FEDERAL RESERVE BANK
OF DALLAS

ERNEST T. BAUGHMAN
PRESIDENT

DALLAS, TEXAS 75222

March 6, 1978

TO: Federal Open Market Committee

FROM: Ernest T. Baughman ETB

I have been thinking for some time about the contribution our long-run growth ranges for the monetary aggregates, established each quarter pursuant to Concurrent Resolution 133 and the recently enacted Federal Reserve Reform Act, may make to achievement of full employment, stable prices, and balance in international payments, three overriding goals of economic policy. The exercise has tended to focus attention of the public and the Congress on the medium-term aspects of monetary policy. Also, it has helped to keep before us the fact that our day-to-day operations must be constrained by our medium-term objectives. Given the thrust of inflation, it seems to me that the economic problems we are attempting to address now require attention to the longer term to a degree not heretofore experienced since the 1930's.

I propose, therefore, that the time horizon over which our targets are announced be extended. I would think it useful to indicate aggregate targets over, say, the next three years.

This would strengthen any positive features inherent in the current quarterly announcement of target ranges for the ensuing 12 months. It would indicate more strongly to the public that prospective monetary policy should be taken into consideration in any long-term private contracts such as wage and mortgage contracts.

So long as monetary policy can be presumed to adjust in the short term to the consequences of private long-term contracts, we would appear to have only very limited ability to impact on the wage-price spiral. Historical evidence indicates inflationary expectations, once built in, are next to impossible to liquidate. An announced goal to slow the rate of growth in money over the next three years would help to reinforce the idea that the battle against inflation must be an ongoing one and that the monetary authority has an ongoing battle plan. I think such an announcement would make the job of this Committee easier in that it would keep more in the forefront our long-run goals and help to insulate short-run actions from attack.

It's unfortunate that monetary policy influences real activity before it has much impact on inflation. This allows us to stimulate economic activity for a while at no apparent cost, i.e., with no immediate worsening of the rate of inflation. And it makes efforts to restrain inflation seem almost futile since the initial impact of monetary restraint tends to reduce economic activity with any slowing in the rate of inflation coming only later.

This unfortunate timing of lags makes easy money very popular and tight money very unpopular in the short run and the short run is always with us. It leads to urging on nearly all fronts for easier money and cries that tight-money policies cannot cure inflation and should be abandoned. Consequently, if we don't constantly keep the long run before us and the public we tend to stimulate the economy too much too long and to restrain it too late and too little. The end result of over a decade of such activity has been the building in of an inflationary thrust that is proving extremely difficult to contain.

Obviously, none of what I have said here is news to any of us. And it is to the Committee's credit that it has taken steps in the last few years to stretch out its policy horizon. Nevertheless, it is disturbing to note that the pattern of monetary growth on an annual basis in recent years may be encouraging further entrenchment of inflationary expectations even though we have stated repeatedly our intention was the opposite. It can be argued we should have had more rapid growth of money in 1975 and then the record would look better. Even so, we would be hard pressed to find a persuasive rationale that monetary policy in the past three years has been countercyclical.

In conclusion, then, I suggest we seriously consider setting money growth targets for a three-year period and announce that our purpose is to enable private markets and private contracts to anticipate that insofar as inflation is affected by monetary policy the future will be less inflationary than the recent past.