee to get a head start on the need for restraint. This early start would, as it works through markets over time, take some of the edge off demands for money and credit later in the year and would therefore work to moderate the extent of upward interest rate movement that may be required later to keep the aggregates on course. Thus, this alternative may place less pressure on thrift institutions and the housing market in the latter half of 1976 than either A or B.

Among the disadvantages of alternative C, though, is that it would begin exerting pressure on thrift insitutions and on the mortgage market in the weeks immediately ahead; therefore, it might introduce more uncertainties into the still none-too-robust housing recovery than is desirable for this stage of the recovery. Moreover, an immediate tightening--at least one of some significant dimension--would also risk a fairly large back-up in interest rates in the market for short- and intermediate-term securities, given the heavy Treasury financing schedule between now and mid-April and the relatively large size of dealer positions in Treasury bills and coupon issues.

Alternative B--which involves a funds rate range centered on the recently prevailing 4-3/4 per cent--has the advantage of encouraging for a while further sizable net inflows of funds to banks and thrift institutions. As compared with alternative C, monetary expansion would be a little more front-loaded--with relatively more growth of the aggregates in the first half of 1976. However, this alternative would require more tightening later in the year, in order to restrain monetary growth, given the continued expansion projected in credit demands and our view that money demand will shift downward only modestly further.

The principal advantage of the easing in money market conditions over the next few weeks contemplated by alternative A is that it would lead to further downward adjustments in the prime loan and mortgage market rates and thus might encourage a somewhat more rapid economic recovery through increased spending by businesses--for inventories, for instance--and by consumers for housing. On the other hand, loading additional monetary ease into the early part of 1976 would, partly because of the added economic momentum that might be built up, exacerbate problems of controlling monetary aggregates later in the year. To minimize such problems, a fairly rapid turn-around in interest rates would appear to be required by early spring. If this developed, we would project only somewhat higher interest rates toward the end of 1976 under an alternative A approach than alternative B, with only moderately greater pressures developing on thrift institutions and on the Regulation Q ceiling rate structure.

Chairman Burns then called for a discussion of monetary policy and the directive. He noted that the Committee had had an interesting discussion yesterday afternoon but that it had not reached a conclusion on technical matters relating to operating procedures. He planned to call a special meeting to give further consideration to the subject of yesterday's discussion and to related matters.

For today, the Chairman continued, he would suggest a procedure that would relate to this meeting only and would not have any longer-run procedural implications. Specifically, he would suggest that the Committee adopt for M_1 a range of 4 percentage points and a sub-range of 2-1/2 or 3 percentage points that would represent a true zone of indifference within that range. Furthermore, he would recommend that the Desk be instructed to attach approximately equal weight to the behavior of M_1 and M_2 in implementing the Committee's instructions over the month ahead. He asked that members address themselves to these procedural suggestions in the course of their comments on monetary policy and the directive.

Mr. Mayo remarked that, as he had said yesterday, he did not like a range for M_1 as wide as 4 percentage points. However, he did not have a more constructive suggestion to offer and he could accept such a range at this time. A 2-1/2 to 3 percentage point zone of indifference was acceptable to him; in operational terms, it kept the range from being too wide.

Mr. Mayo said he favored the specifications shown under alternative B in the blue book. However, he would not center the zone of indifference on the midpoint of the 5 to 9 per cent range for M_1 specified under that alternative. He would skew the zone toward the upper end of that range; thus, it might be 6 to 8-1/2 per cent, 6-1/2 to 9 per cent, or even 7 to 9 per cent. His preference was for 6-1/2 to 9 per cent. In the present environment, he would not be disturbed at all by a 9 per cent annual rate of growth in M_1 over the February-March period.

The Chairman remarked that Mr. Mayo's objective could perhaps be achieved more simply by adjusting the limits of the range up to, say, 6 to 10 per cent and retaining symmetry for the zone of indifference around the midpoint of the range.

Mr. Mayo agreed that raising the range would accomplish the same objective, but he preferred a 5 to 9 per cent range for M_1 because it was not far above the Committee's longer-run M_1 range of 4-1/2 to 7-1/2 per cent. But his main concern was for flexibility with regard to the zone of indifference; he did not feel that it always had to be centered on the midpoint of the range.

Continuing, Mr. Mayo said he found acceptable the suggestion that the Desk be instructed to attach approximately equal weight to the behavior of M_1 and M_2 in the course of its operations over the coming period, provided that the weighting procedure was not overly precise. In the latest inter-meeting interval, when growth in M_1 had appeared to be at a rate near the bottom of its specified range while growth in M_2 had appeared to be close to or above the upper limit of its range, that approach had just about been forced on the Desk. While he could accept more or less equal weighting for the coming period, he was somewhat concerned about placing too much emphasis on M_2 because payments for the recently offered 8 per cent Treasury notes might retard M_2 growth in February.

For the Federal funds rate, Mr. Mayo observed that he favored the 4-1/4 to 5-1/4 per cent range--centered on the prevailing funds rate level--shown under alternative B in the blue book. To his mind there was no persuasive evidence in the pattern of economic growth or in the behavior of interest rates to suggest that a move from the current 4-3/4 per cent rate was called for. However, he favored a range of about 1 percentage point in order to provide the Manager with flexibility in Desk operations.

Mr. Coldwell said he was persuaded that expansion in activity was more likely to exceed than to fall short of current expectations. However, he was not satisfied with the prospects for reducing unemployment, with the outlook for inflation, or with the level of long-term interest rates that had prevailed so far in the current recovery. With respect to the policy decision, he would not want to take any actions that might counter the strength that appeared to be developing in the economy. To his mind, current money market conditions were about right. He favored the standard sort of money market directive that called for maintenance of prevailing conditions, because it was indicative of no change in policy. Moreover, he did not wish to publish any specifications in the policy record. As he had said at other times, publication of the specifications--especially if it had to be done more promptly than at present--hampered Desk operations and created opportunities for the few to make windfall profits.

With regard to the specifications for the monetary aggregates, Mr. Coldwell continued, he could accept a 4 percentage point range for M_1--say, 5 to 9 per cent--particularly in light of the present uncertainties regarding seasonal adjustment and the relationships among the various aggregates. But he would not want to see a zone of indifference as wide as 2-1/2 or 3 percentage points. If the Committee chose a range for M_1 of 5 to 9 per cent, for example, he thought 6-1/2 to 7-1/2 per cent would be an appropriate zone of indifference. A zone of indifference of only one-half percentage point on either side of the midpoint of the range might be considered too narrow, but it would be a step toward establishing a range in which fluctuations in the rates of growth in the aggregates would not trigger Desk operations directed at achieving changes in the level of the Federal funds rate. If a wider zone of indifference were used, the funds rate often would remain unchanged even though growth in the aggregates appeared to deviate significantly from the midpoints of the ranges. In such cases the Committee was likely to be faced at its next meeting with the need to move the Federal funds rate more than if gradual adjustments had been made over the inter-meeting period.

As for the suggestion that approximately equal weight be assigned to M_1 and M_2 in assessing the behavior of the aggregates, Mr. Coldwell said he shared Mr. Mayo's view that that was acceptable as long as the procedure was not too formalistic.

Chairman Burns asked Mr. Holmes for his views on the operating implications of a zone of indifference as narrow as 1 percentage point--particularly in light of the volatility of the weekly data for the aggregates.

Mr. Holmes remarked that because of the volatility in the weekly figures, the Desk would typically want to await cumulative evidence of the rate of growth in the aggregates before beginning to move the Federal funds rate. Accordingly, he thought a range somewhat wider than that suggested by Mr. Coldwell would be reasonable and more or less consistent with past practice.

Mr. Coldwell said he would prefer that the Desk place more emphasis on cumulative rather than week-to-week changes in the aggregates. With the cumulative changes as the focus, he thought a one percentage point zone of indifference would be adequate.

Mr. Black said he agreed with the staff's projection that an acceleration in the rates of growth in the monetary aggregates was in prospect. He would not be at all surprised if growth in M_1, M_2 and M_3 proved to be stronger in the coming period than currently anticipated. He would want to accommodate that part of the projected increase that was due primarily to income tax refunds. But he would not want to resist vigorously the upward pressure on short-term interest rates that was likely to develop in response to the increasing momentum of the recovery and to the pick-up in demands for inventory financing that was likely to emerge. Such upward pressure was already becoming apparent in the behavior of the commercial paper rate; to counter that might result in too rapid rates of growth in the aggregates, forcing the Committee to bring about larger increases in the funds rate later on than it would prefer.

Mr. Black observed that he would not place too much emphasis on the recent shortfalls in M_1 growth because growth in M_2 and M_3 had been at healthy rates. In his view, the System had provided a substantial amount of liquidity to the economy, and he doubted that a continuation of double-digit growth rates in the broader monetary aggregates would be appropriate. Accordingly, in determining the course of operations in the period ahead, he would weigh M_2 and M_3 more heavily than M_1.

Nevertheless, Mr. Black said, he would be reluctant to change the current posture of policy on the basis of his expectations for growth in the aggregates. The fact that they were only expectations had to be kept in mind. Therefore, he would be inclined to maintain the Federal funds rate at about the prevailing 4-3/4 per cent level over the coming inter-meeting interval even if growth in the aggregates proved to be a little stronger than currently estimated in the blue book. If adjustments in policy proved to be necessary, they could be made at the March meeting. By that time more information would be available concerning the contribution of the tax refunds to growth in the aggregates.

Turning to the specifications, Mr. Black remarked that he favored the general policy stance of alternative B, although he would narrow the funds rate range to 4-1/2 to 5 per cent and would reduce the lower limit of the range for M_2--adopting a range of, say, 8 to 13 per cent. As for the zone of indifference, he favored one of less than 4 percentage points in width; the 2-1/2 to 3 percentage point width suggested by the Chairman was about what he had had in mind. For the coming period he would set the zone of indifference for M_1 near the top of its specified range, but in light of the rapid growth in M_2 over recent months, he would adopt a zone of indifference skewed toward the bottom of its 2-month range.

Chairman Burns commented that, as he had indicated earlier in reaction to Mr. Mayo's remarks, he thought it would be better to make the zone of indifference symmetrical around the midpoint of the range and to adjust the range itself in accordance with ideas about acceptable rates of growth. To do otherwise might involve the Committee in separate exchanges of views first on the ranges and then on the zones of indifference within them. Such a procedure might unduly prolong the Committee's deliberations.

Mr. Black responded that he was in agreement with the Chairman's view. He had only intended to indicate the ranges that he believed were appropriate.

Mr. Holland said he thought the economic recovery was progressing satisfactorily--at least in those areas in which monetary policy could hope to have much of an effect. Accordingly, he favored continuing the current stance of monetary policy, which to him was embodied by the specifications of alternative B. He favored zones of indifference of 2-1/2 percentage points within the ranges under that alternative and he would place approximately equal weight on M_1 and M_2.

For the operational paragraph of the directive, he preferred the so-called "money market" language--particularly in light of the uncertainties associated with the effects of tax refunds and of payments for the heavily subscribed 8 per cent Treasury note. However, he would suggest that the language "provided that monetary aggregates appear to be growing at about the rates currently expected" be changed to "provided that monetary aggregates appear to be growing within the ranges currently expected." The current language bothered him because it seemed to imply that the Committee had in mind a point target rather than a range of acceptable rates of growth for the aggregates.

After some discussion, it was agreed that preferences regarding the language for the directive would be discussed further in conjunction with the deliberations preceding the Committee's formal vote.

Mr. Volcker observed that he was in basic agreement with the staff's view of the outlook for business activity, although he was somewhat more uncertain about the prospects for housing and business investment than the staff seemed to be. He favored a policy stance that would foster stability in the financial markets and thus encourage expansion in business investment activity over the next few months. With that objective in mind, he thought that specifications along the lines of alternative B were appropriate. He had intended to suggest raising the upper limit for the M_1 range to 10 per cent, because he would not be concerned about a rate of growth in M_1 above the Committee's longer-term range for a short period in view of the recent shortfall in growth. Nevertheless, while he preferred a range for M_1 of 5 to 10 per cent, he could accept a 5 to 9 per cent range if the general view was to hold the range to a width of 4 points. As for a zone of indifference, he found it somewhat confusing to widen the acceptable range of growth for M_1 to 4 percentage points and then adopt a zone of indifference as narrow as 2-1/2 percentage points. Under such a scheme he was not certain of the meaning of the wider range.

Chairman Burns remarked that when the aggregates appeared to be growing at rates above or below the zone of indifference but still within the wider range of tolerance, the Desk would begin to edge the Federal funds rate up or down within its specified range. The funds rate would not be moved outside its range without special instructions from the Committee.

Mr. Volcker said he would be inclined to make the zone of indifference for M_1 rather wide. For M_2 he favored a range of 9 to 13 per cent, instead of the narrower 10 to 13 per cent range shown under alternative B; M_2

growth might be slowed significantly by payments for the recent Treasury issue, and he would not want a shortfall for that reason to trigger a reduction in the Federal funds rate. He could accept the suggestion that equal weight be placed on M_1 and M_2, but again, he was concerned that the impact of the Treasury financing might lead to difficulties in interpreting incoming data on M_2. He favored the funds rate range of alternative B, and to reflect his reluctance to see a change in the funds rate, he preferred a "money market" directive.

Mr. Kimbrel remarked that at a recent meeting of the Directors of the Atlanta Reserve Bank a general feeling of optimism about the prospects for the economy was expressed by all present, including those from the Florida area where the gloom that had been present earlier appeared to be dissipating even though a revival of construction activity was still being awaited. He personally shared the view that there was evidence of renewed strength in the economy. Accordingly, he saw no need for an easing of money market conditions. He favored maintaining the current posture of policy as represented by the specifications of alternative B. He could accept the 5 to 9 per cent range for M_1, with a zone of indifference of 2-1/2 percentage points, and the suggestion that equal emphasis be placed on M_1 and M_2. He would not like to see a downward move in the Federal funds rate since he believed such a move would have to be reversed in the near term. While he saw no pressing reason for an upward move in that rate at this time, he would not resist such a move if warranted by developments over the coming inter-meeting interval. Therefore, he favored a funds rate range of 4-1/2 to 5-1/2 per cent.

Mr. Jackson remarked that he found economic conditions in general to be satisfactory. With regard to operations for the coming period, he thought that at the outset about equal weight should be placed on M_1 and M_2. However, if growth in the aggregates appeared to be slower than expected and operations were directed toward a reduction in the Federal funds rate, over the rest of the period he would place less emphasis on M_2, because its behavior probably would be distorted by changes in the relationship between yields on money market instruments and Regulation Q ceiling rates. In addition, there was uncertainty about the extent to which growth in M_2 would be affected on the one hand by outflows of time and savings deposits associated with payments for the recent Treasury issue and on the other hand by inflows associated with tax refunds. It was his recollection that in 1975 tax refunds had moved into time and savings deposits much sooner than had been anticipated. On balance, he thought the 10 to 13 per cent range under alternative B was about right. With respect to M_1 he was inclined to favor a narrower zone of indifference than 3 percentage points--perhaps one of 2-1/2 percentage points.

Mr. Eastburn said he believed the question concerning zones of indifference was in essence a question of the freedom with which the Federal funds rate should be permitted to change. As several members had pointed out in yesterday's discussion, it was difficult to find very many occasions in the past when the funds rate had been permitted to move so freely that mistakes had been made and reversals in operations had been called for. On the contrary, the funds rate probably had been too rigid.

Concerning the discussion yesterday afternoon, Mr. Eastburn continued, it was his impression that no conclusion on the issue of zones of indifference had been reached. He believed that pending further staff investigation and Committee discussion, procedures that had been in use should be continued.

Accordingly, Mr. Eastburn observed, he favored a narrower range for M_1 than shown under the various blue book alternatives. He liked the "front loading" of monetary expansion associated with alternative B, as described by Mr. Axilrod, but he favored a range skewed to the upper end of the 5 to 9 per cent range under that alternative--perhaps 6 to 9 per cent. For the funds rate he preferred a range of 4 to 5 per cent, but he could accept the range of 4-1/4 to 5-1/4 per cent under alternative B.

Mr. Partee commented that in his view the procedural suggestions that had been put forth today came close to representing a money market directive. He had no objections to a money market directive at this time because he believed current and prospective economic and financial conditions were satisfactory. He would not want to see a decline in short-term interest rates in the period immediately ahead because it probably would be a temporary move. And he would not like to see an increase in rates because it might well be premature.

Continuing, Mr. Partee said he favored the language for the operational paragraph under alternative B of the money market proposals, and he preferred that as written to the language suggested by Mr. Holland. He would associate with that directive the specifications of alternative B. He took prevailing money market conditions to mean a Federal funds rate of 4-3/4 per cent, and he would interpret the language "provided that monetary aggregates appeared to be growing at about the rates currently expected" to mean 6, 7, or 8 per cent for M_1 and 10, 11, or 12 per cent for M_2. He agreed with Mr. Volcker that the M_2 range might not be adequate to take account of deposit withdrawals for payment of the recently offered Treasury issues. However, it seemed likely that funds for that purpose would be drawn from nonbank thrift institutions as well as from commercial banks, and he thought 9 to 13 per cent might prove to be a satisfactory range for M_2. While he favored retaining a money market directive for another month, he thought the Committee would have to consider how long it would want to continue that approach.

Chairman Burns observed that he agreed in general with the views that had been expressed thus far. He favored the specifications of alternative B--except that he, like Messrs. Partee and Volcker, would reduce the lower limit of M_2 somewhat, perhaps to 9 per cent.

Mr. Balles remarked that the Committee still had before it the task of integrating the 2-month targets for the aggregates with the longer-term ranges that it set periodically. According to his calculations, M_1 was about

\$1.4 billion below the lower limit of the path consistent with the longer-run range set at the January meeting and was about \$3.0 billion below the midpoint of the path's range. Therefore, he also felt that an increase in the funds rate would be premature. An annual rate of growth in M_1 of about 12-1/2 per cent over the February-March period would be necessary to bring that aggregate up to the level implied by the lower limit of its longer-run range.

Continuing, Mr. Balles said he found the Chairman's suggestions on the width of the range for M_1, the zone of indifference, and the weighting of the aggregates generally acceptable. However, he would prefer an M_1 range of 6 to 10 per cent, rather than 5 to 9 per cent, and a somewhat narrower zone of indifference--perhaps 2 percentage points.

Mr. MacLaury said he wished to underline Mr. Eastburn's remarks about the infrequency of instances when misleading or disruptive movements in the Federal funds rate had resulted from the Committee's operating procedures; he thought such instances were rare. However, there were aspects of the Committee's policy-making process that increasingly had raised doubts in the minds of some members and had provoked discussions of the sort held yesterday. First, in his view, the behavior of M_1 at the moment provided little information that was useful for policy purposes, and he would be inclined to attach little weight to movements in that aggregate even on a monthly--much less on a weekly--basis. Secondly, he had doubts about the procedure in the blue book under which the width of the three alternative ranges for M_1 was 4 percentage points in each case and yet the whole range from one alternative to the next differed by only 1/2 percentage point. And thirdly, the distinctions from one set of short-run specifications to the next seemed odd, since all three were said to be consistent with the Committee's longer-run ranges. He concluded that considerable discussion of the Committee's procedures was still in order.

Turning to the economic outlook, Mr. MacLaury noted that the staff had been raising its GNP projections in recent months, but he believed that they continued to be too low. Like Mr. Partee, he expected that business fixed investment in particular would be stronger than projected by the staff. He was also more optimistic about the outlook for consumer spending and for inventory investment.

As for his policy views, Mr. MacLaury observed that political considerations could make it more difficult later in the year than it would be now to take actions that would tend to raise interest rates. Therefore, he would like to ignore the behavior of the monetary aggregates and proceed to raise the Federal funds rate by 1/16 of a percentage point per week over the coming inter-meeting interval, raising the rate to 5 per cent by the time of the next meeting. However, he did not expect such an approach to be adopted. With respect to the suggestions made earlier, he would not favor specifications incorporating a zone of indifference, because he did not think the Committee's existing procedures had led to operations that subsequently had required a reversal. Until the Committee deliberated further on the subject of operating procedures, he would not give even tentative approval to the concept of a zone of indifference by adopting that approach today. As for the weighting of the aggregates, he would place more emphasis on M_2 than on M_1 despite the uncertainties associated with M_2 over the coming period. He prefered the alternative C range of 9-1/2 to 12-1/2 per cent for M_2, and as he had said earlier, he favored a target of 5 per cent for the funds rate.

Chairman Burns commented that, as he had indicated at the January meeting of the Committee, the concept of a zone of indifference was not new; it reflected an operating approach that the Committee had adopted some time ago but from which it had drifted away. He then asked Messrs. Holmes and Sternlight for their comments on Mr. MacLaury's statement that operating procedures rarely had resulted in misleading or disruptive movements in the Federal funds rate.

Mr. Holmes said he thought there had been some occasions when Desk operations had had a disturbing impact on financial markets, but he would prefer to review the record before making a definitive statement.

Mr. Sternlight observed that his recollection on that point was similar to that of Mr. Holmes. He might add, however, that the Desk had operated with an implicit zone of indifference of perhaps 1 or 2 percentage points--even though it had not been spelled out explicitly in the Committee's instructions. The width of the zone of indifference had varied from time to time, depending primarily on the general thrust of comments made during the Committee's policy discussion.

Mr. Baughman remarked that the economic situation appeared to be relatively good and that the current stance of monetary policy appeared to be appropriate. For the coming period, therefore, he favored the specifications of alternative B as shown in the blue book. He would not incorporate the concept of a zone of indifference in the Committee's instructions; in particular he was against including explicit specifications for a zone of indifference. To his mind, such a procedure would complicate rather than simplify the Committee's operating procedures, and it might well be regretted at some point further down the road. He believed that the flexibility needed to respond to cumulative evidence on the aggregates was already available under current procedures and the Desk had demonstrated that such flexibility was adequate.

Continuing, Mr. Baughman expressed agreement with the view that in the current circumstances M_2 should be weighted more heavily than M_1. With respect to the form of the directive, he preferred to place more emphasis on the monetary aggregates than on money market conditions at the present stage of the cycle in order to assure that appropriate policy actions were not delayed unduly--particularly if the economic expansion should prove to be more robust than available data had so far suggested.

Mr. Winn said he, like Mr. Baughman, would endorse the specifications of alternative B, and he would not want to initiate procedures that might inhibit the flexibility of Desk operations--especially in view of the underlying strength apparent in the economy and of the potential problems that lay ahead. Over the coming period he would pay little attention to M_2 because he felt fluctuations in that aggregate would not reflect the underlying economic situation. Accordingly, he would tend to focus on the behavior of M_1 and would instruct the Desk to follow its usual procedures. For the funds rate, he could accept the 4-1/4 to 5-1/4 per cent range shown under alternative B.

Mr. Wallich observed that the various elements of uncertainty about the aggregates led him to favor a directive couched in terms of money market conditions. While he believed a money market emphasis was appropriate this time, he hoped that the Committee would return soon to a monetary aggregates directive. Over time, interest rates would have to become more flexible; and over time, monthly growth in the aggregates should become more stable.

Continuing, Mr. Wallich remarked that he was impressed by the apparent change in the economic climate. He had reflected upon what the condition of the economy might be 6 months from now--when the principal impact of current monetary policy was likely to occur--if the expansion were to continue at the accelerated pace. The greater risks seemed to be on the side of too rapid expansion, which made him cautious. The economy seemed to be awash with liquidity; that was suggested by the behavior of interest rates. How that had come about was unclear, considering the behavior of the monetary aggregates.

Mr. Wallich observed that in line with his preference for deemphasizing the aggregates over the coming period, he had no problem with a zone of indifference for M_1. He could also accept the suggestion that equal weight be given to M_1 and M_2. He believed there was as much uncertainty about M_2 as about M_1 over the coming period; M_2 was exposed to instability from both sides--on the down side from withdrawals for payments on the Treasury note and on the up side from the possibility of re-intermediation in response to changing yield relationships. He thought a reduction in the lower limit of the M_2 range to 9 per cent would be quite appropriate. He preferred a relatively narrow range for the Federal funds rate; a range of 4-1/2 to 5-1/4 per cent would be acceptable.

Mr. Morris observed that while he was generally opposed to a range for M_1 as wide as 4 percentage points, he could accept it for the coming period; he would support alternative B, with a range of 6 to 10 per cent for M_1. He shared Mr. Partee's view that the Committee ought to seek to maintain about the prevailing Federal funds rate level, unless growth in the aggregates appeared to be below the lower limits of their ranges. In that event, he would favor a decline in the funds rate.

Mr. Morris added that, while he preferred stability in the funds rate over the next inter-meeting interval, he thought that the Committee should adopt the practice of setting a range for Federal funds at least 1-1/2 percentage points in width because of the possibility of early publication of the specifications. To his mind, publication of a range as narrow as 1 percentage point would create troublesome market reactions. Accordingly, he favored a range of 4 to 5-1/2 per cent for the funds rate, even though the consensus might be for little if any movement in the rate.

Mr. Clay remarked that the recent pattern of divergent growth of M_1 and M_2 suggested that prevailing money market conditions were about right for achieving the longer-term targets the Committee had adopted. Accordingly, he thought open market operations should continue to be directed at maintaining prevailing money market conditions over the coming inter-meeting interval. Specifically, he favored ranges of 5 to 9 per cent for M_1, 9 to 12 per cent for M_2, and 4-1/4 to 5-1/4 per cent for the funds rate. For the directive, he preferred the language of alternative B under the money market proposals.

Chairman Burns observed that he had not detected any wide difference in the policy preferences of members of the Committee. A majority appeared to favor a money market directive. Personally, he did not believe there was very much difference between the two types of directives. However, he had remarked in the course of the discussion at the last meeting that he planned to urge the Committee to return to a monetary aggregates directive. While he would have no quarrel with a money market directive at this time, he wanted to remind the Committee that he had not forgotten those remarks and that he continued to believe that return to a monetary aggregates directive was an appropriate objective for the Committee.

The Chairman then asked the members to indicate their preferences with regard to the language for the operational paragraph of the directive.

A majority expressed a preference for the language of alternative B under the money market proposals.

Turning to the specifications, the Chairman suggested that the Committee accept the specifications of alternative B with one alteration--a lower limit for M_2 of 9 rather than 10 per cent.

A majority of the Committee agreed with that proposal.

As for a zone of indifference, Chairman Burns observed that it seemed preferable not to set a specific range but to allow the Manager some flexibility in interpreting the sentiment of the Committee.

Mr. Coldwell said that in order to cast his vote he needed to have a better grasp of the understanding that the Committee was attempting to impart to the Manager. He would not want to vote affirmatively if the understanding was that the prevailing Federal funds rate would be maintained as long as the aggregates remained within a sub-range of 2-1/2 percentage points within the broader range the Committee adopted.

Chairman Burns remarked that it would be useful for the Manager to indicate how he now interpreted the sentiment of the Committee with respect to the conduct of operations during the coming period. He believed, however, that the Manager would want to review the record with respect to the observance of zones of indifference in the past and that, in any case, the Committee should not bind him with any rigid instructions.

Mr. Holmes commented that in the period immediately ahead M_1 and M_2 might again exhibit divergent behavior, requiring that the Desk balance one against the other. The problem obviously would be different if growth in both of the aggregates appeared to be high or low relative to the midpoints of their ranges, but there was no way of telling at the moment whether in practice circumstances of the sort concerning Mr. Coldwell would arise. As the situation unfolded over the next 4 weeks, however, opportunities for further consultations would exist, should that appear to be desirable.

Mr. MacLaury asked whether on the basis of today's discussion the Desk's reactions to incoming data on the aggregates would be any different from those of the recent past.

Mr. Holmes replied that operations would differ in two respects. For some time the Desk had begun to shade the Federal funds rate in one direction or the other as the incoming data on the aggregates suggested that growth over the relevant 2-month period was beginning to deviate from the midpoints of the ranges. Now, the evidence would have to suggest that the deviations were somewhat larger than before; there would be a true zone of indifference, although its width was uncertain. Secondly, equal weight would now be given to M_1 and M_2, whereas in the past considerably more attention had been paid to M_1.

Chairman Burns remarked that, as Mr. Sternlight had indicated earlier, some sort of a zone of indifference had been observed before.

Mr. Holmes said he agreed; the Desk had taken account of the uncertainties involved in the estimates of the 2-month rates of growth in the aggregates.

Mr. MacLaury remarked that, like Mr. Baughman, he was concerned about the formalization of a concept of a zone of indifference, as distinct from continuing the Desk's past method of responding to evidence on the behavior of the aggregates.

Mr. Partee commented that the inclusion of M_2 on an equal footing with M_1 could result in very different Desk reactions from those of the past several years when movements in M_1 had tended to dominate the course of Desk operations.

Chairman Burns then proposed that the Committee vote on a directive consisting of the staff's draft of the general paragraphs and the operational paragraph labeled alternative B under the money market proposals. It would be understood that the directive would be interpreted in accordance with the following specifications. The ranges of tolerance for growth rates in the February-March period would be 5 to 9 per cent for M_1 and 9 to 13 per cent for M_2;

the range for RPD's determined to be consistent with those figures was -4-1/2 to -1/2 per cent. The range of tolerance for the weekly average Federal funds rate in the inter-meeting period would be 4-1/4 to 5-1/4 per cent. It would be further understood that in assessing the behavior of the aggregates approximately equal weight would be given to M_1 and M_2.

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

The information reviewed at this meeting suggests that output of goods and services is continuing to expand at a moderate rate in the current quarter. In January retail sales remained at an advanced level and recovery in industrial production continued. Gains in nonfarm employment were large and widespread and the unemployment rate dropped from 8.3 per cent to 7.8 per cent. Average wholesale prices of industrial commodities increased somewhat less than in the preceding 2 months, and average prices of farm products and foods declined appreciably further. The index of average wage rates advanced substantially in January, but a significant part of the rise reflected an increase in the minimum wage on the first of the month.

The trade-weighted value of the dollar has changed little over the past 4 weeks. There have been disturbances in foreign exchange markets affecting primarily European currencies, and rates for several currencies have moved considerably. In December the foreign trade surplus was substantial, although not as large as in other recent months, and bank-reported private capital movements shifted to a net outflow.

M_1, which had declined in December, increased only a little in January, but M_2 and M_3 rose considerably. At commercial banks and nonbank thrift institutions, inflows of time and savings deposits other than large-denomination CD's expanded substantially. Inflows into savings accounts were especially large in January, as short-term market interest rates continued to decline early in the month and fell below Regulation Q ceiling rates on such accounts. In recent weeks, interest rates on both short- and long-term securities have changed little, while mortgage interest rates have declined somewhat.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic recovery, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

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

Following some discussion about the scheduling of a special meeting for further discussion of operating procedures, it was agreed that the next regular meeting of the Committee would be held on March 16, 1976.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

February 17, 1976

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on February 18, 1976

GENERAL PARAGRAPHS

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In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic recovery, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

OPERATIONAL PARAGRAPH

"Monetary Aggregates" Proposal

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 moderate growth in monetary aggregates over the period ahead.

Alternative "Money Market" Proposals

Alternative A

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve somewhat easier bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

Alternative B

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

Alternative C

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve somewhat firmer bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

ATTACHMENT B

February 18, 1976

Points for FOMC guidance to Manager in implementation of directive		Specifications
A. <u>Desired longer-run growth rate ranges</u> (as agreed 1/20/76): (QIV '75 to QIV '76)	M_1	4-1/2 to 7-1/2%
	M_2	7-1/2 to 10-1/2%
	M_3	9 to 12%
	Proxy	6 to 9%
B. <u>Short-run operating constraints</u> (as agreed 2/18/76):		
1. Range of tolerance for RPD growth rate (February-March average):		-4-1/2 to -1/2%
2. Ranges of tolerance for monetary aggregates (February-March average):	M_1	5 to 9%
	M_2	9 to 13%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		4-1/4 to 5-1/4%
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.