MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Monday and Tuesday, March 15-16, 1976, beginning at 3:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Gardner
Mr. Holland
Mr. Jackson
Mr. Kimbrel
Mr. Partee
Mr. Wallich
Mr. Winn

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

Messrs. Eastburn, Guffey, and MacLaury, Presidents of the Federal Reserve Banks of Philadelphia, Kansas City, and Minneapolis, respectively

Mr. Broida, Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Mr. Holmes, Manager, System Open Market Account
Mr. Coyne, Assistant to the Board of Governors

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

Chairman Burns welcomed Messrs. Stephen S. Gardner and Roger Guffey--who had recently become Vice Chairman of the Board of Governors and President of the Federal Reserve Bank of Kansas City, respectively--to their first meeting of the Committee.

The Chairman noted that since the last meeting of the Committee the United States District Court for the District of Columbia had filed a written opinion on its decision against the Committee in a suit that had been brought under the Freedom of Information Act.[1/] This written opinion was filed following an oral ruling in the case, which he had reported to the Committee at the February meeting. He then called upon Mr. O'Connell to brief the Committee on the current status of the litigation and on the actions that the Committee might take.

Mr. O'Connell noted that the Court's order granted the plaintiff's motion for a summary judgment and denied the related motion that had been filed on behalf of the Committee. In its order the Court held as invalid the sections of the Committee's Rules Regarding Availability of Information that provided for a 45-day lag in the publication of the domestic policy directive and other policy actions after their adoption by the Committee and for a related lag in the publication of the Committee's "Record

1/ Copies of the Court's Order and Judgment and Memorandum Opinion, filed on March 9, 1976, had been distributed to the Committee and placed in the Committee's files.

of Policy Actions." The Court further held as unlawful the Committee's failure to release promptly the "reasonably segregable portions" of the memorandum of discussion prepared for each meeting.

As a result of those findings, Mr. O'Connell continued, the Court ordered the prompt publication of the domestic policy directives in the Federal Register following their adoption by the Committee. It also ordered the prompt disclosure--through publication or availability for public inspection--of other policy actions, including statements or interpretations of policy, upon their adoption by the Committee and prompt disclosure of the remaining parts of the "Records of Policy Actions" following their approval.

With respect to the memorandum of discussion, Mr. O'Connell said, the Court ordered the Committee to make promptly available to the plaintiff the "reasonably segregable factual portions" of the memoranda for the meetings held on January 20-21, 1975, and February 19, 1975. If the Committee were to claim that those memoranda contained factual portions that were not reasonably segregable, the memoranda were to be made available to the Court within ten days for in camera inspection. The Court would then determine whether or not the Committee was correct in taking the position that such facts were not reasonably segregable.

Mr. O'Connell added that the Court had granted a 10-day stay of its order insofar as it related to the records of policy actions and the domestic policy directives, but not to the factual portions of the memoranda of discussion. This meant that if the FOMC chose to appeal the order, the stay would remain in effect with respect to the policy records and directives until the Court of Appeals rendered a decision in the matter. The appellate proceedings were likely to take several months, possibly as long as a year.

At Chairman Burns' request, Mr. O'Connell then outlined his recommendations to the Committee. He proposed, subject to consultation with the Department of Justice which officially represented the Committee before the Court, that the Committee file by Friday, March 19, an appeal from the Court's full order with respect to the contents of the "Records of Policy Actions." The appeal would challenge the validity and correctness of the Court's finding that the "Records of Policy Actions" are not exempt from the disclosure requirements of the Freedom of Information Act. Even if the Circuit Court of Appeals were to agree with the original finding, it would be urged to determine that a reasonable period for withholding the information in question would be 45 days, or such shorter period as the Court might determine, but certainly not immediate publication in light of the circumstances that were involved.

With regard to the memorandum of discussion, Mr. O'Connell continued, it was his opinion that the Committee would not have a good basis for an appeal. The reason was that the Court had simply pronounced what the law said, namely, that the Freedom of Information Act itself required the segregation of facts which had to be made promptly available to the public. He believed the staff would shortly complete its work of segregating the facts from the other materials in the memoranda of discussion for the meetings held in January and February 1975. He and his associates then planned to meet with counsel for the plaintiff, disclose the facts that had been segregated and urge him to join in signing a stipulation that would indicate the plaintiff was satisfied that the Court's order had been followed. Counsel for the plaintiff would be given an opportunity to examine the memoranda of discussion for those two meetings in the Board's offices in the effort to satisfy him that all the reasonably segregable facts had been disclosed pursuant to the Court's order. In that event, Mr. O'Connell hoped that the Court would not require a further submission of the memoranda for its *in camera* inspection. The Court always retained the right to make such an inspection and to order further disclosure to the plaintiff.

Mr. O'Connell added that the handling of this matter would tend to set a precedent for the future. This argued in his view for structuring future memoranda of discussion in a way that would facilitate the task of segregating facts from the rest of the material.

In subsequent discussion, Mr. O'Connell responded to questions about the implications of the District Court's decision and the legal alternatives available to the Committee. He also commented further on how his recommendations might be implemented. A number of questions related to the meaning of "reasonably segregable facts" and there was discussion of the problems that could be created for the Committee by the premature disclosure of certain information--which a court might view as "facts" in a future decision--particularly with regard to information obtained on a confidential basis from foreign monetary authorities.

After further discussion the Committee accepted Mr. O'Connell's recommendation to appeal the District Court's decision with respect to the Committee's policy directives and the "Records of Policy Actions." With regard to the memoranda of discussion, Mr. O'Connell was authorized to negotiate with counsel for the plaintiff in keeping with his recommendation to the Committee.

Chairman Burns then asked Mr. O'Connell for his opinion regarding the implications of the Court's ruling for publication of information on inter-meeting changes in short-run specifications and also the implications of releasing information on the longer-run growth ranges for the monetary aggregates. He noted that such specifications and growth ranges were not incorporated in the directive itself but were part of the "Record of Policy Actions."

Mr. O'Connell expressed the opinion that changes in short-run specifications adopted between regular meetings of the Committee should be treated in the same way as the short-run specifications originally adopted at the meeting itself. He recalled the Committee's decision at the February meeting to make the short-run specifications available at the same time the directive was published. If the directive and short-run specifications were to be made public immediately following each meeting, he would advise that changes in those specifications also be made public promptly following their adoption by the Committee.

Mr. O'Connell said he viewed the Committee's longer-run ranges differently. They differed from the short-run specifications in nature, in the way they were stated, and in the manner they were used by the Manager in his daily operations. In his judgment they could be classified as understandings, objectives, or goals that provided an over-all framework for the System's operations, and he did not think it was legally required that they be published on the same basis as the short-run specifications.

In the discussion that followed some Committee members indicated that they would have reservations about making the longer-run ranges available on a more delayed basis than the short-run specifications. Chairman Burns observed in that connection that, pursuant to House Concurrent Resolution 133, he testified regularly on the Committee's longer-run ranges shortly after their adoption at a meeting of the Committee.

Mr. O'Connell noted that the Committee did not have to make a decision on this matter until the outcome of the Committee's appeal on the publication of the directive and "Record of Policy Actions" was known.

Chairman Burns then noted that a Subcommittee had been appointed at the February meeting to make recommendations regarding the course that should be followed with respect to the memorandum of discussion, given the possible implications of the current suit against the Committee under the Freedom of Information Act. The Subcommittee was comprised of Messrs. Coldwell, Mayo, Partee, and Winn and its written report had been distributed to the Committee.[1/]

Mr. Coldwell, who served as Chairman of the Subcommittee, reported that he and his colleagues had considered the potential

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1/ A copy of the report from the Subcommittee on the Memorandum of Discussion, dated March 15, 1976, has been placed in the files of the Committee.

problems that might be created for the Committee if a future legal decision were to compel the Committee to make public the full text of the memoranda of discussion, or some major portions of them, shortly after the meetings to which they related. The Subcommittee members were concerned that such disclosure might well inhibit the Committee's ability to discharge its monetary policy responsibilities. Two kinds of risks were recognized. One related to projections contained in the memoranda of discussion; the other had to do with the frank exchange of views among the Committee members. The Subcommittee's recommendations had been drafted with those risks in mind.

To reduce the first type of risk, Mr. Coldwell said, the Subcommittee recommended a substantial reduction in the space devoted to staff reports and their replacement by summaries that gave their general thrust with respect to the current situation and the outlook. To minimize the second type of risk each speaker would be asked to review the transcript of his own remarks in the policy "go around." An alternative to the latter recommendation had been proposed, namely to have the Committee's secretary review the remarks and subsequently obtain each member's concurrence. He thought such a modification was consistent with the Subcommittee's original recommendation.

Mr. Coldwell added that the Subcommittee had considered, and rejected, a number of other proposals. Those included continuing the memorandum of discussion in its present form; discontinuing it entirely; replacing the present memorandum with a summary statement of the issues and broad policy positions; and retaining the present form but eliminating the names of the speakers. The Subcommittee's reasons for rejecting those proposals were contained in the report that had been distributed.

Mr. Coldwell said he hoped the Committee would adopt the recommended procedures promptly. In the discussion that followed several members agreed with the Subcommittee's conclusion that the memorandum of discussion was a useful document. On the other hand, a number of members emphasized the risks that would be associated with the premature disclosure of certain portions of the memoranda as they were presently prepared. A range of views was expressed on the desirability of the alternative proposals considered by the Subcommittee and a number of suggestions were made for modifying some of the proposals. Particular attention was devoted to the manner in which sensitive portions of the Committee's meetings might be recorded if the memoranda were to be released to the public shortly after those meetings. Several members said they found the Subcommittee recommendations more or less acceptable, but a number indicated a preference for a summary of the discussions and some favored doing away with the memoranda of discussion completely.

At the end of the discussion Chairman Burns suggested that a decision on the memoranda of discussion be deferred until the next meeting to give the members more time to consider the alternative proposals. The Committee members indicated their agreement with that suggestion.

The following then entered the meeting:

Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Messrs. Brandt, Davis, Hocter, Keran, Parthemos, and Reynolds, Associate Economists

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

Mr. Kalchbrenner, Adviser, Division of Research and Statistics, Board of Governors
Mr. Henry, Associate Adviser, Division of International Finance, Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant, Board of Governors

Messrs. Boehne, Doll, Eisenmenger, and Scheld, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Kansas City, Boston, and Chicago, respectively
Messrs. Balbach and Burns, Vice Presidents, Federal Reserve Banks of St. Louis and Dallas, respectively

Mr. Duprey, Senior Economist, Federal Reserve Bank of Minneapolis

Mr. Ozog, Manager, Acceptance and Securities Departments, Federal Reserve Bank of New York

Chairman Burns then called on Mr. Holland to summarize the recommendations of the Stage II report[1/] of the Subcommittee on the Directive. The Chairman noted that the report deserved extended consideration by the Committee and that only a preliminary discussion could be held in the time available today. He therefore intended to convene a special meeting of the Committee later this month in order to permit a full discussion of the report.

Mr. Holland observed that the Subcommittee, comprised of Messrs. Balles, Morris, Wallich, and himself (as Chairman), had been at work for some 18 months and had overseen the production of numerous staff studies. A Stage I report had been distributed to the Committee in March 1975 and the Stage II report was circulated to the members during January 1976. A paper incorporating findings of the staff studies, including a listing of individual studies, had also been distributed in recent weeks.[2/]

Mr. Holland said he would not comment in detail on the Stage II report, but he would focus on three concrete actions that were recommend

1/ A copy of the report, dated January 13, 1976, and entitled "Improvements in FOMC Operating Procedures: Preliminary Report (Stage II)" has been placed in the Committee's files.
2/ The paper in question, "Interim Staff Report: Stage II," was distributed to the Committee in sections on January 30, 1976, February 2, 1976, and February 5, 1976. A copy has been placed in the Committee's files.

for initial Committee approval. First, the Subcommittee reaffirmed the Stage I recommendation that the FOMC replace reserves available to support private deposits (RPD) with nonborrowed reserves (NBR) wherever aggregate reserve targets entered into FOMC consideration. The Subcommittee felt that, as a general rule, the Committee would be better advised to aim at a nonborrowed reserve target in its operations rather than focusing on a Federal funds target as much as it did currently. This recommendation contemplated the retention of a specified range of tolerance for the Federal funds rate during inter-meeting periods. However, the Subcommittee members believed that the funds rate should be allowed to fluctuate within a wider range over the short run, and it recommended that the inter-meeting range ordinarily be specified at two percentage points.

Mr. Holland added that it would be consistent with the principles of the Subcommittee report for the Committee to specify a Federal funds rate--or a narrow range for that rate--as the primary operating target on occasions when the Committee was particularly uncertain about monetary or reserve needs or was especially concerned about market conditions.

Mr. Holland said the second Subcommittee recommendation was to instruct the staff to provide the Committee with information on nonborrowed reserves that would furnish a basis for Committee decisions using that measure of reserves. The New York Bank had already supplied a memorandum[1] on how the Trading Desk might actually work with nonborrowed reserves as an operating target, should the Committee decide to move in that direction, and the Desk might now be asked to report regularly on how its operations would be conducted from day to day if a nonborrowed reserve guide were in use. The Board staff might likewise be asked to focus on this question in the blue book[2] and in other materials prepared for the Committee.

The Subcommittee's third recommendation, Mr. Holland continued, was that the staff be encouraged to continue the work of applying optimal control theory to the formulation of monetary policy. The Subcommittee had found this approach quite promising, since it provided a systematic means or framework for bringing germane information to bear on the Committee's decisions. The Subcommittee recognized that the optimal control method was still too theoretical for immediate application, but the staff should be urged to continue its studies and to provide periodic reports to the Committee.

Messrs. Balles, Morris, and Wallich indicated that they endorsed the recommendations outlined by Mr. Holland. Mr. Morris added that recent events had highlighted one area of concern to the Committee

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1/ The memorandum prepared at the Trading Desk and entitled "Open Market Operations and a Nonborrowed Reserve Operating Target" was distributed to the Committee on March 12, 1976. A copy has been placed in the Committee's files.
2/ The report "Monetary Aggregates and Money Market Conditions" prepared for each meeting of the Committee by the Board staff.

which the Subcommittee had not explored for its report, namely, the short-term framework for policy making. He suggested that the Subcommittee be instructed to give its attention to that subject in its further work.

After discussion it was agreed that the staff should study the question and provide whatever insights it could by the time of the contemplated special meeting of the Committee.

Mr. Volcker observed that he had some intellectual sympathy for the proposed use of nonborrowed reserves, but his reading of staff work done at the New York Bank suggested that the relationship between nonborrowed reserves and the monetary aggregates was less reliable than that between the Federal funds rate and the aggregates. He thought it would be useful if pertinent evidence on this question were made available to the Committee for its discussion at the special meeting.

Mr. Holland remarked that staff studies conducted for the Subcommittee had included one on the relationship between the Federal funds rate and the monetary aggregates. Unfortunately, a fairly close relationship during the sample period did not hold outside the sample period. He would prepare a summary of the evidence for the special meeting.

Mr. Holland then responded to questions about the application of optimal control theory to monetary policy. He observed that the approach, while not an integral part of the Subcommittee's reasoning, had had a beneficent bearing on its conclusions.

Mr. Wallich added that if optimal control theory were applied to monetary policy it would tend to focus attention on such ultimate objectives as full employment and price stability. However, he had strongly endorsed the Subcommittee's recommendation that monetary policy continue to focus primarily on intermediate objectives rather than on ultimate objectives. The main issue, as he saw it, was whether the Committee should aim at the real sector or agree on intermediate financial variables that influenced the real sector.

In further discussion individual members of the Subcommittee commented on the reasons why they had not favored directly relating an operational instrument, such as nonborrowed reserves or the Federal funds rate, to ultimate objectives. Those reasons included the difficulty of linking instrumental variables to ultimate objectives, both intuitively or through use of econometric models; the problem of reaching an agreement on necessary tradeoffs among ultimate objectives; and the complications created by the fact that monetary policy was but one of many influences on the ultimate objectives. In the latter connection the Subcommittee thought it would be helpful for the Committee to consider alternative staff projections whose purpose would be to suggest how monetary policy might be adjusted one way or another to influence such objectives as economic growth and the rate of inflation.

In further comments about the Subcommittee report, Mr. Morris said he thought the recommended approach to the monetary aggregates was one that both the monetarists and the nonmonetarists could live with. Monetarists could choose to view the aggregates as targets, while nonmonetarists might prefer to regard them as values they expected would be consistent with particular rates of economic growth.

Mr. Holland observed that use of monetary aggregates or other intermediate targets need not be inconsistent with optimal control theory since, under conditions of fundamental uncertainty, it was reasonable to shift the focus from ultimate to more knowable and controllable variables. He also indicated that the Subcommittee's recommentations would not necessarily call for much change in the form of the Committee's domestic policy directive; rather, they would provide a firmer intellectual discipline for operating procedures that heretofore had been developed partly pragmatically.

Subsequent discussion focused on the question of why the RPD experiment had not lived up to expectations. Comments included the suggestion that a tighter relationship between RPD's and the aggregates had been assumed than really existed. It was also noted that RPD's were a measure that the Manager could not control directly.

Mr. Morris observed that nonborrowed reserves would have the advantage of being controllable by the Manager. Moreover, their use as a target would involve a built-in safety valve in that they would not be affected by member bank borrowing at the discount window. That in turn would tend to avoid the excessive fluctuations in short-term market rates that control of other reserve measures, such as total reserves, could produce.

Mr. Partee said a concrete question the Committee had to ask itself was whether nonborrowed reserves were likely to be a significantly better target than RPD's. Specifically, would the Committee be able to achieve objectives formulated in terms of nonborrowed reserves?

Mr. Wallich said he shared Mr. Partee's misgivings. However, he thought the staff could assist the Committee in understanding the sometimes strange relationship between nonborrowed reserves and the monetary aggregates and that the Committee could react sensibly to seemingly peculiar movements in nonborrowed reserves.

Mr. Morris added that the publication of anticipated patterns in related measures such as the monetary base could be helpful from a public information standpoint. The public would be in a better position to judge the meaning of gyrations in nonborrowed reserves such as those experienced recently.

The meeting then recessed. It reconvened at 9:30 a.m. on Tuesday with the same attendance as at the Monday afternoon session except that Messrs. Kalchbrenner and Henry were absent, and the following were present:

Mr. Gramley, Economist (Domestic Finance)
Mr. Kichline, Associate Economist
Mr. Keir, Adviser, Division of Research and Statistics, Board of Governors
Mr. Gemmill, Adviser, Division of International Finance, Board of Governors

In the agenda for this meeting, it was reported that advices had been received by the Secretary of the election by the Federal Reserve Banks of members and alternate members of the Federal Open Market Committee for the term of one year beginning March 1, 1976, and that they had executed their oaths of office.

The elected members and alternate members were as follows:

Robert P. Black, President of the Federal Reserve Bank of Richmond, with Frank E. Morris, President of the Federal Reserve Bank of Boston, as alternate;

Paul A. Volcker, President of the Federal Reserve Bank of New York, with Richard A. Debs, First Vice President of the Federal Reserve Bank of New York, as alternate;

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

Monroe Kimbrel, President of the Federal Reserve Bank of Atlanta, with Ernest T. Baughman, President of the Federal Reserve Bank of Dallas, as alternate;

John J. Balles, President of the Federal Reserve Bank of San Francisco.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after February 28, 1977, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, as the case might be, they would cease to have any official connection with the Federal Open Market Committee:

Arthur F. Burns	Chairman
Paul A. Volcker	Vice Chairman
Arthur L. Broida	Secretary
Murray Altmann	Deputy Secretary
Normand R. V. Bernard	Assistant Secretary
Thomas J. O'Connell	General Counsel
Edward G. Guy	Deputy General Counsel
Baldwin B. Tuttle	Assistant General Counsel
Stephen H. Axilrod	Economist (Domestic Finance)
Ralph C. Bryant1/	Economist (International Finance)
Lyle E. Gramley	Economist (Domestic Business)
Harry Brandt, Richard G. Davis, William J. Hocter, Michael Keran, James L. Kichline, James Parthemos, John E. Reynolds, and Joseph S. Zeisel	Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Federal Open Market Committee after February 28, 1977.

1/ On leave of absence.

By unanimous vote, Alan R. Holmes, Peter D. Sternlight, and Scott E. Pardee were selected to serve at the pleasure of the Committee in the capacities of Manager of the System Open Market Account, Deputy Manager for Domestic Operations, and Deputy Manager for Foreign Operations, respectively, on the understanding that their selection was subject to their being satisfactory to the Federal Reserve Bank of New York.

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

Before this meeting the Deputy Manager of the System Open Market Account for Foreign Operations had distributed to the members of the Committee a report on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period February 18 through March 10, 1976, and a supplemental report covering the period March 11 through 15, 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:

In recent weeks we have passed through a rather turbulent period of realignment of major European currencies, a process which may by no means be yet complete. So far, at least, the dollar has not been affected greatly by this turbulence, nor has the United States been identified as a factor in this problem.

Since January 21, when the Italian lira was set free, the lira has dropped by over 20 per cent against the dollar. Since March 4, when sterling suddenly dropped off, the pound has fallen by about 4 per cent amidst some international concern about the way the decline occurred. Over this past weekend, as you know, the French franc was set free from the snake, and the franc has fallen by about as much as sterling. Moreover, the Belgian franc and the Danish krone have come under substantial pressure. As we have seen so often, these moves reflect a combination of economic fundamentals, market dynamics, and policy decisions.

For each of the presently weaker economies in Europe, current balance of payments trends and other direct measures of competitiveness would still not show serious disequilibrium. Moreover, all of them have made at least some progress in reducing their very high rates of inflation. At the same time, these inflation rates have remained uncomfortably high. Italy and the United Kingdom were generally still expected to have price increases this year well in excess of 10 per cent and France of nearly that much. On the other hand, German prices are expected to rise by only about 5 per cent and Swiss prices even less. Consequently, the market has been persuaded for some time that as long as such wide inflationary differentials persisted, sooner or later exchange rates would have to be adjusted. Exchange market tensions had been building for some time, but the sudden decline of the lira in late January threw into question other exchange rate relationships and led to heavy flows of funds across the exchanges.

In effect, the market was betting that the respective governments would be forced by circumstances to let their rates go. The policy dilemma for these governments was acute: a problem of balancing the need to restore full employment, with economic recovery still in incipient state, against the need to make further progress against inflation. Each of the governments was reluctant to let its rate go for fear of rekindling domestic inflation. Nevertheless, each has considered it politically unacceptable to restrain domestic demand further to support its exchange rate at this time. It is significant that only the Italians have taken restrictive measures in recent weeks, and then only after the exchange rate had already dropped by more than 10 per cent. So far, I don't believe that we have gotten into a period of an exchange rate war--where individual countries try to gain a competitive advantage in international trade. But I do believe that we are getting uncomfortably close to such an unsettling position.

So far, the dollar has been shielded from speculative pressures. The continuing string of good news about our economic recovery has helped, as has the further easing of our own rate of inflation. We have also been helped by the expectation that interest rates here are about as low as they are going to go for the time being and that rates may even rise somewhat as our economy picks up steam. In fact, sentiment has been so favorable that the U.S. trade deficit for January was taken by some market observers as another indication of a strong domestic recovery and therefore bullish for the dollar. In addition, European willingness to intervene in their own currencies in exchange markets--particularly to maintain the French franc-German mark relationship--has helped to insulate the dollar from the European problem.

Nevertheless, the turmoil in European markets occasionally slipped over into the New York market and we operated on four occasions, selling a total of $69 million equivalent of marks in order to maintain orderly conditions. These sales were financed mainly out of balances acquired before and during the period, but so far in March we have drawn $23 million equivalent of marks under our swap line with the German Federal Bank. Since we repaid a slightly larger amount of marks earlier in the period, we ended up about even, with a total debt of about $78 million equivalent outstanding under that swap line.

On balance over the period, we have conducted our exchange market operations very cautiously, preferring to remain on the sidelines as much as possible while the Europeans were trying to settle their own problems. So far as other operations are concerned, we managed to acquire over the period enough guilders to repay the $20 million equivalent swap drawing on the Netherlands Bank that was made in mid-February. In our continuing program to repay longer-term debt, we paid off $27 million equivalent of the 1971 Belgian franc swap drawings and for the first time we made a token payment of $20 million equivalent against our drawings of Swiss francs, using francs acquired outside the market.

So far, although the Bank of Italy has sold a net of $466 million since resuming its operations in the exchange market on March 1--and that figure will be raised after today's operations--it has not drawn more than the original $250 million taken down in January on its swap arrangement with the System. The Italians still have $500 million available to them, of course, if they need it in subsequent operations, and they may well have such a need. I should add that the Bank of Italy is quite prepared to see the exchange rate take the brunt of pressures against the lira, but there are political considerations about how far the lira should be allowed to depreciate. This morning it has already dropped to 850 lire to the dollar, down another 3 per cent.

Mr. Wallich referred to Mr. Holmes' comment about the prospective danger of competitive depreciations. He noted that the currencies of four major countries had been depreciated. It was his impression that two of the countries involved--France and Italy--had defended their currencies vigorously, perhaps excessively, in the exchange market. He was not sure about the other two countries, Great Britain and Spain. He asked Mr. Holmes for his evaluation.

Mr. Holmes said he did not have enough information to comment about Spain. The British pound, as the Committee members knew, had been remarkably steady for an extended period at a rate of just over $2. Money market observers had come to the conclusion, however, that such a situation could not last. On March 4, as the Committee members would recall, the pound initially came under strong upward pressure, but a decision not to let the pound appreciate had obviously been made and the Bank of England intervened heavily, taking in over $280 million. Around midday, however, the market for sterling turned around abruptly and the Bank of England reversed its operations. Through the next day the Bank sold all of the dollars it had acquired during the morning of March 4. Since then, the British had continued to support the pound on a substantial scale while permitting the rate to drop gradually to its present level of just below $1.92. Thus, the pound was defended, but questions were raised by some observers regarding developments on March 4. There seemed to be a suspicion in some quarters that the British had engineered a decline in the rate. Widespread circulation and acceptance of such a suspicion would have dangerous implications in his opinion.

In response to a further question by Mr. Wallich, Mr. Holmes said he was in Frankfort on February 27 when the Bank of England reduced its minimum lending rate by 1/4 percentage point to 9-1/4 per cent. Private bankers in Germany had viewed that reduction as a significant development since the pound was then in the process of falling below the $2 level.

Mr. Holland observed that Mr. Holmes had raised an early warning signal regarding the risk of competitive devaluations, and he believed that U.S. authorities, including the System, should have some contingency plans regarding steps that might be taken to head off such a development.

Chairman Burns commented that an old argument against a system of floating rates was that movements under such a system could easily be interpreted as reflecting an effort by a country to help its exports. That argument appeared to have been submerged in the euphoria about floating rates, but it seemed to be in the process of being rediscovered.

Mr. Partee noted that the performance of the dollar against other currencies could have an impact on the strength of the domestic recovery and should therefore be monitored by the Committee. He cited a recent conversation with an exporter who had expressed concern because his firm was in danger of losing a large contract to a British competitor because of the drop in the pound.

In reply to a question by the Chairman, Mr. Holmes indicated that no swap drawings would mature in the period until the next meeting of the Committee. A drawing by the Bank of Italy would come up for renewal shortly after that meeting, if it was not repaid in the interim, but the Committee could take the matter up at that time.

By unanimous vote, the System open market transactions in foreign currencies during the period February 18 through March 15, 1976, were approved, ratified, and confirmed.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on February 17-18, 1976, were approved.

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 summarized the following statement:

Economic news coming in over the past month has continued to be relatively favorable. Total retail sales rose considerably in February--by 1-1/2 per cent--led by a sharp increase in sales of autos. Unit auto sales, at a 10.2 million annual rate, were back to near the levels of late 1973, and a substantial further rise occurred in the first ten days of March.

Industrial output in February advanced 0.6 per cent--which equals the average rise of the previous 4 months. Output of durables was up

0.8 per cent, reflecting the strengthening of new orders for hard goods in December and January. Judging by the reports of purchasing agents, orders for durables rose again in February so that further good gains in the production of durables seem likely.

There has also been continued improvement in the condition of labor markets. Total employment increased again in February, and the unemployment rate declined two-tenths further, to 7.6 per cent.

On the price side the news has also been favorable recently. In each of the past 4 months, over-all wholesale prices have remained unchanged or have declined. For industrial commodities, the rate of price increase over this period moderated to an annual rate of 6 per cent, compared with 9 per cent during the previous 4 months. And if food prices at retail stores declined last month, as seems likely, the February Consumer Price Index to be released later this week will probably show another rather moderate rise.

These favorable price developments are due in large part, however, to special factors reducing the prices of food and fuel. Thus, wholesale prices of industrial commodities other than fuel and power have gone up as much in the past 4 months as in the previous four. And consumer prices excluding food and fuel rose a little faster from October through January than they did in the previous 4 months.

On the wage side the more moderate rate of rise that has developed over the past 3 or 4 months suggests that wages are continuing to respond to the better over-all performance of prices, to the relative slack of labor markets, and to the light schedule of collective bargaining agreements. Given this recent improvement in wages, an increase of unit labor costs during 1976 in a range of 5 to 6 per cent, as the staff has been projecting, seems quite plausible.

The less happy news of the past month relates to business fixed capital investment. According to the late January-early February Commerce survey, businesses plan to increase nominal capital expenditures in 1976 by only 6-1/2 per cent over the 1975 level. Plans to spend did not change materially from December to February, contrary to what we had been expecting. This survey has a remarkably accurate forecasting record; its average error over the past 28 years in forecasting the annual total of capital outlays amounts to an overestimate of about 1 per cent, and there is no clear cyclical pattern to the errors. A survey of such accuracy cannot be taken lightly.

The survey results appear consistent with the continued weakness in construction contract awards and in the trend of new orders for nondefense capital goods. The latter rose a little in January but are still below the levels of last April, even in current dollars. The survey results may not be consistent, however, with the National Industrial Conference Board series on new capital appropriations of large manufacturers, which registered a 22 per cent increase in the fourth quarter of last year. The NICB believes that the rise in appropriations would suggest about a 13 per cent year-over-year increase in capital expenditures of large manufacturers in 1976, compared with an 8 per cent rise for all manufacturers forecast in the latest Commerce survey.

In light of recent developments, the staff has trimmed marginally its projection for business fixed investment in 1976. We did so with some misgivings, because the evidence has been mixed and the survey results are hard to believe--given the recent strength of consumer spending, the rise of corporate profits, and the improvement in business confidence since late last fall. But while investment outlays have been lowered in our staff projection, the expected rise of consumer spending has been strengthened and the GNP projection in this green book[1/] is, on balance, very

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

similar to that of a month ago. We are still expecting a growth rate of real GNP of around 5-1/2 per cent over the projection period, with the unemployment rate coming down to 7 per cent by the middle of next year.

The sluggish pace of fixed investment to date has affected significantly the contours of the current economic recovery. I thought it might be useful to look at a few charts that illustrate this point by comparing the current recovery with the upswing that began after the recession of 1957.[1/]

The current business expansion started off with a bang but has proceeded at a more subdued pace since last fall. The expansion of real GNP since the trough in the first quarter of last year has begun to fall behind the pace of the upswing in the 1957-59 cycle. The shortfall has been entirely in the growth of real final sales.

Growth of real personal consumption expenditures--by far the largest sector of final demand--has been about as strong in this expansion as in 1957-59. But in residential construction we have had less relative growth this time, and for business fixed investment real outlays have as yet shown little improvement.

The weakness in capital investment has been exerting a substantial drag on the industrial sector. Total industrial production is now about 9 per cent above the business cycle trough, which for charting purposes we have taken as March 1975. This compares with an 18 per cent rise at the same stage of the 1957-59 cycle and an average rise of 15 per cent at the same stage of all previous postwar recoveries. The shortfall this time has been particularly pronounced for output of durable goods, including durable materials as well as business equipment.

In the labor markets, the weakness has shown up in employment in the goods-producing industries--that

1/ The charts in question are attached to this memorandum as Appendix A.

is, manufacturing, mining, and construction--where we still have a long way to go to regain pre-recession levels of jobs. Employment in service-producing industries held up rather well during the recession and has since kept rising quite vigorously. As a result total nonfarm payroll employment is now not far from its pre-recession peak in September 1974, and total employment as measured in the household series has actually exceeded its previous peak.

My conclusion is that the current cyclical expansion to date has been rather unusual. We have had a relatively good growth of aggregate real output and employment, with comparatively little involvement of the durable goods industries which normally provide a major source of stimulus during a cyclical upswing. Weakness in the recovery of durable goods output clearly has limited the speed and extent of the cyclical expansion to date. It may, however, extend its duration. For, if business capital spending strengthens later in 1976, as seems very likely, this new source of stimulus could keep the economy moving forward through all of 1977, and perhaps even beyond.

Chairman Burns observed that Mr. Gramley had picked March, 1975, as the trough of the recession. The charts distributed by Mr. Gramley suggested that the present recovery would look somewhat stronger if May had been chosen instead.

Mr. Gramley said he agreed. He added that the staff had tried to select a National Bureau-type reference trough. The staff did not know what month would ultimately be chosen to mark the trough, but it had experimented with both March and April and had gotten very similar results on the basis of currently available data. Whatever basis was chosen, it was clear that there had been little recovery in the output of durable goods.

The Chairman remarked that he had not studied the data closely, but his impression was that the trough might have occurred in May rather than March.

In response to a question by Mr. Partee, Mr. Gramley said that the weakness in durable goods output included durable materials as well as business equipment.

Mr. Black inquired why the staff was not projecting a greater decline in the unemployment rate through the third quarter, given the expansion projected in real economic activity. For example, the staff expected growth in nonfarm payroll employment to outstrip growth in the labor force by some 200,000 over this period. The staff was also projecting that the rate of increase in industrial production would accelerate and that real GNP would rise significantly. He wondered whether seasonal adjustment factors were tending to hold up the unemployment rate in the staff projection.

Mr. Gramley replied in the affirmative. The staff was assuming that the procedure used for making seasonal adjustments would result in an understatement of the unemployment rate in the first quarter and an overstatement later in the year. For that reason and because of certain other technical considerations, actual unemployment was likely to decline more than the official statistics would indicate.

Mr. Black then observed that the staff had made a sizable upward revision in its projection of consumer expenditures on durable goods and a similar downward revision in its projection of consumer spending on nondurable goods. He wondered why the projection of consumer spending on nondurable goods had been cut back as much as it had.

Mr. Gramley said that the revisions were based on recent data which indicated substantial strengthening in the durable goods area, particularly in sales of automobiles, and less-than-expected strength in the nondurable goods area. He would emphasize, however, that a rather healthy rate of expansion was still projected for nondurables. Over-all, the staff was projecting quite substantial growth in consumer spending and a significant drop in the saving rate.

Mr. Coldwell asked whether the indicated shift in consumer spending from nondurables to durables was expected to have a noticeable impact on the relative price performance of the two sectors.

Mr. Gramley replied in the negative. He recalled certain statistical problems in making the relevant estimates when prices were calculated on a 1958 base, but the shift to a 1972 base had greatly reduced those problems. In any event, the staff projection did not envisage much difference in the rates of inflation in the two sectors, and therefore the shift to purchases of durable goods would not have much impact on the implicit GNP deflator.

Mr. Wallich asked whether a large increase in consumer expenditures might tend to crowd out business investment over the year ahead. Normally, in a situation where there were unemployed resources, one would expect increased consumption to foster increased investment. He wondered, however, whether the staff foresaw circumstances where a large expansion in consumer spending might tend to restrain investment, perhaps through the mechanism of upward pressures on interest rates stemming from the financing of consumer expenditures.

Mr. Gramley replied that there could be a tendency for some crowding out of investment to occur. The staff projection suggested that short-term interest rates would begin to rise relatively soon and that the bill rate would increase to around 7-1/2 per cent by the middle of 1977. The higher rates would be accompanied by a diminution of savings inflows to banks and nonbank thrift institutions. Accordingly, the initial impact of rising interest rates on investment would probably be felt in the housing market. In the staff's judgment, however, the reduction in savings inflows was likely to be small enough so that housing starts would level out rather than decline. The current liquid position of savings institutions would also help to produce that result. In sum, the staff did not anticipate an unusually strong investment response, but there certainly would be some.

Mr. Kimbrel noted that a drop had been reported in the civilian labor force and he inquired whether such a development was unusual in a period of economic recovery.

Mr. Gramley said he would not assign any significance to the reported drop. The monthly labor force figures were quite erratic, and it was not unusual for increases to occur in spurts that were later followed by a leveling out or a slight decline. Job opportunities were improving substantially except in the durable goods industries where the recovery had been relatively weak to date. However, he anticipated further improvement even in those industries as time went on, and over the course of 1976 he expected a larger rise in the labor force than was normal at this stage of the cycle.

Mr. Eastburn remarked that in conversations with bankers in recent weeks he had noted an attitude of marked caution with respect to lending policies. For example, the chairman of a medium-size bank had given instructions not to make any loans that might become classified. It seemed that many bankers were so concerned about the condition of their loan portfolios that small- and medium-size businesses would find it difficult to secure financing. He thought such a cautious attitude could have an impact on the recovery, to say nothing of possible social and political repercussions.

Mr. Gramley agreed that bankers were being very cautious. However, since small- and medium-size businesses tended to rely mainly on internal sources of financing, highly conservative banker attitudes should not have serious consequences for them. More generally, he did not anticipate any significant weakening of the recovery because of such attitudes. Indeed, the effects of favorable liquidity positions and business sentiment were likely to swamp those cautious lending policies of banks.

Chairman Burns commented that more liberal lending attitudes seemed to be developing in the securities markets, judging from the reviving investor interest in lower-quality issues.

Mr. Winn observed that officials in the insurance industry were complaining of having to struggle with the problem of finding suitable investment outlets for very large cash flows.

Mr. Baughman referred to Mr. Gramley's comments about the slowing rate of wage increases. It was his own feeling that if the recovery were to end prematurely, the most likely cause would stem from wage developments. He wondered, therefore, if there was any evidence to indicate whether the slower rise in wages was related primarily to relatively high levels of unemployment or to other factors. The latter might include the possibilities that a disproportionate part of the increase in employment was occurring in low wage industries, or that wages were being affected by second- and third-year provisions in existing wage contracts calling for smaller increases than in the first year. To the extent that the latter two factors were exerting an influence, the chances of continued favorable developments in wage trends would be reduced.

Mr. Gramley said he attributed the slowdown in wage increases to three factors: the generally improved performance of prices, the relative slack in labor markets, and the light collective bargaining calendar over the past 3 or 4 months. In the period since October the average hourly earnings index had been rising at an annual rate of about 7 per cent. That estimate made an allowance for the industry-mix problem referred to by Mr. Baughman.

Mr. Gramley added that the staff did not expect the slower rise of wages to continue. The staff projection indicated that the rate of increase in average hourly earnings would go back up to around 8 per cent. In his view a heavy collective bargaining schedule later this year would make it difficult to realize wage settlements that were any better than those negotiated in 1975 when first-year settlements plus fringe benefits averaged around 11 per cent.

Mr. Winn inquired whether the staff felt that financial pressures on State and local governments had lifted sufficiently to permit them to undertake more capital spending projects.

Mr. Gramley said that in general the budgetary positions of State and local governments were much improved. On the other hand, financial markets were evaluating the risks of lending to such governments much more carefully than they had before the New York City financial crisis and as a result State and local governments were bound to conduct their affairs in a much more conservative way than they might have otherwise. Accordingly, the staff was not projecting any major pickup in capital spending by State and local governments. A rise of 9.3 per cent in current dollars was projected for all of 1976, and that figure implied only a small increase in real terms.

Mr. Holland asked whether surveys of business plans for capital expenditures suggested relatively large additions to capacity in the major materials industries. Those industries might experience bottlenecks and price pressures as time went on, and he wondered if they were likely to expand capacity to keep pace with the growing demand for their products.

Mr. Gramley said that in 1975 the major materials industries had invested in plant and equipment at a significantly faster rate than manufacturing industries in general. However, he had not reviewed recent surveys of capital spending plans in sufficient detail to make a judgment about their further additions to capacity in 1976.

Mr. Black observed that relatively low capacity utilization rates in manufacturing generally and the probability of further additions to capacity in the major materials industries should provide a good deal of room for increases in productivity as output expanded. He asked what sort of gains in productivity were incorporated in the staff projection.

Mr. Gramley replied that a gain at an annual rate of just over 3 per cent was projected for the remainder of 1976. For the projection period as a whole--that is, through the second quarter of 1977--a gain at an annual rate of 2.9 per cent was indicated. Those rates were higher than the long-term average, but it was his hunch that they might in fact be exceeded. Productivity gains had been rather poor thus far during the present recovery, and he was inclined to attribute that weakness in part to the lagging performance of the durable goods industries where productivity improvements typically were substantial. If those industries should now begin to play their usual role in the expansion process, then over-all productivity gains might well exceed the staff projection.

Mr. Black said he shared Mr. Gramley's view. He added that larger gains in productivity would have important implications for prices.

Mr. Gramley said that unfortunately they would also have adverse implications for employment.

Mr. Kimbrel commented that the lagging productivity gains in the current recovery might be related in part to the impact of new environmental and safety regulations.

Mr. Gramley said he agreed. Environmental and safety requirements had raised the cost of capital equipment and would continue to exert a negative influence on productivity.

Mr. Partee noted that the staff projection depended rather heavily on a strengthening of consumer demand. Associated with that improvement was a projected decline in the saving rate of almost one percentage point over the next five quarters. He wondered if such a decline was consistent with the experience of past recoveries.

Mr. Gramley replied that the projected reduction in the saving rate was reasonably in line with past cyclical performance. He would also note that a report just received from the Survey Research Center at the University of Michigan indicated a very substantial improvement in consumer confidence between November 1975 and February 1976. The confidence index had climbed more than 9 points between the two survey dates and had recovered all but 6 points of the nearly 35-point decline during 1973-74. Consumers were now in a very different frame of mind, and he did not regard the staff projection as unduly optimistic.

Mr. Partee said that the projected decline in the saving rate appeared to be consistent with other elements of the staff forecast, but the large size of the decline had attracted his attention. Despite its optimism with respect to the consumer sector, however, the staff projection could not be said to portray a strong economic outlook. After the current quarter, the projection indicated a rate of growth in real GNP of around 5-1/4 per cent. That would not be a bad performance but it was not good either. Growth in a 6 to 7 per cent range would be more acceptable. He wondered what sectors of the economy might be holding the expansion back from a stronger, and perhaps more typical, recovery.

Mr. Gramley said that greater strength in business fixed investment would be needed if the economy were to expand more rapidly. A better-than-projected performance in the housing sector would also help, although he would note that the recovery in housing was not especially weak in comparison with previous cyclical experience. The most unusual feature of the current recovery to date had been the failure of business fixed investment to show more strength. In that connection he had reservations about the latest Department of Commerce survey of business spending plans. The survey results did not seem to fit in with the evidence of strengthening consumer confidence and improving corporate profits.

In reply to a question by the Chairman, Mr. Gramley said he would question the bias adjustment used in the survey. That adjustment did not make an allowance for the cyclical position of the economy. It was designed rather to take into account the systematic errors made on average by reporting firms. The adjustment had produced some strange results for recent years. If it was omitted, the anticipated increase in investment spending by all business firms would be 9 per cent rather than 6-1/2 per cent. The actual results therefore suggested that business fixed investment might be stronger than the survey indicated. If that in fact turned out to be the case, a stronger economic expansion could develop in late 1976 and early 1977 than the staff was projecting.

Mr. Partee said he thought the performance of the housing sector might prove to be better from this point onward than it had been in some earlier recoveries when a quick initial runup in housing starts had been followed by little further improvement. He was not sure about net exports, but it was his impression that they had been notably weaker than in earlier recoveries.

Mr. Baughman remarked that major bankers in the Dallas district were reporting strong evidence of a resurging interest in acquiring firms, and he thought such a development should be viewed as an indication of growing optimism among businessmen. A few of the large bankers also indicated that they were gearing up to expand their loans to small businesses. These bankers had decided that for now they would not compete with the commercial paper market in the extension of credit to large business firms, and so they were concentrating on smaller businesses.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period February 18 through March 10, 1976, and a supplemental report covering the period March 11 through March 15, 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 after the February meeting started out with the objective of maintaining the availability of reserves and money market conditions unchanged, with a Federal funds rate centering around 4-3/4 per cent. Data reviewed on February 27, however, indicated a significant strengthening in the aggregates--especially in M-2, which was at or near the top of its range--and accordingly the Desk sought to shade its stance slightly to the firmer side, anticipating that Federal funds would trade largely in a 4-3/4 to 4-7/8 per cent range. But market participants exaggerated the intended extent of the System's move, and the funds rate pushed above desired levels, carrying a wide spectrum of other market rates sharply upward as well.

The extent of the market reaction to the slight move intended by the Desk appeared to reflect the highly sensitive market climate rather than any particular Desk action. Some market observers made much of the Desk's failure to provide reserves on February 27, noting that the Federal funds rate rose to 5 per cent and higher on that day. Actually, through 1:30 p.m. that day, funds trading was at 4-13/16 to 4-7/8 per cent, and reserve projections indicated no great need for additional reserves. The rate edged up to 4-15/16 by about 1:40 p.m., already rather late for Desk activity, and went to 5 per cent and higher after 2:00 p.m. Market observers noted the Desk's absence as well as the previous day's publication of somewhat stronger aggregate numbers. There was also an expectation that the Desk had substantially more reserves to add for the week, as it was not appreciated that the previous day's repurchase agreements had been sizable. Moreover, there was a view that the economy was strengthening and that at some point in the near future a firmer monetary policy was likely. All of this led some market analysts to conclude that the System was starting to tighten, and based on past experience it was considered likely that the Desk planned to aim currently for a funds rate around 5 per cent, with a 5-1/4 per cent rate likely to follow in another week or so.

As these views gained adherents, the funds rate quickly advanced from an effective rate of 4.89 per cent on that crucial Friday, February 27, to 5.21 per cent on March 1. While the market saw the Desk pump in a large volume of reserves on March 1, this was regarded as reassurance that the System did not currently want rates as high as 5-1/8 to 5-1/4 per cent, and temporarily left intact the view that a 5 per cent rate was acceptable. Over the next few days the funds rate gradually edged down with the help of additional Desk injections of reserves, but the Desk avoided massively aggressive action to push in reserves, because such an approach might have compounded the market's uncertainty about current objectives.

By March 5 another week's data on the aggregates suggested considerably more moderate growth and the Account Management shifted its objective back to aiming at conditions consistent with a funds rate around 4-3/4 per cent. With uncertainty still rife in the market, the Desk continued to avoid aggressive tactics that would have risked conveying a view that substantially easier conditions were suddenly desired. Pursuit of this approach in recent days has brought the funds rate down to about the 4-13/16 area.

One uncommon feature of the Desk's operations during the period since the February meeting was the sale to a foreign official account of about $107 million of coupon issues in the 2-year area. The foreign purchase order was received at a time when the System needed to absorb reserves so that the sale fitted the usual criteria under which the System has often sold bills to foreign accounts.

For the period as a whole, interest rates were about unchanged to moderately higher, as rather sharp increases midway through the interval were partly offset by declines early and late in the period. Three-month bills were auctioned yesterday at 4.98 per cent, up modestly from the 4.85 per cent rate set in the auction just before the last meeting and down from an inter-meeting high point of 5.26 per cent. Six-month bills went yesterday at about 5.46 per cent, up from 5.17 per cent before the last meeting but below the 5.72 per cent level of a couple of weeks ago. Intermediate-term Treasury issues were up 10 or 15 basis points on balance over the interval, with the market readily absorbing a new 4-year note. Long-term bond rates were slightly lower on balance, even though the market expects that the Treasury might well use its new authority to sell additional bonds and longer maturity notes in the near future. The market also expects sizable Treasury borrowing in the short-term area in the next few weeks to meet heavy cash needs in early April.

Chairman Burns remarked that at its meeting in February the Committee had had a useful discussion of zones of indifference for the short-run monetary aggregates. In the course of that discussion a question was raised regarding the frequency of false starts generated by current procedures. Clearly, a false start had been made during the past month. He had asked Mr. Holmes to review the recent history of the Desk's operations and to report on the number of such occasions in the past few years.

Mr. Holmes said he had reviewed the record back to the beginning of 1973 and had uncovered either seven or nine periods when a change in the availability of reserves and in the Federal funds rate subsequently had to be reversed. The exact number of such reversals depended upon how one chose to define a change in Desk operations. Regardless of the definition adopted, however, most of the changes were so small that they were barely perceived by the market. Moreover, some of them had occurred at a time of relatively large movements in market interest rates. Thus, the false starts were more apparent to System officials than to outsiders. It was his impression that the market had been affected on two of those occasions, but in neither case was the market impact large. Perhaps the most dramatic instance was the most recent one described by Mr. Sternlight in his report today. Because the market had been looking for some indication of a shift in System policy, it had exaggerated the significance of a very small move.

Mr. Holmes added that any analysis of false starts was complicated by certain factors. First, it was often difficult to identify false starts because, as a result of errors in the staff's forecasts of the relationship between the Federal funds rate and the monetary aggregates, the Desk found itself engaging in operations that had not been anticipated at the time of the meeting. Second, there were a number of occasions when the Desk would have had to reverse its operations if the Committee had not issued interim instructions to disregard certain developments in the aggregates. Finally, the frequency of reversals had been reduced by the Desk's generally cautious approach to incoming data on the aggregates, which involved waiting for confirmation from new data before responding to indications that the funds rate might need to be changed.

Chairman Burns observed that false starts were disturbing to financial markets. He thought the Committee should minimize their frequency, although it could not avoid them completely and indeed should not try to do so. Therefore, when the Committee turned to monetary policy later in the meeting he would recommend once again that fairly broad zones of indifference be set for the short-run aggregates.

In reply to a question by Mr. Eastburn, Mr. Sternlight said the temporary increase in the Federal funds rate associated with the recent reversal in Desk operations had seemed to upset the market. On the day when the Desk decided to shade its operations toward the firmer side, Federal funds were trading at 4-7/8 per cent. In the absence of a desire to firm, the Desk would have considered intervening at that level, but any decision to do so would have been marginal. With the shift to a slightly firmer stance, the Desk did not intervene at 4-7/8 per cent; however, it was prepared to take action if the rate went above that level. As he had noted earlier, the rise in the Federal funds rate to 5 per cent and higher had occurred too late in the day for the Desk to intervene.

Mr. Kimbrel asked whether market particpants were reading correctly the current target for the Federal funds rate. In particular, did they believe it was above 4-3/4 per cent?

Mr. Sternlight said the market seemed to have concluded that the System would tolerate a rate above 4-3/4 per cent, perhaps something in the 4-3/4 to 5 per cent range or in the narrower range of 4-13/16 to 4-7/8 per cent. There was little recognition of the fact that the target had been brought back down to the area of 4-3/4 per cent.

Mr. Jackson said he was somewhat concerned about the System's operations in the securities of the Federal National Mortgage Association (FNMA). Both he and Mr. Volcker were familiar with that agency; he had served at one time as the Chairman of its advisory committee and Mr. Volcker had been a director of the agency.

Mr. Jackson noted that FNMA had become increasingly like a private organization in its operations. Its common stock was listed on the New York Stock Exchange, and it traded very actively at times. The System held nearly 10 per cent of FNMA's outstanding debt obligations and those holdings constituted over 40 per cent of all Federal agency securities owned by the System. He did not question the fact that FNMA was still considered to be a Federal agency, although he preferred to think of it as a "quasi" Federal agency. Nevertheless, he thought the System's operations in FNMA's debt issues should be reviewed. In particular, he thought consideration should be given to the extent of the System's activity in those issues, and if a change in the current policy should be deemed advisable, the speed with which such a change should be implemented. He recognized that the matter was sensitive in light of the attention given to housing in the Congress and the publicity given to the agency through the stock market. In the latter connection he wanted to avoid any suggestion that the System might somehow influence the relatively volatile price of the agency's common stock through its operations in FNMA debt obligations.

Mr. Volcker indicated that he was in sympathy with Mr. Jackson's suggestion for reviewing the System's operations in FNMA obligations. He too felt uneasy about conducting transactions in the securities of an agency that more and more talked, looked, and acted like a private corporation. He was not prepared to propose any drastic changes today, but he thought it might be useful for the Committee to review its policies with respect to the securities of that agency. Those policies might depend on where FNMA itself was going.

Chairman Burns said he thought the suggestion for reviewing System operations in FNMA securities was a good one. He asked Messrs. Axilrod and Holmes to study this question and to consult with members of the Committee and appropriate officials of government housing agencies before reporting back to the Committee.

In reply to a question by the Chairman, Messrs. Axilrod and Holmes indicated that it would be feasible to complete the study within two months.

Mr. Holland referred to the sale of Treasury coupon issues during the inter-meeting period. He noted that the securities had not been sold in the market but directly to a foreign official account. Even so, the sale had produced a great deal of comment when it became known. He thought such a reaction underscored the wisdom of returning to the practice of occasionally selling modest amounts of Treasury coupon and Federal agency securities in the open market. It was his impression that no Treasury coupon issues had been sold from the System Account since 1963 and that sales of Federal agency obligations had not exceeded $2 or $3 million a year since 1972. In that year they had totaled $145 million. It was important to make clear that System transactions in Treasury coupon and Federal agency issues were intended to help implement the System's monetary policy objectives and not to support the market for such securities. A misinterpretation could be expected when the System made only rare sales of the securities in question. In his view it was especially important to undertake occasional sales of Federal agency issues since officials of those agencies were probably less familiar with System objectives than the Treasury and were therefore more likely to be misled by the Desk's abstention from the selling side of the market.

Mr. Holland said he understood the difficulty of selling securities other than Treasury bills. It was only on rare occasions that sales of such securities would seem preferable to sales of bills in terms of market impact and best prices. Perhaps the Committee should instruct its Manager to be prepared to accept second-best prices for such securities compared with those available on Treasury bills.

The Chairman said he strongly endorsed Mr. Holland's proposal for more frequent sales of the securities in question. However, he did not want the Desk to be instructed to accept a second-best price. System operations should be conducted at all times along sound financial lines.

Mr. Volcker indicated that he too would favor more frequent sales. He added that the question of best price was necessarily a matter of interpretation.

Mr. Holmes observed that the best price was considered by the Desk to be the best available in the market at a particular time.

Mr. Holland said he had made his suggestion because the opportunities to sell coupon issues at a better price than bills would be rare. The difficulty might be solved by defining the "best price" as the best available within a particular maturity range such as the 1-to-5 year maturity area.

Mr. Holmes remarked that without careful preparation of the market such sales would be likely to have an exaggerated impact. Even relatively small sales of coupon issues in the open market would probably cause a much greater reaction than had the relatively large recent sale directly to a foreign official account. Moreover, it would be desirable to conduct such sales at a time when the Treasury was not offering new coupon issues as frequently as it had been of late. If he interpreted the Committee's views correctly, it was agreed that occasional sales of Treasury coupon and Federal agency securities would be desirable; unfortunately, there never seemed to be a good time to undertake such sales.

Mr. Partee agreed that such sales should be handled with great care, especially in light of the present concern in the Congress and elsewhere about long-term interest rates. If System sales of coupon issues were interpreted erroneously as an effort to push up long-term interest rates, the System would face a very difficult problem.

Mr. Jackson commented that if the System was never going to find an opportunity to sell longer-term agency issues, it might be appropriate for the Committee to reconsider the extent to which it was willing to continue purchasing such securities.

Chairman Burns said it was necessary to proceed cautiously in this area. The Federal Reserve had been prodded repeatedly by the Congress to purchase longer-term obligations. The System had indicated that it saw little advantage, but also no harm, in such transactions and it had agreed to engage in them. He did not think they should be discontinued without thorough consideration.

Mr. Coldwell recalled that the Federal Reserve had indicated clearly its intention to sell as well as to purchase coupon obligations.

Mr. Baughman said he had participated in the morning conference call with the Desk during part of the recent inter-meeting period. It seemed to him that the Desk's performance had been good; in particular, he was pleased with the way the Desk had responded to the incoming evidence on the monetary aggregates. Unfortunately, the intended adjustment in the Federal funds rate had occurred after a long period of rather close commitment to a 4-3/4 per cent rate. Market participants--especially the letter writers who advise investors on movements in interest rates--were waiting for the first hint of any change from a 4-3/4 per cent target rate. Accordingly, the Desk's actions happened to hit a responsive note and the resulting press coverage probably served to amplify the market's reaction. Nonetheless, he did not think the Committee should leave the impression that it wanted the Manager to be even more cautious in the future than he had been in the past in responding to new evidence on the aggregates. He, for one, would encourage the Manager to change the Federal funds rate a bit in response to new evidence as it became available, even though the action might prove in retrospect to have been erroneous.

The Chairman observed that the issue was not whether the Desk should respond to evidence but what constituted evidence. Extensive studies by the staff had indicated that a rather wide range of short-run monetary growth rates could be associated with some particular underlying growth rate. He had alluded frequently to the staff conclusion that in the short run a growth rate of 4 per cent did not differ significantly from one of 8 per cent. While he thought that result had been demonstrated conclusively by the staff, the implications of the staff study were a matter for the Committee to decide. The members would return to that question later in the meeting when the Committee considered the domestic directive.

Mr. Mayo said he had concluded that the market did not believe the Committee wanted to see the Federal funds rate fluctuate within the ranges established for inter-meeting periods. For example, market participants had decided that the rate had been pegged at 4-3/4 per cent for an extended period. When they saw evidence that the System might be moving away from that rate level, the reaction was grossly exaggerated. That experience suggested to him that the Federal funds rate should have been allowed to fluctuate earlier in a wider range around 4-3/4 per cent. Judging from the comments he was now reading in the press it was possible that the market had begun to think less in terms of a pegged rate. In any event, he thought it might be helpful for the Committee to consider how it might get across the point that the Federal funds rate was intended to fluctuate within a range.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period February 18 through March 15, 1976, were approved, ratified, and confirmed.

Mr. Axilrod then summarized the following statement on prospective financial relationships:

The analysis behind the blue book alternatives is essentially unchanged from that of recent meetings. The staff still believes that there will be some continued downward shift in the demand for money for a while, but that short-term interest rates will have to begin rising later in the spring to keep money growth in line with the FOMC's longer-run ranges. The recent slightly weaker performance of M-1 relative to expectations has caused us to extend the period of declining money demand a little and thus the turnaround in rates has also been pushed somewhat further forward in the year, compared to earlier expectations. Moreover, we have adjusted downward slightly the level of short-term rates we expect by the last quarter of the year, but have done so by no more than a symbolic 1/4 of a percentage point in view of the huge uncertainties involved in estimating when and to what extent the public will no longer find it feasible, or desirable, to economize on cash balances.

While the public's demand for money, and particularly demand deposits, has apparently continued to drop relative to income over the three quarters of economic recovery that we have thus far experienced, this period has nonetheless been characterized by a strong demand for liquidity. This can be seen in the behavior of liquidity measures for key lending institutions. The ratio of liquid assets to liabilities for weekly reporting banks has risen steadily since the economic recovery began, and by more than past experience would have suggested in the early stages of recovery. Banks have discouraged loans by keeping the prime loan rate relatively high, have been unwilling to issue CD's in order to invest in longer-term securities, and have used other deposit inflows in large part to acquire short-term securities. Savings and loan associations and mutual savings banks also have been intent on rebuilding liquidity during the current cyclical recovery. The recent accumulation of liquidity by banks and other institutions may have been in part unintended or unplanned, of course, since credit demands on banks and thrifts have been comparatively weak.

Nonfinancial sectors of the economy also appear to be attempting to enhance their liquidity. Businesses have done so in part by using proceeds from capital market issues to repay bank debt and also by adding to holdings of short-term assets, principally Treasury securities. It is a little difficult to draw conclusions about the household sector. Data from the flow-of-funds accounts indicate that the ratio of liquid assets to disposable personal income is now much higher than in earlier cycles going back to 1957-58, but it has been on a rising trend over the period. Looking at specific cyclical behavior, though, households appear to be behaving little differently than they had in similar stages of earlier cycles. That is, they have about maintained their liquidity position in the early stages of recovery.

Efforts by lending institutions and others to build up, or maintain, liquidity even while economic activity has been rising, have been reflected in the slope of the yield curve. Yields on short-term highly liquid securities, indexed by the 3-month Treasury bill rate, have thus far in 1976 been about 3-3/4 percentage points less than those on high-grade corporate bonds. In similar stages of earlier cyclical upturns, this spread was more like 1-1/2 to 2-1/2 percentage points. Investors have thus been willing to pay a substantial premium to hold liquid assets, or to avoid accumulating short-term debt, and they apparently continue to do so.

The Federal Reserve has surely accommodated the continued demand for liquidity by permitting short-term rates to drop below levels prevailing at the time of the 1975 cyclical trough in economic activity even while a fairly strong cyclical recovery has been under way. In fact, if you assume that inflationary expectations affect short-term as well as long-term rates, the present level of short-term rates in real terms--that is, reduced by the expected change in the average level of prices--would be lower than in earlier cyclical recoveries, except perhaps for the 1970-71 period.

How financial institutions and the public behave with respect to liquidity in the future of course has implications for financial markets and the economy. At one extreme, institutions and others may consider that their liquidity positions are now so easy that they will actively seek to reduce them--thereby leading to a much more expansive economy than is currently contemplated. At the other extreme, liquidity demands may remain so strong that an unusually large infusion of central bank credit would be required to accommodate those demands and also to assure the availability of funds to finance the credit needs of an expanding economy.

In our analysis and the one that underlies the blue book, we have assumed a mid course. We have assumed that much of the desire to improve liquidity on the part of financial institutions and others may have been satisfied, given current nominal and real interest rates. For instance, there has been evidence recently that banks and other financial institutions have been willing to lengthen security portfolios and have become more eager to make business and mortgage loans. However, we do believe that a certain amount of caution will remain, still reflecting financial difficulties that developed in the aftermath of the 1973-74 inflation. On balance, we would expect liquidity demands to be gradually moderated, with banks reducing their acquisitions of short-term securities and businesses becoming somewhat more willing to borrow at short term; as a result, we would expect a moderate rise in short-term interest rates as the year progresses, given the FOMC's ranges for the longer-run aggregates.

In reply to a question by Mr. Holland, Mr. Axilrod said he would expect long-term rates in private debt markets to fluctuate somewhat in coming months; for example, they might rise temporarily in response to a rise in short-term rates. On balance, however, he did not think that private long-term rates would change significantly this year.

Mr. Wallich noted that in comparing the current spread between short-term and long-term rates with earlier cyclical experience, Mr. Axilrod had cited figures for absolute differences in percentage points. He wondered how the comparison would look in proportional terms.

Mr. Axilrod said that some rough estimates indicated that the differences in proportional terms were not as large as those in absolute terms. He did not recall, however, whether the current spread in proportional terms was wider than the spreads at a similar stage of earlier economic recoveries.

Mr. Coldwell inquired whether the staff had more or less confidence in its current projection of the monetary aggregates than it had had in past projections.

Mr. Axilrod said he felt highly uncertain about the current projection. In particular, he was not sure whether the demand for money would keep shifting down, stabilize, or shift back up. Any of those outcomes was possible at this stage of the recovery, and he had no reliable way of predicting which would occur.

Chairman Burns then asked Mr. Broida to report on the scheduling of the special meeting the Committee had agreed to hold to discuss its operating procedures.

Mr. Broida reported that all Committee members and Reserve Bank Presidents not currently serving on the Committee had been polled to determine acceptable dates for the special meeting. The only date during the period from March 26 through April 11 on which all Committee members--as distinct from non-member Reserve Bank Presidents--could attend was Monday, March 29, 1976. There was no other date in that period on which more than 10 Committee members could attend. Unfortunately, two non-member Reserve Bank Presidents--Messrs. MacLaury and Mayo--would be unable to be present on March 29, but that seemed to be the most suitable date.

Chairman Burns said he thought the meeting should be scheduled for March 29, beginning at 10:00 a.m. and lasting the full day if necessary. He hoped Messrs. MacLaury and Mayo could rearrange their schedules so that they might be present. Because Reserve Bank Presidents who were not now members of the Committee would be members later on, he thought all should participate in the deliberations on operating procedures.

Mr. Balles observed that an important issue had been raised at the last Committee meeting and again today regarding the quality of incoming data on the aggregates. Because of the volatility of the weekly data several members had expressed concern about the role these numbers played in influencing the course of open market operations. It had been suggested that perhaps some of the statistical "noise" apparent in the weekly series could be filtered out by incorporating incoming data into a moving average series. In that way new information would be taken into account in a form that might better capture the underlying trend of growth in the aggregates. He had made a rough attempt at constructing such a series and had distributed to those around the table today copies of a chart on which weekly data and data representing a 13-week centered moving average for both M-1 and M-2 had been plotted.[1/] As was apparent from visual inspection, the latter series tended to dampen the random fluctuations evident in the weekly data and seemed to provide a fairly reliable indication of the underlying trend. He was not certain that a period of 13 weeks was the optimum time span to be used in such an average, but he thought the use of a moving

1/ A copy of the chart distributed by Mr. Balles has been placed in the files of the Committee.

average would be a step toward developing a framework in which to view the Committee's longer-run targets. He looked forward to seeing the conclusions of other research efforts in this area.

Mr. Balles then commented on the rough rule of thumb that he would apply. If the latest plot of an appropriate moving average was significantly below the lower end of the Committee's longer-run range, the best strategy would probably be to conduct operations in a way that would move the curve back into the range in an orderly way. That movement could be accomplished in whatever period of time the Committee might deem to be reasonable, not necessarily in a single month. While he agreed that there might be no difference between growth rates of 4 per cent and 8 per cent over a short period of time, that certainly could not be true over a span of several months.

Chairman Burns commented that Mr. Balles' suggestion was a promising one that deserved further consideration. He thought the matter should be placed on the agenda for discussion at the March 29 meeting, even though he was uncertain about the extent to which the staff would be prepared to report on the question then. In regard to that meeting, while he thought its format might best be informal and unstructured, he planned to discuss the meeting with Messrs. Holland and Axilrod to ensure that it covered the key issues growing out of the work of the Subcommittee on the Directive and of staff research projects.

Chairman Burns then called for a discussion of monetary policy and the directive.

Mr. Volcker remarked that in reviewing the record of recent months he had been struck by the fact that despite the considerable degree of uncertainty about the economy and the aggregates, the outcome on both scores had been relatively satisfactory. The economy appeared to be expanding in an orderly way and the risks of overheating or of a downturn appeared to have lessened. While inflation continued to be a current problem and to pose a serious threat for the future, the progress made thus far on the inflationary front was about as good as could have been expected--in fact, it had been better than he personally had anticipated. That should bolster the confidence of consumers and others and lessen fears that further advances in business activity would be accompanied by an intensification of inflation.

Continuing, Mr. Volcker said he was concerned that investment spending might be the laggard in this recovery. Nevertheless, current financial conditions provided a basis for optimism in that respect: Interest rates had been steady, liquidity had been rebuilt, and the stock market had improved. As for the aggregates, when viewed in light of the technical factors involved, he was not unhappy with their recent performance or with the behavior projected for the near term. He might note in that regard that an additional element of uncertainty was introduced by the disparity between the projections made by the New York staff and those made by the Board staff for the coming period--with the former showing stronger growth, particularly for M-1.

Against that background, Mr. Volcker said, this did not seem to him to be an appropriate time for a major change in policy. The current unsettlement in the international financial sphere was another factor that led him to that view. Turning to the specifications for the Federal funds rate, he favored maintaining the present range and keeping the rate at about its current 4-3/4 per cent level or a little higher. However, he would not want to see the funds rate move above 5 per cent at any time in the near future. As for the aggregates, he was impressed by the hazards of attaching too much significance to the weekly or monthly figures; moreover, he was not worried that the aggregates would get out of line over the next inter-meeting interval, given the general policy stance he advocated. To reflect those views, he would set relatively wide ranges for the aggregates for the March-April period--say, 3 to 8 per cent for M-1 and 6 to 11 per cent for M-2.

Mr. Coldwell remarked that he shared most of Mr. Volcker's views. He too favored relatively wide ranges for the aggregates since he had little confidence at present in the money supply figures. He had intended to suggest ranges of 4 to 8 per cent for M-1 and 7 to

11 per cent for M-2 with zones of indifference of 5 to 7 and 8 to 10 per cent, respectively. However, the ranges proposed by Mr. Volcker also were acceptable to him. For the Federal funds rate, he favored retaining the current 4-1/4 to 5-1/4 per cent range. In his judgment, stability should be a primary objective for policy at present and the proposed language for the operational paragraph of the directive shown in alternative B of the so-called "money market" proposals best fit his policy preference.

While his policy prescription called for stability in money market conditions, Mr. Coldwell continued, he thought it would be desirable to accustom the market to some flexibility in the funds rate. To his mind, the market had become overly sensitive to minor changes in the Federal funds rate, as evidenced by the sharp market reaction to the Desk's slight firming operations in the previous period--the operations referred to by some as a "false start." However, in the coming period stability was his first priority and he would not want to see the funds rate deviate from its current level by more than about 1/8 of a percentage point in either direction.

Mr. Coldwell added that he found the statements concerning price developments in the staff's draft of the directive[1/] somewhat misleading because they referred, first, to increases in prices of

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

industrial commodities and then--almost as a postscript--to further appreciable declines in prices of farm and food products. He would change the emphasis by referring first to the total wholesale price index and then to prices of industrial commodities.

Chairman Burns proposed that the staff be asked to draft modified language for the directive along the lines suggested by Mr. Coldwell. There was no objection to that proposal.

Chairman Burns observed that he agreed with the general economic views advanced by Mr. Volcker and supported by Mr. Coldwell. As for specifications--while he would not quarrel much with the monetary aggregates ranges proposed by his two colleagues--his preference was for an M-1 range of 4 to 8 per cent and an M-2 range of 7-1/2 to 11-1/2 per cent. With respect to the directive, he thought the choice of a money market or a monetary aggregates formulation for the operational paragraph would make little practical difference in the conduct of open market operations over the coming period, if the consensus was for a funds rate range of the kind that had already been suggested. However, he believed the symbolic difference was of some importance. Moreover, the Committee had adopted a money market directive at its previous two meetings and he was concerned that the procedure might become a habit. In his judgment, it was normally appropriate for the Committee to place primary emphasis on the monetary aggregates; a money market directive should be adopted only under special circumstances and then only after due deliberation. He thought this subject should be on the agenda for the March 29 meeting. As he had said, for today he saw no practical difference between the two, and he would like to see the Committee return to a monetary aggregates directive at this time.

The Chairman added that he would suggest a change in the staff's draft of the monetary aggregates formulation to convey the Committee's awareness of the need for some flexibility in open market operations in light of the current turbulence in foreign exchange markets. Specifically, he would suggest that the paragraph begin: "To implement this policy, while taking account of developments in domestic financial markets and the sensitive state of foreign exchange markets, the Committee seeks to achieve...." He would return to that suggestion later.

Mr. Black observed that he continued to be a bit more optimistic than the Board's staff about the long-run strength of the economy. He was a little concerned about the double-digit rate of growth in M-2 in recent months, particularly since he currently placed more emphasis on that aggregate than on M-1. But he had been reassured somewhat by a review of the record, which revealed that in the past such spurts of growth in the aggregates typically had been associated with tax refunds and rebates or with periods of strong credit demands. He was inclined to believe that the recent acceleration in money supply growth had been associated with income tax refunds. Clearly, private credit demands--which had been weak--had not been a contributing factor.

Continuing, Mr. Black remarked that he saw no evidence of a near-term pickup in credit demands, but he would expect such a pick-up to materialize by mid- or late-spring if the recovery continued to proceed as now seemed likely. Nevertheless, he was reluctant to recommend any significant firming in policy until clear evidence of a strengthening in credit demands emerged. It seemed to him that a move toward tightening now might produce more slowing than desired further down the road. Moreover, the extreme sensitivity of financial markets--as demonstrated in late February and early March--had to be taken into account.

Against that background, Mr. Black observed that he favored a policy stance aimed at maintaining current money market conditions for the coming period. By the end of that period, the major impact of tax refunds on M-1 and M-2 would be over and the Committee would be better able to identify the underlying relationship between the aggregates and current money market conditions.

Turning to the specifications for the inter-meeting interval, Mr. Black said he found the alternative B ranges for the aggregates acceptable. He would prefer to narrow the funds rate range somewhat to 4-1/2 to 5-1/4 per cent, but he would not move the rate above 5 per cent unless M-2 growth exceeded the upper limit of its range.

Given the recent weakness in M-1, however, he would not be concerned if its growth exceeded the upper bound of its specified range as long as M-2 growth was within its prescribed limits. He shared Chairman Burns' view on the desirability of returning to a monetary aggregates directive, and he favored the modification of the language for the operational paragraph suggested by the Chairman.

Mr. Eastburn said he agreed with the general thrust of policy preferences expressed by those who had already spoken. He favored the specifications of alternative B and the monetary aggregates formulation of the directive. He would only caution that the Committee not become committed to the practice of adopting M-1 and M-2 ranges as wide as 4 percentage points. In his judgment determination of the appropriate width for the monetary aggregates ranges was closely related to the question of the degree to which the funds rate should be allowed to fluctuate. Those questions should be taken up in the Committee's discussion of its operating procedures.

Mr. Kimbrel commented that he too thought the current posture of monetary policy was appropriate. The recovery appeared to be proceeding satisfactorily, with a rather strong financial base that did not require additional monetary stimulus. And the current unsettlement in international markets seemed to call for maintaining a steady policy posture. Nevertheless, recent developments in wage negotiations as well as discussions of future price increases in such industries as lead, paper, and lumber intensified his concern about a possible resurgence of inflation.

Turning to the specifications, Mr. Kimbrel said it was his belief that the market judged the current funds rate target to be slightly above 4-3/4 per cent. With that in mind, he would take advantage of the opportunity to achieve a slight firming in the funds rate without undue risk of unsettling the market. Accordingly, he would move the funds rate range up to 4-1/2 to 5-1/2 per cent. He would not want the funds rate to drop below 4-1/2 per cent, and despite his preference for an upper limit of 5-1/2 per cent, he would not like to see the funds rate go above 5 per cent unless incoming data on the aggregates strongly indicated that that would be appropriate. For the language of the directive, he favored the monetary aggregates formulation, with the modification suggested by the Chairman.

Mr. Baughman agreed that the economic recovery was proceeding about as well as could be expected. That suggested to him that a continuation of current policy was called for and he thought the specifications of alternative B best fit his policy prescription. He concurred with the suggestion of others that now was an appropriate time to allow somewhat more flexibility in the funds rate as a means of discouraging overly sharp market reaction to slight changes in that rate in the future. As for the aggregates, he would tend to place more weight on M-2 than on M-1 at present; in his district, at least, incoming data confirmed that funds were continuing to move from demand deposits to the types of time deposits included in M-2. For the directive, he too favored the monetary aggregates formulation.

Chairman Burns observed that the Committee had agreed at its last meeting that in the course of Desk operations approximately equal weight should be attached to M-1 and M-2. He tended to favor following the same procedure in the coming period and he asked that members express themselves on that issue as the discussion continued.

Mr. Jackson said he agreed that equal weight should be attached to M-1 and M-2 unless that approach would call for an increase in the funds rate to a level competitive with Regulation Q ceilings on time and savings deposits. In that case, he would not be concerned if growth in M-2 should slow.

The Chairman asked about the likelihood that the funds rate would rise over the coming period to a level that might be considered competitive with Regulation Q ceilings.

Mr. Holmes said he did not think that that would occur if the Committee adopted a funds rate range close to the one it had been discussing so far.

Mr. Axilrod expressed the view that a rise in the funds rate to 5-1/4 per cent could produce a substantial effect on M-2; a large volume of interest-sensitive funds was currently being held in passbook accounts, and such funds could be withdrawn rather rapidly. He was not certain whether a funds rate of 5-1/8 per cent would bring about such withdrawals.

Mr. Jackson then remarked that he concurred in general with the policy views already expressed by others. He was concerned, however, that the relatively favorable performance on the inflation front in recent months--particularly with regard to food and energy prices--might be short-lived. For that reason, he would support the suggestion that the Desk allow more fluctuation in the funds rate in an effort to lessen the sensitivity of financial markets to the System's operations. For the specifications over the coming period he favored alternative B.

Mr. Balles commented that recent evidence on the state of the economy had been encouraging although there continued to be some areas of weakness. In his view, this was not the time for an overt change in policy in either direction. Accordingly, he would support the 4-1/4 to 5-1/4 per cent funds rate range of alternative B, the proposal to give equal weight to M-1 and M-2, and the monetary aggregates directive with the modifications suggested by Chairman Burns. He also agreed that it was desirable to condition the markets to somewhat greater fluctuation in the Federal funds rate.

Turning to the specifications for the aggregates, Mr. Balles said he personally was leaning toward the following rule of thumb: when the aggregates were growing at rates below the Committee's longer-run targets, he would set the lower limits of the 2-month ranges no lower than the lower bounds of the longer-term ranges; similarly, if the aggregates were exceeding the upper bounds of their longer-term ranges he would set the upper limits of the short-term ranges no higher than the corresponding longer-term limits. Otherwise, it seemed that the Committee would have no systematic way to return the aggregates to their targeted paths. In line with his general rule, he would propose 2-month ranges of 4-1/2 to 8-1/2 per cent for M-1 and 7-1/2 to 11-1/2 per cent for M-2.

Chairman Burns commented that Mr. Balles' remarks on relating the short- and longer-run targets had been quite useful, but he would caution that the longer-run ranges should be viewed as expectations that were subject to change rather than as definite targets.

Mr. Partee observed that he expected a somewhat stronger recovery than that projected by the staff. At present he saw no reason to change policy and he would not want to prejudge the future direction of interest rate movements and nudge the funds rate up in the expectation that rates would have to be higher later on. While he agreed that that was the most likely prospect, it was not a certainty;

accordingly, he would prefer an even-handed approach, with flexibility in the funds rate both above and below its current level. He concurred in the Chairman's proposal to return to a monetary aggregates formulation of the directive, but he thought the question of zones of indifference became more relevant under a monetary aggregates than a money market directive, and that it was quite important to reach a consensus on that question.

Continuing, Mr. Partee said he was generally satisfied with the specifications of alternative B except that he would raise the ranges for the aggregates somewhat. His preference was for ranges of 4 to 8 and 7 to 11 per cent for M-1 and M-2, respectively, with corresponding zones of indifference of 5 to 7 and 8 to 10 per cent. For the funds rate he favored the 4-1/4 to 5-1/4 per cent range of alternative B, and he would move the rate away from the 4-3/4 per cent midpoint of the range before the aggregates reached the outer bounds of their respective ranges. He would give approximately equal weight to M-1 and M-2.

Chairman Burns observed that he could accept the zones of indifference proposed by Mr. Partee and that he was glad that issue had been raised. He thought that others might wish to address themselves to that question in the course of their comments.

Mr. Wallich remarked that because the major elements of weakness in the economy were in areas that appeared likely to strengthen--such as investment and perhaps housing--he thought the vigor of the recovery was more likely to be underestimated than overestimated. Indeed, considerable upward momentum could be developing in the real sector. Nonetheless, he viewed the relatively low rates of growth that had occurred in the aggregates as a safeguard against overheating. At the same time, however, he recognized that businesses were increasing liquidity in ways other than through the accumulation of bank deposits included in M-1 and M-2, and that some degree of caution in policy was warranted.

Turning to the language of the directive, Mr. Wallich said he would prefer a money market rather than an aggregates directive were it not for the considerations noted by the Chairman. A good case could be made for maintaining stable money market conditions to avoid upsetting exchange markets and to provide businesses with more time to restructure their debt. Nevertheless, he recognized the advantages of returning to an aggregates directive, since the language of the Concurrent Resolution was in terms of objectives for monetary and credit aggregates and since too much focus on interest rates in System statements could give a misleading impression of System policy objectives.

Accordingly, Mr. Wallich remarked, he would opt for a compromise that would take into account both the benefits of continued stability in the money market and the Committee's objectives for the aggregates. Specifically, he would narrow the range for the Federal funds rate to 4-1/2 to 5-1/4 per cent. For the 2-month growth rate in M-1, he favored the 4 to 8 per cent range specified under alternative A, given the shortfall from the Committee's longer-run objective for that aggregate evidenced in the chart provided by Mr. Balles. For M-2, he preferred a range of 7 to 11 per cent--somewhat lower than the 8 to 12 per cent range specified under alternative A.

Chairman Burns observed that new data on housing starts and building permits had just been received for February. Housing starts had increased dramatically and building permits, which had risen substantially in January, had moved slightly higher in February. He asked Mr. Gramley to comment in more detail on the new figures.

Mr. Gramley reported that housing starts had risen by about 27 per cent in February, to an annual rate of 1,555,000 from a rate of 1,224,000 in January. All of the increase had been in starts for single-family units. A very slight rise had been recorded for building permits--from a rate of 1,120,000 in January to 1,127,000 in February.

Mr. Mayo remarked that he favored a range of 4-1/4 to 5-1/4 per cent for the Federal funds rate, and ranges of 4-1/2 to

8-1/2 and 7 to 11 per cent for the short-run growth rates of M-1 and M-2, respectively. He also favored instructing the Manager to attach approximately equal weight to the behavior of M-1 and M-2. He could accept the concept of a zone of indifference within the ranges adopted for the aggregates and a return to the monetary aggregates formulation of the directive.

Mr. Morris expressed agreement with the specifications suggested by Mr. Balles--4-1/4 to 5-1/4 per cent for the funds rate, 4-1/2 to 8-1/2 per cent for M-1, and 7-1/2 to 11-1/2 per cent for M-2. He also supported attaching approximately equal weight to M-1 and M-2 and adopting a monetary aggregates directive.

Continuing, Mr. Morris said he thought that the question of a zone of indifference was of critical importance to the Committee. To his mind, a relatively wide zone of indifference would lead to sluggishness in the Committee's responses to incoming evidence of changes in the growth rates of the aggregates. While the outcome of open market operations over the past month--involving an increase in the funds rate to the 5 per cent area and a subsequent retrenchment to 4-3/4 per cent--could be considered unfortunate, he viewed the course of events as generally constructive. Policy actions had been initiated in response to evidence of change in the monetary aggregates. To his mind, that was the way monetary policy should be implemented.

Chairman Burns remarked that the question hinged on what constituted evidence of a real change in the aggregates--whether, or to what extent, the reported rates of growth in the aggregates reflected actual events.

Mr. Morris commented that on the basis of his experience as a member of the Committee he believed that in the past the Committee typically had waited too long for confirming evidence before initiating a policy change. With regard to the events of the past month, he would grant that the market's reaction to the Desk's modest firming action had been substantial. However, that reaction was a reflection of the manner in which monetary policy had been conducted in the past. Market participants had come to perceive ever so slight differences in the Desk's apparent funds rate objective as indicative of a significant change in the Committee's policy stance. If the Desk permitted more flexibility in the funds rate during inter-meeting intervals, the market would, in time, adapt; and modest changes in the funds rate would not trigger such vigorous market reaction as had occurred last month. He thought that the costs of increased flexibility would be minimal, while the long-run benefits--in terms of the efficient conduct of monetary policy--would be considerable.

Mr. Winn observed that he had no quarrel with the general thrust of the discussion so far. However, he was not sure about the operational implications of various possible specifications for the funds rate range and zones of indifference. For example, if a funds rate range of 4-1/4 to 5-1/4 per cent were adopted, under what circumstances would the Desk aim at a rate of 4-1/4 per cent?

Mr. Holmes replied that for the Desk to aim at the lower limit of that funds rate range there would have to be evidence of considerable weakness in the aggregates--rates of growth not only below their respective zones of indifference but at or below the lower ends of their ranges. Moreover, the move toward that lower limit would be gradual, and it was possible that at some point the Committee would want to reassess the desirability of achieving a 4-1/4 per cent funds rate in light of other considerations, including developments in the exchange markets. A similar pattern, involving substantial strength in the aggregates, would apply to reaching the upper limit of the specified funds rate range.

Chairman Burns observed that the Committee had reached a decision at an earlier meeting that the full width of the funds rate range agreed upon was to be considered available for use during an inter-meeting period. Of course, special circumstances could arise between meetings that would call for a change in the Committee's instructions, but as a general operating principle the funds rate range chosen should reflect the changes in the funds rate that the Committee was willing to accept. A moderately wide zone of indifference within the range for the aggregates was not inconsistent with that interpretation of the funds rate range.

Mr. Eastburn asked whether the Desk would operate to prevent fluctuations in the funds rate in a case where the Committee had adopted a 4 percentage point range for the aggregates and a 2 percentage point zone of indifference, and where the aggregates were growing at rates within the zone of indifference.

Mr. Holmes replied that under such circumstances the Desk would seek to maintain the prevailing funds rate, although the actual rate might, of course, vary slightly on either side of the desired level. Before seeking any significant change in the rate, however, the Desk would await fairly firm evidence of growth in the aggregates at rates outside their zones of indifference.

Mr. Holland said he shared the views expressed by Mr. Volcker that the economy appeared to be expanding satisfactorily and that the recent posture of monetary policy had been appropriate for achieving progress towards the dual objectives of slowing down the rate of inflation and reducing unemployment. He favored maintaining the current policy stance and, for the reasons set forth by the Chairman and Mr. Wallich, returning to an aggregates directive. For M-1 and M-2 he would set ranges of 4 to 8 per cent and 7 to 11 per cent, respectively, with zones of indifference of 5 to 7 per cent and 8 to 10 per cent as suggested by Mr. Partee. He would view those zones of indifference in the manner outlined by Mr. Holmes. He would favor the modifications in the language of the directive proposed by the Chairman. With respect to the Desk's operations, he thought that small fluctuations in the Federal funds rate were hard to avoid and were probably desirable in any event. He would give the Manager, in consultation with the Chairman, some leeway in conducting open market operations.

Mr. Guffey said he agreed that the recovery was proceeding satisfactorily. As for policy, he thought it might be appropriate to take a small step in raising the Federal funds rate now in light of what he saw as the longer-term outlook for a rise in the level of interest rates; moreover, he thought the market would be less sensitive to a slight firming action in coming weeks in view of the recent experience described by Mr. Sternlight and others. Specifically, he favored a range of 4-1/2 to 5-1/2 per cent for the funds rate. The Desk should aim initially at a rate near the current 4-3/4 per cent level and then move the rate up toward 5 per cent over the course of the inter-meeting period.

Mr. Coldwell observed that in his earlier comments he had not given his views on the appropriate width of a zone of indifference for the aggregates. He would not want to limit the Desk's ability to respond to incoming data by including a zone of indifference as wide as 2 percentage points within a 4 percentage point range. Instead, he would prefer a zone of indifference only 1 percentage point wide; for example, with an M-1 range of, say, 4-1/2 to 8-1/2 per cent he would favor a zone of indifference of 6 to 7 per cent.

Mr. Volcker commented that, while he would not want to anticipate an increase in interest rates, he thought it was likely that rates would rise somewhat over the course of the year. Because he would not want to see the Federal funds rate move down as low as 4-1/4 per cent over the coming inter-meeting interval, he agreed with those members who favored a narrowing of the funds rate range to 4-1/2 to 5-1/4 per cent. As for the suggestion that the funds rate be allowed to fluctuate more freely, he did not think that that was a viable operating technique given the market's awareness that the funds rate is the operational variable the Committee uses to achieve its policy objectives. It was his view that as long as the Federal Reserve continued to use the funds rate as its mechanism for implementing policy, the market would continue to interpret any move in the funds rate as an indication of a change in policy. A change in operating procedures to allow more fluctuation in the funds rate would, to his mind, run the risk of generating overreactions by the market and thus further complicating Desk operations. Consistent with that view, he might note that because of the volatility of incoming data for the aggregates he favored a wide zone of indifference for the aggregates; a narrow zone would generally result in more movement in the funds rate than he was willing to accept.

Mr. Gardner observed that he agreed with the consensus thus far with regard to the performance of the economy. As for policy, he favored the specifications shown under alternative B in the blue book and the monetary aggregates language for the directive.

Chairman Burns then proposed that the Committee adopt a directive consisting of the general paragraphs as drafted by the staff with the statement on recent price developments modified along the lines agreed upon earlier, and the monetary aggregates formulation for the operational paragraph with the addition of a reference to the sensitive state of foreign exchange markets. 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 March-April period would be 4 to 8 per cent for M-1 and 7 to 11 per cent for M-2; the corresponding zones of indifference would be 5 to 7 per cent and 8 to 10 per cent, respectively. The range for RPD's would be chosen by the staff to be consistent with the ranges specified for the aggregates. The range of tolerance for the weekly-average Federal funds rate in the intermeeting period would be 4-1/4 to 5-1/4 per cent, and the Desk would permit a little more flexibility with regard to fluctuations in the Federal funds rate than it had previously.

After some discussion about the differences in Board staff and New York Bank projections for the aggregates, the Committee indicated it was prepared to vote on the proposal set forth by the Chairman. Mr. Coldwell indicated that while he intended to cast an affirmative vote, the zones of indifference for the aggregates ranges were wider than he would have preferred.

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

The information reviewed at this meeting suggests that output of goods and services has continued to expand at a moderate rate in the current quarter. In February retail sales rose considerably and recovery in industrial production continued. Gains in nonfarm employment were again widespread and the unemployment rate dropped from 7.8 to 7.6 per cent. Wholesale prices of all commodities declined again in February, as average prices of farm products and foods fell appreciably further. Average wholesale prices of industrial commodities increased somewhat less than in January, owing in part to a reduction in crude oil prices required by the Energy Policy and Conservation Act. Over recent months, the advance in the index of average wage rates has moderated somewhat.

The average value of the dollar against leading foreign currencies has increased in recent weeks to its highest level in 2 years. In the exchange markets, the British pound has depreciated sharply; the lira has weakened further; and most recently, the French franc has depreciated after abandonment of efforts to maintain fixed margins with certain other European currencies. In January the U.S. foreign trade balance shifted into deficit.

> M-1, which had increased only a little in January, expanded moderately in February; M-2 and M-3 rose sharply. At commercial banks and nonbank thrift institutions, inflows of time and savings deposits other than large-denomination CD's remained large. Since mid-February, both short- and long-term interest rates have changed little on balance.
>
> 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 financial markets and the sensitive state of foreign exchange markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.

The Chairman then called for a discussion of the dollar limit that the Committee had set on System holdings of special short-term certificates of indebtedness purchased directly from the Treasury. He asked Mr. Broida to bring the Committee up to date on this matter.

Mr. Broida noted that the Committee had voted at its meeting on March 18, 1975, to increase the limit on direct lending to the Treasury from $1 billion to $2 billion. The new higher limit was established for a period of 1 year from the date of the March 1975 meeting, and unless the Committee decided otherwise, the limit would revert automatically to $1 billion 2 days after today's meeting. There was no recommendation before the Committee to retain the $2 billion limit.

Mr. Broida added that if the lower limit was in fact the Committee's current preference, he saw some small advantage in taking positive action today rather than simply letting the consequence of a year-old decision unfold. Since a vote on the matter would be reported in the Federal Register, the public record would make it clear that the reduction was a deliberate action reflecting the Committee's present intent.

In reply to questions, Mr. Holmes said he saw no problem with going back to a $1 billion limit. Should the Treasury need to borrow a larger amount--and there was always a possibility that it might--the Committee could give the Desk emergency telegraphic authorization to lend the funds as it had done many times in the past. He also saw no problem with keeping the limit at $2 billion.

Mr. Partee said it struck him as a little odd to be reducing the borrowing limit, given the enormous increase in the volume of funds managed by the Treasury that was in turn associated with a sharp expansion in the Federal budget in recent years. A $2 billion miss in the Treasury cash balance was a comparatively small amount under current circumstances.

Mr. Holmes observed that the Treasury was making effective use of a relatively new debt-management technique--the cash-management bill--to carry it over anticipated low spots in its cash balances. Employment of that technique had reduced significantly the probability that the Treasury would have to borrow directly from the Federal Reserve to meet temporary cash needs.

Mr. Volcker said that, while he did not feel strongly about the matter, he agreed with Mr. Partee and would prefer to leave the direct borrowing limit at $2 billion.

Mr. Coldwell indicated that he too preferred a $2 billion limit.

The Chairman said he also thought the higher limit was desirable, especially since the Committee would in any event approve an increase from $1 billion to $2 billion if the Treasury clearly needed to borrow the funds. He therefore proposed that the Committee vote to retain a $2 billion limit.

> By unanimous vote, the Committee removed the 1-year time limitation it had attached on March 18, 1975, to an increase from $1 billion to $2 billion in the dollar limit, specified in paragraph 2 of the Authorization for Domestic Open Market Operations, on System holdings of special short-term certificates of indebtedness purchased directly from the Treasury.

The Chairman noted that in a memorandum dated March 1, 1976,[1/] the Manager of the System Open Market Account had recommended that the Committee renew for a period of one year the authorization for the Desk to lend securities from the System Open Market Account. He asked Mr. Holmes to comment.

1/ This memorandum, entitled "Annual Review of System Lending of Securities," was distributed to the Committee on March 5, 1976. A copy has been placed in the Committee's files.

Mr. Holmes said that over the past year, for the first time since the System began to lend securities in 1969, the volume of such lending activity had declined somewhat. The reduction reflected in part the fact that the System had doubled its standard lending fee. At the same time dealer failures to deliver securities had not changed much despite a 65 per cent increase in the volume of dealer transactions. He thought such a performance by the dealers was quite remarkable.

In his judgment, Mr. Holmes added, the lending of securities from the System Account continued to be reasonably necessary for the effective conduct of System open market operations. In particular, extensive use was made of System loans of securities to help assure the effective functioning of the System's mechanism for clearing securities and he thought that it was essential to continue making such loans. He therefore recommended that the authorization to make such loans be extended for another year.

Mr. Holmes noted that gross earnings of the securities lending function had been just over $1-1/2 million in 1975 while the costs of the operation were about 10 per cent of that amount. Those earnings were sufficient to pay the costs of running the Securities Department at the New York Bank.

Mr. Coldwell inquired whether the Desk used its fee schedule or moral suasion or both to dissuade borrowers from making unwarranted use of the lending facility.

Mr. Holmes replied that the fee schedule was the primary means of control. The rates were set on a scale ranging from a standard charge of 1-1/2 per cent to charges of up to 6 per cent--all at annual rates--the higher rates being imposed for failure to cover in borrowed securities on a timely basis. The standard rate in the market was in the area of 1/2 to 3/4 per cent. However, moral suasion was also used; thus two dealers were cut off briefly from access to the borrowing facility because the Desk felt they had been abusing the privilege by not promptly covering in their borrowed securities.

In reply to a further question by Mr. Coldwell, Mr. Holmes said that there had been no significantly adverse reaction when the System had raised its fee schedule last year. Dealers recognized that the System did not want to monopolize this business.

Mr. Partee inquired whether there was any potential for a loss in the lending operation and whether the Desk had ever come close to a loss.

Mr. Holmes said there was always the possibility of a loss but none had ever occurred. The Desk required adequate security against the borrowed securities, and he felt the System was fully protected.

In reply to a question by the Chairman, Mr. Holmes said that borrowers of securities were required to put up other Treasury securities of similar maturity. Moreover, those securities were valued at a discount from the market.

Mr. Kimbrel noted that the Committee's Counsel had conditionally approved the legality of the securities lending operation[1/] and added that in his judgment that operation clearly made a prudent contribution to the orderly functioning of the Government securities market.

In reply to a question by the Chairman, Mr. Holmes said that he had heard of no criticism of the lending facility outside the System.

The Chairman then proposed that the Committee reaffirm the authority of the Desk to lend securities from the System Open Market Account.

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

The Chairman next called for consideration of the continuing authorizations of the Committee in accordance with the customary practice of reviewing such authorizations at the first meeting in March of every year.

1/ Secretary's Note: In a memorandum dated March 5, 1976, a copy of which has been placed in the Committee's files, the General Counsel expressed the opinion that if the Committee agreed with the Manager and found the continued lending of securities from the System Account to dealers and clearing banks to be reasonably necessary for the effective conduct of open market operations, such lending was within the "incidental powers" of the Reserve Banks.

Secretary's note: On February 25, 1976, certain continuing authorizations of the Committee, listed below, had been distributed by the Secretary with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the March organization meeting to give members an opportunity to raise any questions they had concerning them. Members were asked to so indicate if they wished to have any of the authorizations in question placed on the agenda for consideration at this meeting, and no such requests were received.

The authorizations in question were as follows:

1. Procedures for allocation of securities in the System Open Market Account.
2. List of Treasury Department officials to whom weekly reports on open market operations may be sent.
3. Authority for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account in case the New York Bank is unable to function.
4. Resolutions providing for continued operation of the Committee and for certain actions by the Reserve Banks during an emergency.
5. Resolution relating to examinations of the System Open Market Account.
6. Guidelines for the conduct of System operations in Federal agency issues.
7. Regulation relating to Open Market Operations of Federal Reserve Banks.
8. Rules of Organization, Rules Regarding Availability of Information, and Rules of Procedure.

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

AUTHORIZATION FOR DOMESTIC OPEN MARKET OPERATIONS

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

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

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

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

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

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

Turning to the Committee's foreign currency instruments--the Authorization for Foreign Currency Operations and the Foreign Currency Directive--the Chairman noted that a Subcommittee had been appointed to reexamine those instruments. The members of the Subcommittee included Mr. Wallich, who served as Chairman, and Messrs. MacLaury and Volcker. Chairman Burns asked Mr. Wallich if his Subcommittee had any changes to propose in the current instruments.

Mr. Wallich indicated that the Subcommittee was not yet in a position to submit any changes. A substantial revision had been worked out, but some difficulties had arisen in the course of consultations with the Treasury. He expected those difficulties to be resolved in the near future.

The Chairman suggested that the outstanding foreign currency instruments be reaffirmed without setting a specific deadline for reviewing them. However, it would be understood that the Committee would consider modifying these instruments as soon as the Subcommittee made a recommendation.

By unanimous vote, the Committee reaffirmed the following authorization:

AUTHORIZATION FOR FOREIGN CURRENCY OPERATIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	2,000

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Italy	3,000
Bank of Japan	2,000
Bank of Mexico	360
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	1,400
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

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

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

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

6. The 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, and 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.

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

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

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

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

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

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

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

FOREIGN CURRENCY DIRECTIVE

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

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

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

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

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

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

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

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

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

C. To aid in avoiding disorderly conditions in exchange markets. Special factors that might make for exchange market instabilities include (1) responses to short-run increases in international political tension, (2) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, and (3) market rumors of a character likely to stimulate speculative transactions. Whenever exchange market instability threatens to produce disorderly conditions, System transactions may be undertaken if the Manager reaches a judgment that they may help to reestablish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. In such cases, the Manager shall consult as soon as practicable with the Committee or, in an emergency, with the members of the Subcommittee designated for that purpose in paragraph 6 of the Authorization for Foreign Currency Operations; and

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

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

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

The Chairman noted that a memorandum by Mr. Sternlight had been distributed recently on System operations in bankers' acceptances.[1] He asked Mr. Sternlight to comment.

Mr. Sternlight indicated that in response to questions raised at the November meeting of the Committee, the Account Management had reviewed the role of System operations in acceptances from the standpoint of benefits and costs or potential costs. The conclusion from that review was that the Desk's ability to arrange short-term repurchase agreements in acceptances was a significant tool of open market operations, and the risks of such operations were judged to be minimal. It was therefore felt that they should be continued. Outright activity in acceptances, on the other hand, made little significant contribution in the context of over-all System operations. At the same time outright operations exposed the System to potential problems so long as the Desk continued to accept only "prime" paper. That was because Desk rejection of a particular bank's name, especially at a time of fragile confidence such as the present, could stigmatize a bank and add to its difficulties in regaining the market's confidence. Yet, a decision by the System to discontinue outright operations in acceptances could also weaken confidence in the banking system generally and make it

1/ A copy of the memorandum entitled "Acceptance Operations" and dated March 5, 1976, has been placed in the Committee's files.

more difficult to continue the Desk's repurchase agreement activity in acceptances.

The Account Management believed, Mr. Sternlight continued, that potential risks from outright operations could be minimized if the Desk were to permit the size of the portfolio to be worked down from the current $600 million level to a modest $200 million. In fact, such a reduction would return the portfolio to a magnitude not far different from that maintained prior to the decision in 1974 to expand the System's holdings. The earlier decision had been taken partly in light of potentially unsettled conditions in the acceptance market.

Accordingly, Mr. Sternlight said, the recommendation of the Account Management was that the current authorization for outright operations in acceptances be retained with the understanding that the portfolio would be permitted to decline over the next several months to about $200 million and that continued use would be made of repurchase agreements in acceptances. At a later date, the Committee might wish to consider revising the present $1 billion limit on outright holdings.

In response to a question from the Chairman, Mr. Axilrod said he concurred in the approach suggested by Mr. Sternlight.

Mr. Holmes said he would suggest that holdings of acceptances be allowed to run off gradually and that the consequences be observed pending a review by the Committee at a later date.

Mr. Volcker said he would be perfectly happy to see the Account Management's recommendation implemented. He agreed that outright operations created a bit of a problem right now in light of the questions that could be raised about particular banks. He did not think the proposed reduction would resolve the problem, but he had no difficulty with that proposal.

Mr. Coldwell said he was not at all sure the System needed to hold any acceptances on an outright basis. At the same time, he would not favor a sudden cessation of the System's purchases. He would therefore support the Account Management's recommendation to the extent of favoring a gradual reduction in the System's outright holdings, but he would not set a target level of $200 million for such holdings.

The Chairman remarked that the $200 million figure might be regarded as an interim target, pending a Committee review of the question.

Mr. Partee indicated that he agreed with Mr. Coldwell.

Mr. Holland said he thought the Account Management's recommendation was a prudent one so long as the System continued to operate only in prime acceptances. However, he would not agree with Messrs. Coldwell and Partee regarding the desirability of phasing out outright transactions altogether. In fact, he believed there would be a clear benefit to the System over the longer run if it were to operate in acceptances of varying quality. In his judgment the banking system was evolving in a manner that would make it useful for the Federal Reserve to conduct transactions from time to time in acceptances of less than prime quality, thereby permitting the System to cover a broader range of banks. He recognized that such a proposal was controversial, especially since some members favored abandoning all outright transactions, but he thought that the Committee and its staff should explore the matter further in the future.

Mr. Jackson asked how certain acceptances were determined to be "prime."

Mr. Holmes replied that Mr. Jackson's question focused on a sensitive problem. The Desk liked to think that the market made the decision on what acceptances were "prime" and traded them accordingly. Unfortunately, the market also regarded as "prime" any acceptance that the System was willing to buy. There obviously was some circular reasoning in this process. Problems had arisen for the Desk because some acceptances were not considered to be prime by the market and did not trade at the rate set for prime acceptances.

Mr. Holmes added that the Desk had been able to handle the problems thus far without creating disturbances in the market for acceptances. To date the Desk had not been put in a position of having to refuse to buy an acceptance because it was not considered to be of prime quality by the market.

In reply to a question by Mr. Jackson, Mr. Holmes indicated that the Desk sought to protect the quality of its portfolio in acceptances by checking bank statements and conferring with bank examination staff at the New York Bank and at other Reserve Banks. As a result several small banks with problems had been asked very quietly to withdraw their acceptances from the market and most had done so.

Mr. Coldwell noted that Mr. Holmes' comments illustrated the reasons why he wanted the System to phase out its outright holdings of acceptances.

Mr. Volcker said he did not share Mr. Coldwell's view. He recognized that problems of the kind cited by Mr. Holmes would exist so long as the System continued to purchase acceptances. Like Mr. Holland, however, he saw an advantage in conducting some operations outside the Government securities market. He realized that the compromise proposed by the Desk was not entirely satisfactory, but he would support that compromise.

The Chairman asked Mr. Sternlight how long the Desk anticipated it would take to reduce System holdings of acceptances to the $200 million level.

Mr. Sternlight indicated that the Desk did not have a specific schedule in mind but was thinking in terms of a gradual reduction over a period of several months.

The Chairman suggested that the Desk might plan to achieve its objective in, say, six months. At the end of that period the Committee might take another look at the question and decide then whether to maintain holdings at around $200 million or phase them out completely.

Mr. Holland said he hoped the Committee would also consider the question of whether to undertake operations in acceptances of less than prime quality.

Mr. Gardner said he would welcome a review in six months. He was troubled by the contradiction implied by the current policy of buying only prime acceptances. System officials made frequent protestations that the banking system was sound, and yet the System was unwilling to purchase the acceptances of particular banks because the market traded them at a rate that was 1/8 percentage point above that on prime bank acceptances.

The Chairman remarked that difficult questions were raised when the System exercised selectivity in the purchase of acceptances, by implication blessing some but not others.

Mr. Partee said the Committee should not be unmindful of another implication of its operations in acceptances, namely that it was directing credit to a particular sector of the financial markets. As the Committee members knew, there were proposals for System purchases of municipal securities, guaranteed mortgages, and other obligations. It so happened that the law permitted the System to buy acceptances, but to many people there was no great distinction between one use of System credit and another.

The Chairman asked whether there were any objections to the Account Management's suggestion that outright System holdings of bankers' acceptances be reduced to around $200 million. It would be understood that such a reduction would be accomplished gradually over a period of around 6 months.

No objections were heard.

Chairman Burns then said that in light of the questions that had been raised during the Committee's discussion, he would appoint a subcommittee to study the matter and report to the Committee in 6 months. He designated Messrs. Balles, Eastburn, and Partee as members, with Mr. Gardner to serve as Chairman.

It was agreed that the next meeting of the Committee would be held on April 20, 1976.

Thereupon the meeting adjourned.

Secretary

APPENDIX A

STRICTLY CONFIDENTIAL (FR)

CLASS I- FOMC

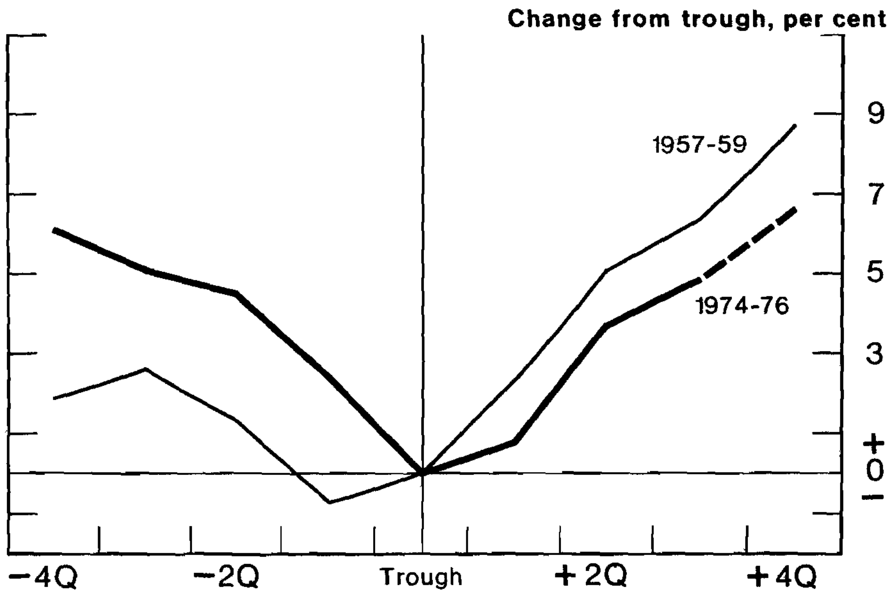
Material for Staff Presentation

at the March FOMC Meeting

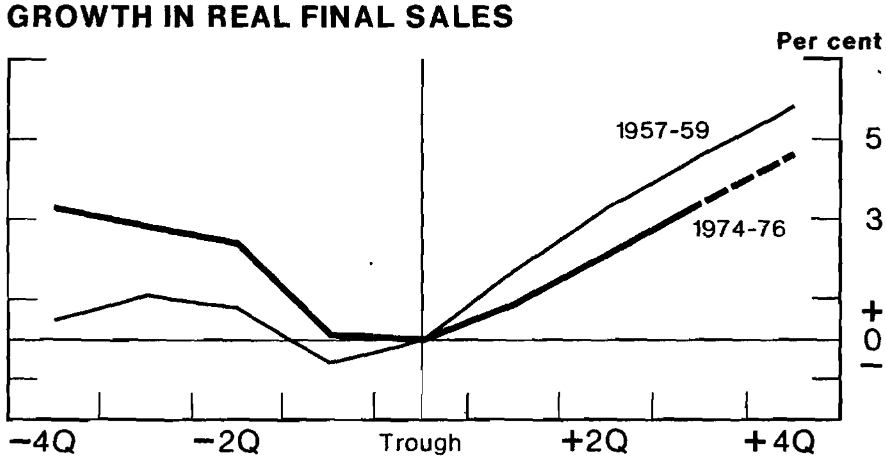
March 16, 1976

Division of Research and Statistics
Division of International Finance
Division of Data Processing

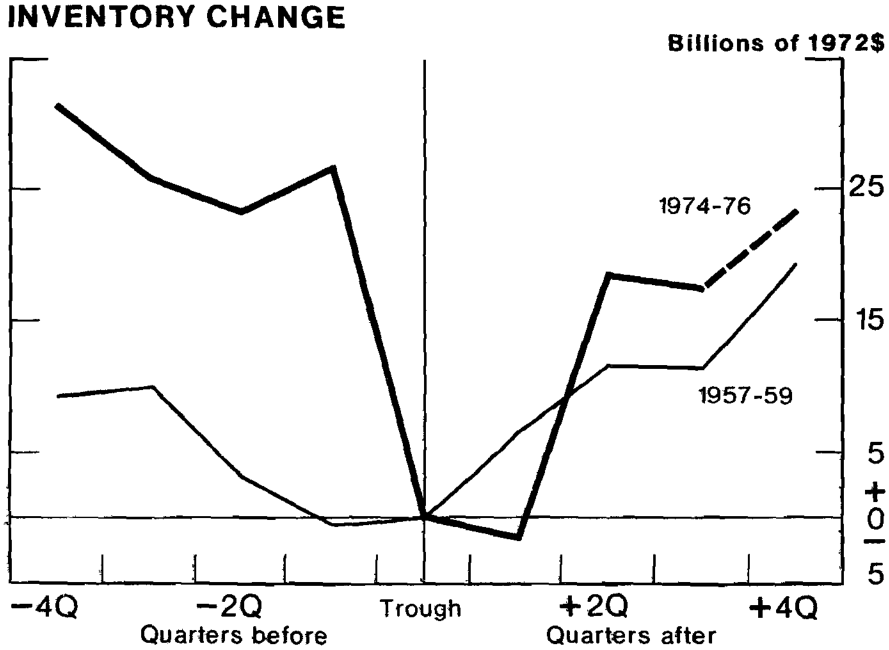
REAL GNP GROWTH



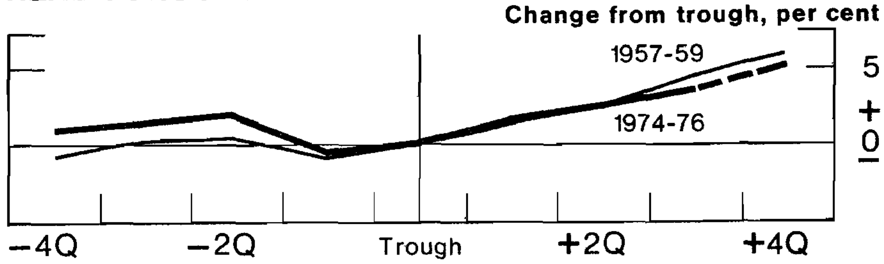
GROWTH IN REAL FINAL SALES



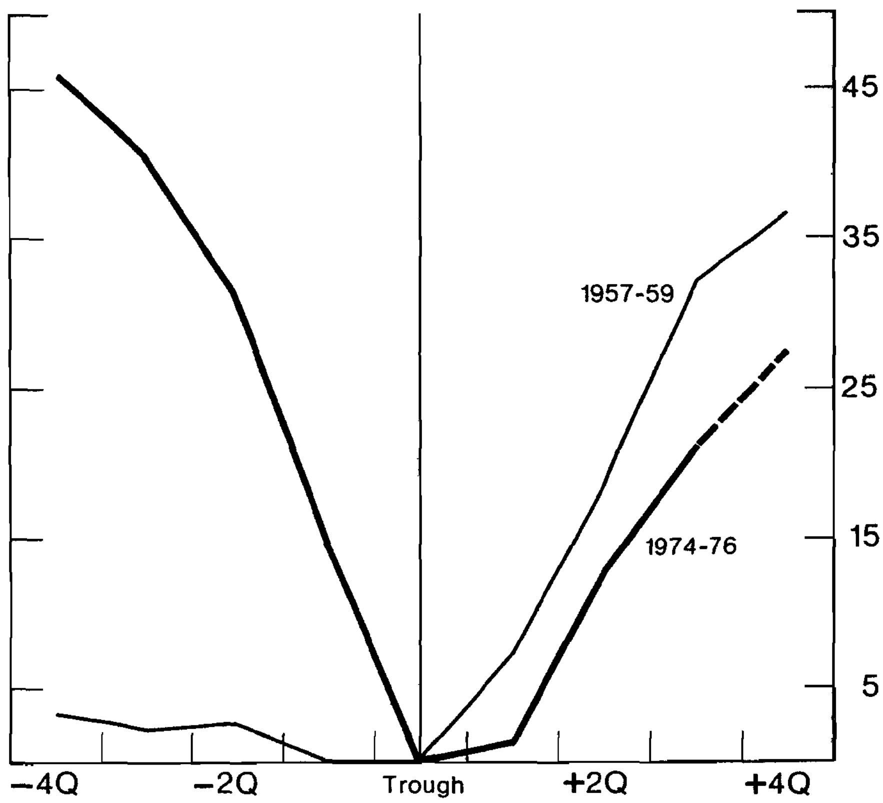
INVENTORY CHANGE



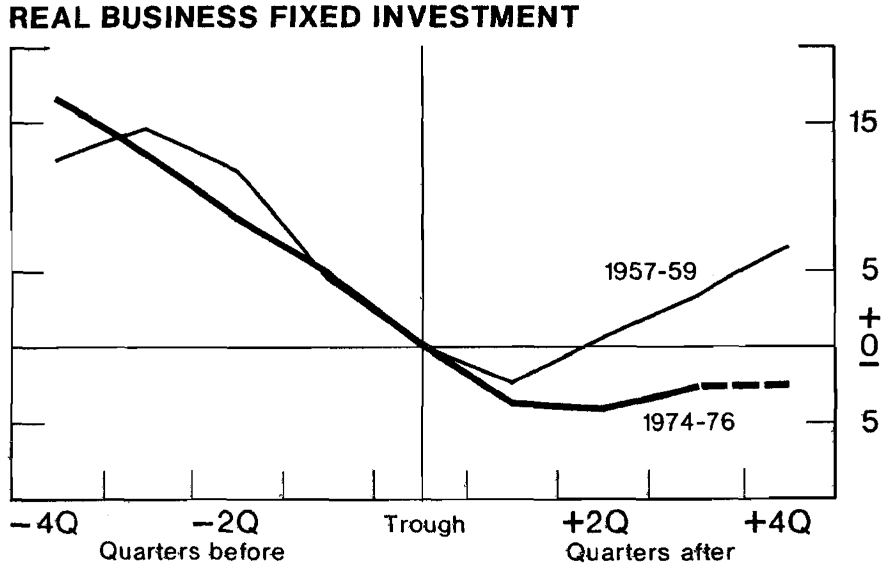
REAL CONSUMPTION EXPENDITURES



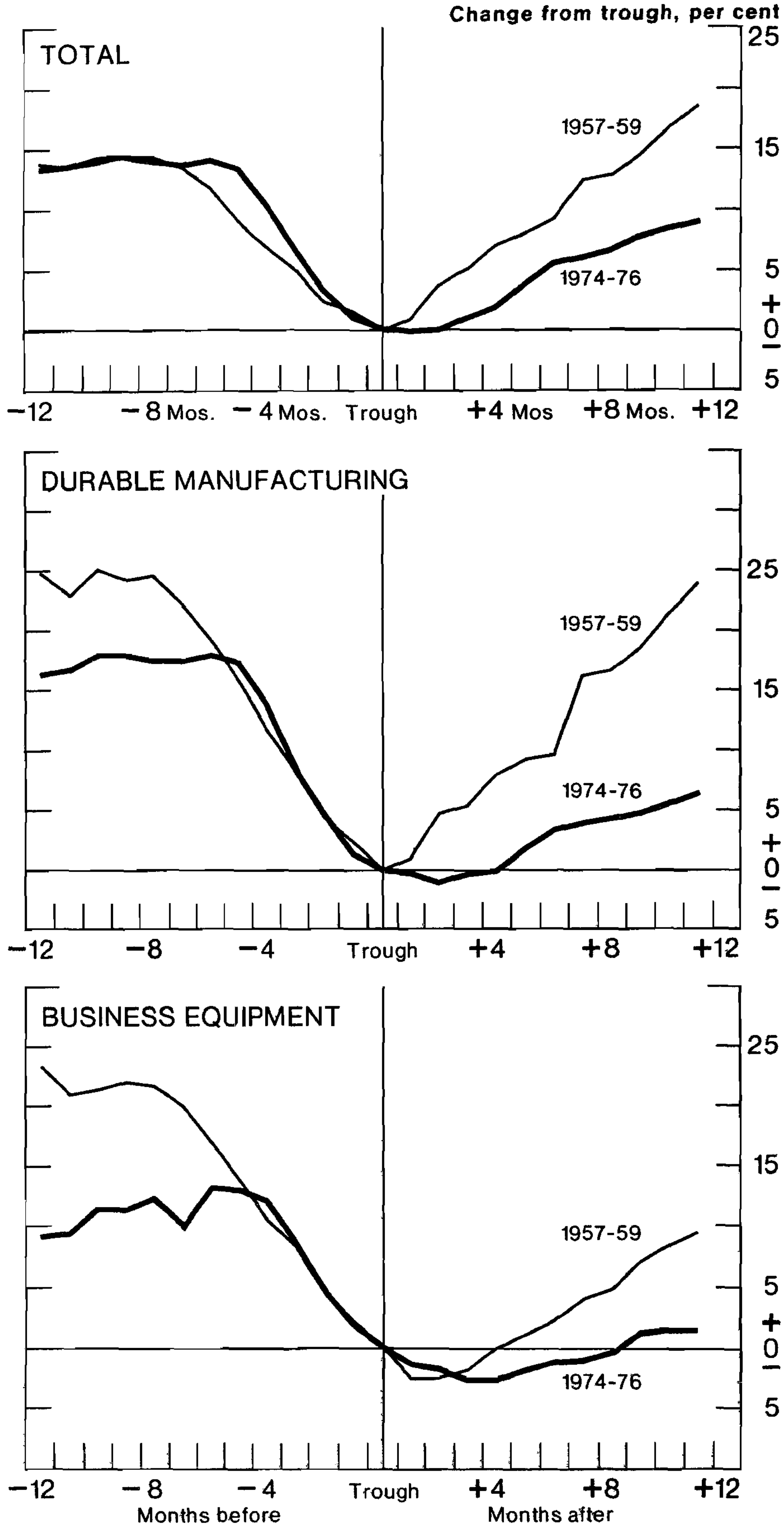
REAL RESIDENTIAL CONSTRUCTION



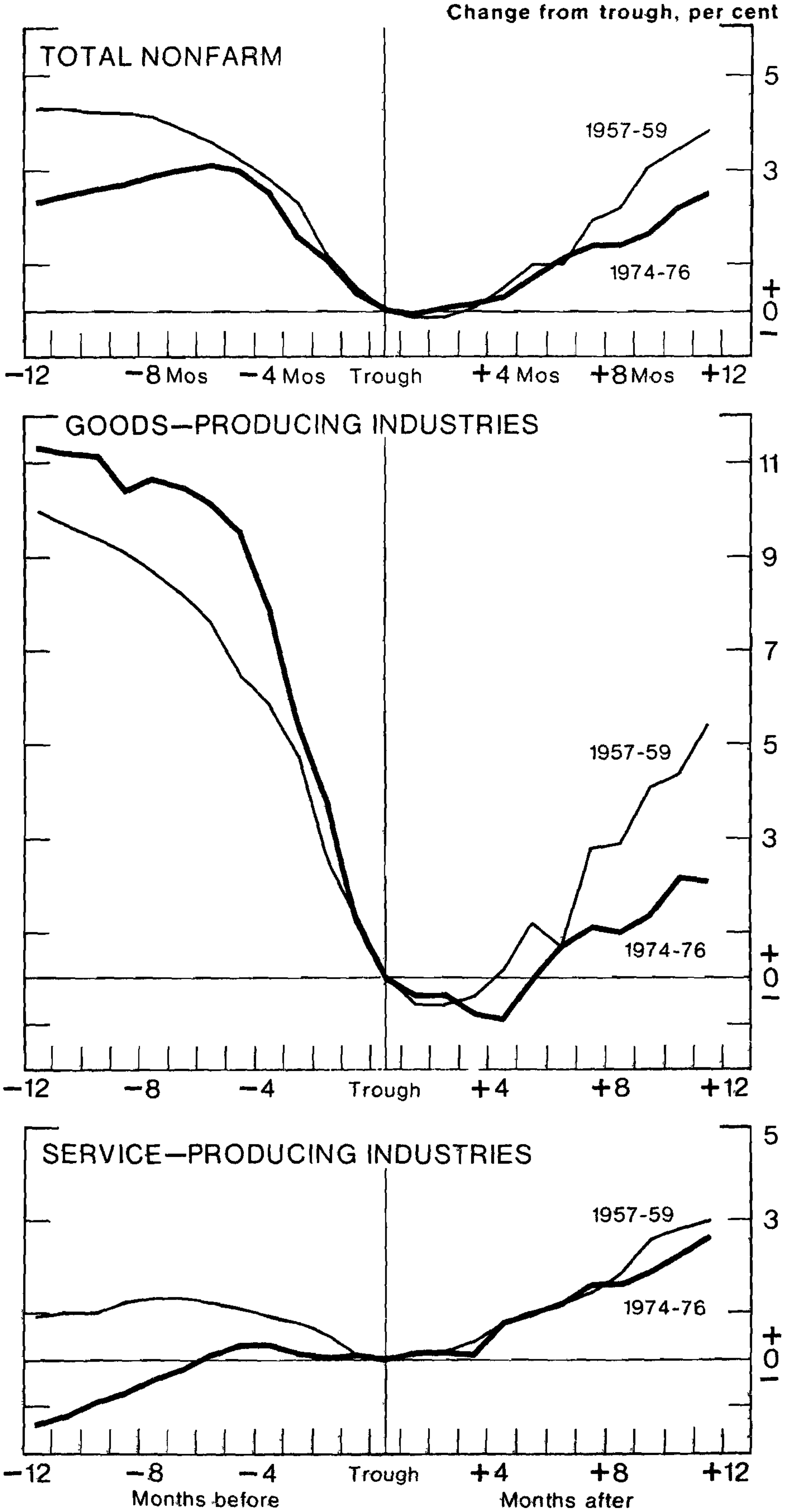
REAL BUSINESS FIXED INVESTMENT



INDUSTRIAL PRODUCTION



PAYROLL EMPLOYMENT



March 15, 1976

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 15-16, 1976

(The drafts with capital letters and strike-throughs, showing changes from the directive issued at the February meeting, follow this draft.)

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that output of goods and services has continued to expand at a moderate rate in the current quarter. In February retail sales rose considerably and recovery in industrial production continued. Gains in nonfarm employment were again widespread and the unemployment rate dropped from 7.8 to 7.6 per cent. Average wholesale prices of industrial commodities increased somewhat less than in January, owing in part to a reduction in crude oil prices required by the Energy Policy and Conservation Act; average prices of farm products and foods declined appreciably further. Over recent months, the advance in the index of average wage rates has moderated somewhat.

The average value of the dollar against leading foreign currencies has increased in recent weeks to its highest level in 2 years. In the exchange markets, the British pound has depreciated sharply; the lira has weakened further; and most recently, the French franc has depreciated after abandonment of efforts to maintain fixed margins with certain other European currencies. In January the U.S. foreign trade balance shifted into deficit.

M_1, which had increased only a little in January, expanded moderately in February; M_2 and M_3 rose sharply. At commercial banks and nonbank thrift institutions, inflows of time and savings deposits other than large-denomination CD's remained large. Since mid-February, both short- and long-term interest rates have changed little on balance.

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.

March 15, 1976

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 15-16, 1976

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that output of goods and services ~~is-continuing~~ HAS CONTINUED to expand at a moderate rate in the current quarter. In ~~January~~ FEBRUARY retail sales ~~remained-at-an-advanced-level~~ ROSE CONSIDERABLY and recovery in industrial production continued. Gains in nonfarm employment were ~~large-and~~ AGAIN widespread and the unemployment rate dropped from ~~8.3-per-cent~~ 7.8 to ~~7.8~~ 7.6 per cent. Average wholesale prices of industrial commodities increased somewhat less than in ~~the-preceding-2-months~~ JANUARY, OWING IN PART TO A REDUCTION IN CRUDE OIL PRICES REQUIRED BY THE ENERGY POLICY AND CONSERVATION ACT; ~~and~~ average prices of farm products and foods declined appreciably further. OVER RECENT MONTHS, the ADVANCE IN THE index of average wage rates HAS MODERATED SOMEWHAT ~~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~~ AVERAGE value of the dollar AGAINST LEADING FOREIGN CURRENCIES has ~~changed-little-over-the-past-4~~ INCREASED IN RECENT weeks TO ITS HIGHEST LEVEL IN 2 YEARS. IN

THE EXCHANGE MARKETS, THE BRITISH POUND HAS DEPRECIATED SHARPLY; THE LIRA HAS WEAKENED FURTHER; AND MOST RECENTLY, THE FRENCH FRANC HAS DEPRECIATED AFTER ABANDONMENT OF EFFORTS TO MAINTAIN FIXED MARGINS WITH CERTAIN OTHER EUROPEAN CURRENCIES. ~~There-have been-disturbances-in-foreign-exchange-markets-affecting-primarily European-currencies,-and-rates-for-several-currencies-have-moved considerably.~~ In ~~December~~ JANUARY the U.S. foreign trade BALANCE ~~surplus-was-substantial,-although-not-as-large-as-in-other-recent months~~ SHIFTED INTO DEFICIT~~,-and-bank-reported-private-capital movements-shifted-to-a-net-outflow~~.

M_1, which had ~~declined-in-December,~~ increased only a little in January, EXPANDED MODERATELY IN FEBRUARY; ~~but~~ M_2 and M_3 rose ~~considerably~~ SHARPLY. At commercial banks and nonbank thrift institutions, inflows of time and savings deposits other than large-denomination CD's ~~expanded-substantially~~ REMAINED LARGE. ~~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~~ SINCE MID-FEBRUARY, ~~interest-rates on~~ both short- and long-term ~~securities~~ INTEREST RATES have changed little ON BALANCE~~,-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.

OPERATIONAL PARAGRAPH

"Monetary Aggregates" Proposal

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

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 ~~maintain-prevailing~~ 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 ~~maintain prevailing~~ 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.