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 19-20, 1973, beginning at 4:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Balles
Mr. Brimmer
Mr. Bucher
Mr. Daane
Mr. Francis
Mr. Mayo
Mr. Mitchell
Mr. Morris
Mr. Robertson
Mr. Sheehan

Messrs. Clay, Eastburn, Kimbrel, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. MacLaury and Coldwell, Presidents of the Federal Reserve Banks of Minneapolis and Dallas, respectively

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Altmann and Bernard, Assistant Secretaries
Mr. Hackley, General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Bryant, Eisenmenger, Garvy, Gramley, Hersey, Scheld, and Sims, Associate Economists

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

Mr. Melnicoff, Deputy Executive Director, Board of Governors
Mr. O'Brien, Special Assistant to the Board of Governors
Messrs. Keir, Pierce, Wernick, and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Gemmill, Adviser, Division of International Finance, Board of Governors
Mr. Zeisel, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Kichline, Chief, Capital Markets Section, Division of Research and Statistics, Board of Governors
Mr. Wendel, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Enzler, Economist, Division of Research and Statistics, Board of Governors
Mrs. Rehanek, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors

Messrs. Black and Fossum, First Vice Presidents, Federal Reserve Banks of Richmond and Atlanta, respectively
Messrs. Boehne, Parthemos, and Doll, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Richmond, and Kansas City, respectively
Messrs. Hocter, Jordan, and Green, Vice Presidents, Federal Reserve Banks of Cleveland, St. Louis, and Dallas, respectively
Mr. Meek, Assistant Vice President, Federal Reserve Bank of New York
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis

The Secretary reported that advices had been received of the election by the Federal Reserve Banks of members and alternate members of the Federal Open Market Committee for the term of one year beginning March 1, 1973; that it appeared that such persons were legally qualified to serve; and that they had executed their oaths of office.

The elected members and alternates were as follows:

Frank E. Morris, President of the Federal Reserve Bank of Boston, with David P. Eastburn, President of the Federal Reserve Bank of Philadelphia, as alternate;

Alfred Hayes, President of the Federal Reserve Bank of New York, with William F. Treiber, First Vice President of the Federal Reserve Bank of New York, as alternate;

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

Darryl R. Francis, President of the Federal Reserve Bank of St. Louis, with Monroe Kimbrel, President of the Federal Reserve Bank of Atlanta, as alternate;

John J. Balles, President of the Federal Reserve Bank of San Francisco, with George H. Clay, President of the Federal Reserve Bank of Kansas City, as alternate.

Mr. Holland then noted that the members had been given copies of a telegram from Chairman Burns, in his capacity as Chairman of the Committee on Interest and Dividends, to commercial banks that had announced increases in their prime rates to 6-3/4 per cent. As indicated in the telegram, officials of those banks had been invited to meet with representatives of the Committee on

Interest and Dividends on March 22 to discuss their costs and interest rate policies. Secondly, later today Reserve Bank Presidents and Board members would be given copies of a memorandum, entitled "Documented Discount Notes and Bank Loan Commitments," that Governor Mitchell had sent to the other agencies represented on the Interagency Coordinating Committee on Bank Regulation. That memorandum raised the question of possible need for increased supervisory or regulatory attention to the subject areas, and he mentioned it at this point because of the implications for bank credit developments.

Chairman Burns noted that this Monday afternoon session of the Committee's meeting had been called to provide adequate time for consideration of the domestic economic outlook and longer-run targets for monetary policy. He asked Mr. Partee to begin the staff presentation.

Mr. Partee made the following statement:

> This is an unusually difficult time in which to have a firm view as to the economic outlook for a period ahead of as long as a year. The incoming information is very strong--stronger, perhaps, than we had been anticipating. And the views expressed by businessmen, as reflected in the red book,[1/] for example, are now almost universally bullish. Yet, there is a sense of disquiet that could work to

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

undermine the current prosperity. Inflation, and the expectation of inflation, is on everyone's mind. It is now being reported as a major concern in opinion surveys, and it could in time depress consumer spending behavior. The international financial crisis, though very remote to most, is a disturbing factor and is commonly associated with a sense of deterioration in the value of the dollar. The stock market has dropped further in the last month despite very good profits reports. And more business forecasters are beginning to point to the possibility of a slowdown late this year or in early 1974.

Under the circumstances, there has been more diversity than usual expressed in the staff meetings leading to our current green book[1/] projection. It can be reasonably argued that the current strength of the economy will carry over fully into the second half, fueled perhaps by a major inventory investment boom. Conversely, it can be argued about as effectively that the economy will show less strength by then than we have projected, reflecting perhaps a major dampening in consumer psychology and/or a failure of exports to respond with vigor to the devaluation. On the price side, a case can be made for a more rapid inflation than we have projected, with the rate of rise in wage rates escalating as the year progresses. But a case can also be made that we have already weathered the major inflation shock--in food prices--and that Phase III control processes, after a rocky start, will now begin to take hold.

As it happens, the net result of these deliberations has been that we have made very little over-all change in our projections. The increase in GNP this year is now expected to be a little larger than we were projecting 5 weeks ago, but this entirely reflects a somewhat faster rate of inflation. Real GNP is projected to rise 5.4 per cent over the course of 1973, with the rate of gain receding as the year progresses. The unemployment rate is expected to decline to 4.7 per cent by the fourth quarter, the same as in our preceding projection. And although there are small changes in some

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

of the GNP components--business fixed investment and residential construction are projected slightly higher as a result of recent developments, for example--they do not amount to very much.

Component details of the projection are presented in Table 1 of the packet before you.[1] For the whole period--from the fourth quarter of 1972 to the fourth quarter of 1973--the rise in GNP is expected to amount to about $124 billion. Most demand sectors are expected to increase as much as, or more than, in the recent past, the only exceptions being residential construction, which is likely to be turning down from extremely high levels, and inventory investment, where the rate of accumulation may accelerate a little less rapidly than it has in the five quarters since the summer of 1971. On the other hand, larger dollar increases are expected over the course of this year in exports, reflecting the devaluation; in business capital spending, as manufacturers' outlays rise more sharply; in State and local spending, reflecting revenue sharing and secular growth; and in consumption of nondurable goods and services.

You will note at the bottom of the table that the annual rate of increase projected in current dollar GNP over the next four quarters is about the same as in the preceding five quarters--the period since the beginning of the new economic program. However, growth in constant dollar GNP is projected to moderate considerably. That moderation, which is progressive from quarter to quarter, is expected to bring a slowing in employment growth, as is shown in the top half of Table 2. But we expect also that the expansion in the civilian labor force will slow, reflecting a much smaller contribution from reductions in the size of the armed forces and a slower rise in labor force participation rates as growth in employment opportunities moderate. Consequently, the total unemployment rate should continue to drift downward, reaching about the same level by the fourth quarter of 1973 as in the spring of 1965, when labor markets had appeared to be reasonably in balance. The rate for adult males will be lower than in 1965, however, which implies more upward demand pressure on wage rates than at that time.

1/ Copies of the eight tables distributed at the meeting are appended to this memorandum as Attachment A.

Table 3 presents our detailed projections of compensation, productivity, and unit labor costs. The difficulty inherent in the current situation is shown by the fact that, even though we are not projecting a faster rise in hourly earnings for the year as a whole than occurred during 1972, the increase in unit labor costs is expected to be substantially larger. This reflects partly the effect on employer costs of the social security tax increase this past January, but more importantly, the progressively smaller productivity gains likely to accompany the projected slowing in the expansion of real output. A slowing of this sort is a usual cyclical development, and we see no reason why it should not recur.

The expected increase in the fixed-weight price deflator over the year to come is a little larger than the advance in unit labor costs. This discrepancy is explained mainly by the abnormal increases in food prices that we have been experiencing and the internal effects on commodity prices of the recent currency realignment, which may directly add two- or three-tenths of a percentage point to the domestic price level. Table 4 shows our projection of price developments in the coming year. The increase shown for the first quarter is expected to be the largest of the year, due to the unprecedented surge in food prices. These increases should moderate, particularly as food output expands in the latter part of the year. But the rise in prices of other goods and services will probably tend to accelerate, reflecting growing cost pressures and, to some extent, the devaluation. As a result, we expect the deflator to be rising as fast in the fourth quarter--at about a 4-1/2 per cent annual rate--as for the year as a whole.

The purpose of presenting these tables on costs and prices in some detail is to emphasize how stubborn the near-term inflationary problem appears to be. Even with wage increases no larger on average than during 1972, and even with little or no further improvement in profit margins, the projected rise in unit labor costs and in prices is significantly larger than last year. Our estimates, I believe, are defensible but they are clearly on the conservative side; a more rapid escalation in both costs and prices is readily conceivable. It is

difficult to see how aggregate demand management policies could make much difference in this short-term price outlook. Influencing prices through aggregate demand, as the experience of recent years has indicated, takes a great deal of patience.

As the Committee requested, we have given consideration to the possible effects that alternative monetary policy formulations might have on the prospects for both economic growth and inflation. The results that we would think likely for calendar 1973--the limits of our forecasting horizon at present--are shown in Table 5. Reducing money growth to 4 per cent, from the present 5-1/2 per cent longer-run target which underlies the green book GNP projection, would cut expansion in nominal GNP for the remainder of the year by about $6 billion and it would reduce the real growth rate by about 1/2 of a percentage point for the three quarters. By the fourth quarter, unemployment might be at a somewhat higher rate than otherwise, but inflation probably would be reduced little if at all. Increasing the monetary growth rate to 7 per cent would have approximately the reverse effects.

Of course, the lags in monetary policy are such that far and away the major economic impact from a shift in posture now would come in 1974, aside from the effects on public psychology of appearing to resist, or to countenance, the present rate of inflation. Later, Mr. Pierce will discuss, on the basis of our econometric model, the dimensions of the economic impacts in 1974 that might reasonably be expected. First, however, Mr. Axilrod will present the implications of the alternative policies for financial markets in 1973. You will note from the bottom line of Table 5 that the differences this year in the level of interest rates would likely be substantial.

Mr. Axilrod made the following statement:

Over-all financial and credit market developments that would appear to emerge from the various alternatives discussed by Mr. Partee imply rather sharply different problems of market adjustment. In the case of alternative A, credit markets would not be under much, if any, strain because we expect that interest rates have already, or will shortly, peak if M_1 is permitted to grow at a 7 per cent rate in 1973. However, alternatives B and C, calling

respectively for 5-1/2 and 4 per cent M_1 growth rates in 1973, imply considerable readjustments yet to come in the pattern of financial flows.

The threat of severe dislocations unduly affecting particular market sectors, such as housing, may be mitigated by an increase in ceiling rates on consumer-type time and savings deposits. But before discussing the possible need for, and implications of, such an increase, I'll first sketch in what appear to be the significant shifts in credit markets under alternatives B and C if Q ceilings are left unchanged.

The second and third columns of Table 6 indicate key financial flows expected for alternatives B and C, respectively. The succeeding columns show comparisons for earlier years. One year of particular comparative interest is 1969. That was the last year when net savings inflows to banks and nonbank savings institutions came under severe pressure and when, as a result, the mortgage market had to be supported by a large rise in Federal agency borrowing and when these agencies and the U.S. Government itself had to rely wholly on individuals to finance their issues. I have circled key figures for 1969 and also for the projections of alternatives B and C for 1973.

You will notice that net inflows of consumer-type time deposits to banks (line e) and into nonbank savings accounts (line g) are projected for 1973 at rates in excess of the 1969 pace. This is partly because existing ceiling rates are higher than in 1969, particularly on longer maturity certificates, and also because under alternative B we do not expect the short-term market rate structure to rise as high as it did in 1969. Under alternative C, we expect short-term rates to be closer to 1969 levels, but not quite to reach the very high peak rates of that year.

Even though we do not expect time and savings deposit inflows to become as depressed this year as earlier, you can see from the circled figures on line j that we anticipate greater Federal agency borrowing than in 1969, with borrowing especially large under alternative C. The reason, of course, is that the dollar volume of mortgage commitments is substantially larger now than in the earlier period, reflecting a larger number of commitments and much higher prices for houses. The net increase in

residential mortgages is shown on line i, and you can see that we expect the volume in 1973 to be more than double that of 1969.

The circled figures on line 1 indicate the extent to which we think that individuals, including personal trusts and nonprofit institutions, will have to be relied on to finance the U.S. Government and Federal agency securities market. The figure for alternative B is not particularly fearsome relative to 1969, but under alternative C we would expect individuals to have to finance about as much of this kind of debt as they did in 1969. The need to get them to do so is one of the reasons we would expect short-term rates to rise from 1 to 1-1/2 percentage points further under this alternative--with the 3-month bill rate moving up as the year progresses to a range somewhat over 7 per cent. Under alternative B, with less debt to be financed outside financial institutions, we would anticipate, on balance, a more moderate further rise from current levels of short-term interest rates.

While comparisons with 1969 are instructive, the extent of developing tightness likely this year can also be gauged by comparisons with the year 1972. In 1972, individuals liquidated Treasury and Federal agency securities on balance, and they bought less corporate bonds than in the previous four years. In 1973, substantially slower growth in money supply aggregates as the Federal Reserve holds back on reserve provision will require the higher interest rates needed to make individuals change their investment preferences and become more willing to buy riskier market securities.

Bank credit under alternatives B and C slows relatively less in 1973 compared with last year than do money supply aggregates. We have assumed that banks are able, at rising interest rates, partially to offset reductions in demand and consumer-type time deposit flows by continuing to issue large amounts of negotiable CD's and also by expanding nondeposit sources of funds. Business credit demands on banks are expected to continue strong, although we have assumed an abatement of such demand from the recent extraordinary pace as movements out of commercial paper at least slow down and as tightened bank lending terms and higher short-term rates begin to shift some corporate borrowers into the bond market.

If financial developments were to evolve as projected under alternative B, it would seem to me that monetary restraint would become more pervasive but that an undesirable crunch-type situation might just be avoided. It could be that markets would work relatively smoothly without any adjustment in Q ceilings as they apply to consumer-type time deposits, provided that only modest further upward pressures on market rates develop. The test for such a conclusion is, of course, ahead of us, and may even be closer at hand than is comfortable.

The absence of a significant crunch under alternative B depends on a number of factors. First, net savings inflows to banks and other institutions are not depressed beyond the comparatively moderate rates shown. Second, banks have the capacity to obtain large CD funds to help cushion their adjustment to the reduced inflows of other deposits that do develop. Third, the tightening of lending terms that accompanies continued reliance by banks on high cost short-term funds discourages some business and consumer borrowers completely and shifts some to other markets. Fourth, other markets are able to absorb fairly smoothly the increased demands that we foresee in part because the Treasury, given the financing it has already accomplished, is not expected to borrow much more than its seasonal requirement in the second half of this year.

Some of these developments are illustrated by the half-yearly figures shown in Table 7. For instance, Treasury and Federal agency net new debt issues, taken together, are projected to drop sharply from the first half of 1973 to the second half of 1973; the low second-half figure is circled. These figures, however, do not assume a significant reflow of funds from abroad and an accompanying disgorgement of Treasury issues by foreign central banks. If that did occur, more of the Treasury debt would have to be absorbed by domestic holders, especially individuals in the circumstances assumed, and there might be considerable additional interest rate pressures focused on the Treasury area. However, the returned money would be invested in the U.S. market and thus would tend to offset, for the rate structure as a whole, the upward impact on Treasury interest rates.

Maybe I'm being more optimistic than the average of our staff about how financial markets might react to a tight monetary policy of alternative B dimensions.

Some of our staff would tend to believe that a minor adjustment--perhaps 1/4 of a percentage point--would be required in ceiling rates on consumer-type time deposits at banks and other savings institutions. Perhaps the safest way to put it is that alternative B seems to place policy at the margin where adjustments in small Q ceilings could be required.

The policy of alternative C, however, seems to entail high odds that some upward adjustment in ceiling rates will be required. A very substantial shifting in financial flows will be involved without such a rise, and housing finance will become highly dependent on Government support. Large-scale diversions of funds among financial markets may require sharp rises of short- and long-term interest rates in a short period, which could lead to highly adverse psychological repercussions on business and consumer attitudes. Moreover, even though Governmental support moderates the mortgage market reaction, the heavy dependence of savings and loan associations on borrowed funds, together with a sharp drop in their liquid asset holdings, is likely to cause a very marked tightening of commitment policies and thereby pose serious problems for housing activity in 1974.

We have run a projection through our flow of funds accounts which assumes the M_1 growth of alternative C but in addition assumes that small Q ceilings are raised by 1/4 percentage point in mid-spring and by another 1/4 point toward the end of summer. The financial flows that emerge very much resemble the alternative B pattern shown without Q ceiling rate adjustments. Of course, interest rates would be appreciably higher, so that considerable monetary restraint would still be built into the financial system and credit market flows in 1974 would be seriously affected.

Mr. Pierce will now discuss the implications for 1974, as indicated by our econometric model, of various assumptions as to monetary growth rates.

Mr. Pierce made the following statement:

Mr. Partee and Mr. Axilrod have discussed implications for the economy in 1973 of various monetary policy alternatives. The alternative chosen now will also have important implications extending well beyond 1973. Admittedly, it is

extremely difficult to predict the course of economic events in the more distant future; nevertheless the exercise should not be avoided because the economy's response to monetary policy spreads over a period much longer than a year. As a matter of fact, there is substantial evidence that the real sectors of the economy do not even begin to respond significantly to a monetary stimulus for 6 to 9 months unless expectations change drastically in the meantime. If this is the case, the die is already cast for much of 1973 and the policy target chosen by the Committee will have its main implications for output, employment, and prices toward the end of 1973 and more importantly in 1974.

We have used our quarterly econometric model as a tool for assessing the probable course of the economy in 1974 under different monetary policy assumptions. The model was designed to provide a detailed characterization of the underlying structure of the economy, particularly in its dynamic aspects. In constructing the model, great emphasis was placed on specifying the channels through which monetary and fiscal policies exert their influences on the economy. While we believe that the model offers the best blend of economic theory and statistical measurement available, it is, of course, far from perfect. We, like all serious users of such models, have learned that it can be used most productively if it is adjusted judgmentally in terms of levels to conform to the events of the recent past and to our best feel for special future developments. These adjustments are sometimes small and sometimes sizable. At present, the unadjusted form of the model would provide a more bearish projection for 1973 and 1974 than we believe will be the case. As a result, we have adjusted the levels of the spending relationships for business fixed investment and consumer durables in the model upward to account for this judgment. The model results thus conform to the projections presented by Mr. Partee for 1973, and we have continued these adjustments, in terms of levels, for 1974 as well.

Given these adjustments to more realistic expected output levels, the model then introduces the dynamics of the basic underlying forces in the economy that may be at work. Most important of these for the current discussion are: (1) The decline in the rate of growth of real output projected for the second half of 1973 is

likely to induce a cutback in the rate of inventory accumulation and in the rate of growth of business fixed investment in 1974. These cutbacks, in turn, will serve to retard further the growth in real output during the year. (2) The decline in the rate of growth of real output will retard the growth of employment in 1974. (3) The inflation rate, because of the relationship between costs and productivity, is likely to respond sluggishly to the reduced rate of growth in the economy.

These prospective developments serve to pinpoint the policy dilemma. Due to the sluggish response of wage and price inflation, a restrictive monetary policy for 1973 will have its primary impact in 1974 on real output and employment, not on wages and prices. Our model, like others, indicates that wages and prices possess so much inertia that they are relatively insensitive to monetary (or fiscal) pressures unless these pressures are sustained for several years. In the interim, real output and employment bear the brunt of adjustment. Certainly the events of the past several years bear out the model's conclusions.

The model also suggests that, given existing inflationary pressures, a rate of growth of the money stock of 5 to 6 per cent per year cannot be sustained for a substantial period of time without inducing a rise in the unemployment rate from current levels. With an inflation rate of around 4 per cent per year, a 5 per cent rate of monetary expansion adds to <u>real</u> money balances at the rate of only 1 per cent per year. Since the growth in real GNP in 1973 is projected to be far in excess of the growth in real money balances, the private sector will limit additions to its real money balances only if interest rates rise. As the rise in short-term rates is transmitted to longer-term interest rates and as the availability of credit declines, real demands for goods and services will be reduced. This process of reduction in the rate of expansion in real output is already evident in the staff's projections for the second half of 1973. The model, even in its judgmentally adjusted form, indicates that the tendency toward slower economic growth will persist and intensify in 1974 unless it is counteracted by a pickup in monetary expansion by late 1973 or early 1974.

To gain some perspective on the nature of the trade-off between unemployment and inflation between now and the end of 1974, we obtained projections from the model under three alternative assumptions of steady growth in the money stock (M_1) over the entire period--7, 4, and 5-1/2 per cent, respectively. The results from these simulation experiments for key economic variables are reported in the first three columns of Table 8. The model shows that a steady 7 per cent money growth pursued through 1974 would be likely to hold unemployment down in 1974, but at the cost of more rapid inflation. Alternatively, a 4 per cent money growth, if sustained, would lead to sharply higher unemployment as 1974 progressed, although there would be a declining trend of inflation. The third alternative of a 5-1/2 per cent money growth pursued through 1974 would be likely to retard real growth, raise unemployment significantly, and make only limited headway against inflation during this period.

In an attempt to find a more acceptable blend of policy tradeoffs, we also ran an experiment that shifted rates of monetary growth in 1974 as against 1973. In this experiment it is assumed that the money stock grows at a steady 5-1/2 per cent rate in 1973 followed by a 7 per cent rate in 1974. The results are reported in the last column of Table 8. The move to a higher rate of monetary expansion in 1974 would appear likely to produce a more acceptable pattern for the economy in 1974. The decline in the economy would be moderated (although not eliminated, because of the lags involved), the unemployment rate would still rise but to a lesser degree than in the straight 5-1/2 per cent money growth case, and some modest progress would be made against inflation.

It appears from the model, then, that a relatively tight monetary posture in 1973, if continued into 1974, would most likely produce a chain of events leading to a significant weakening in the economy in 1974. A timely shift toward a more expansive policy, however, would reduce this effect and permit some small degree of progress in working toward a lower inflation rate. Of course, it may be argued that the model could be badly wrong. But since we have adjusted upward the levels of spending relationships in the model and since its results

conform to established theoretical and empirical findings, it seems to me more likely that the model is providing a fairly accurate account--at least in broad outline--of the results that can be expected to flow from the various policy actions discussed.

Mr. Partee made the following concluding remarks:

The conclusions from our presentation today, I believe, can be stated simply. First, though there are new uncertainties in both directions, we still believe that the over-all rate of economic growth will slow gradually to around 4 per cent by year-end. Economic developments then, however, may be displaying some of the cyclical configuration that would suggest developing weakness later on. Second, continued economic expansion in the interim is likely to bring us appreciably closer to our practical output potential, so that available resources in some areas--especially skilled manpower--may soon be in relatively short supply. Third, we would expect growing demand pressures on costs and prices, with generalized price inflation becoming more prevalent despite a leveling tendency in food prices later this year.

In these circumstances, a substantial degree of restraint in monetary policy clearly is warranted, both to provide some resistance to wage and price inflation and to guard against the possibility that we are underestimating the underlying strength in the economic situation. Relatively little progress should be expected on the inflation front in the short term, however, since the basic cost factors are unfavorable and since aggregate economic policy clearly appears to operate on these factors only with a very long lag.

To adopt a substantially more restrictive policy that carries with it the danger of stagnation or recession would seem unreasonable and counterproductive. As unemployment rose, there would be strong social and political pressure for expansive actions, so that the policy would very likely have to be reversed before it succeeded in tempering either the rate of inflation or the underlying sources of inflation. The alternative course of encouraging continued substantial economic expansion and pushing down further on the unemployment rate, with little regard for inflation and for inflationary expectations, would seem equally unwise. It would risk a speculative blowoff, with the prospect of recession farther on down the road.

> The best solution in the present difficult situation, I believe, would entail a slowing in the economic expansion to the minimum sustainable rate, which would appear to be in the 3 to 4 per cent range. The unemployment rate would tend to drift upward once this slower growth rate had been sustained for a while. Even so, progress in reducing inflation would probably be modest--all that can be expected in today's environment from aggregate demand management measures.
>
> Of the alternative monetary policies considered, the 5-1/2 per cent money growth target seems to me to come closest to meeting the combination of our economic objectives. That rate of growth would doubtless bring some further rise in short-term interest rates, and would probably induce significant shifts in financial flows and higher long-term interest rates as well. Indeed, 5-1/2 per cent growth would imply very little real expansion in the money stock if our projection of the inflation rate is correct. If upward momentum in the economy is to be sustained, it appears likely to us that the money growth target would need to be increased again later on, once it becomes apparent that the desired moderation in economic conditions is being achieved.

Mr. Daane noted that under all three alternative policy courses, prices--as measured by the private fixed-weight deflator--were projected to be rising in the fourth quarter of 1973 at a rate of about 4.5 per cent. He asked whether that was not close to the rate of price advance prevailing prior to the introduction of Phase I of the new economic program in August 1971.

Chairman Burns said it was his recollection that the rate of increase in the fixed-weight deflator had been about 5 per cent in the first half of 1971, and close to that figure in 1969 and 1970.

Mr. Partee agreed that the rate of price advance anticipated for late 1973 was not much lower than that prevailing before the

new economic program. He might note, however, that part of this year's projected advance represented an assumed "catch up" during Phase III following a period of more restrictive controls on wages and prices.

Mr. Daane then asked what fiscal policy assumptions had been made in the projections.

Mr. Pierce replied that the figures shown in the January budget document had been used for the period through the first half of 1974. The January document implied a balance in the high-employment budget in that half-year. For the second half of 1974 it had been assumed that Federal purchases of goods and services would continue to increase at the same rate as in the first half. That might well be a poor assumption, but there appeared to be no basis at present for improving upon it. That situation illustrated the difficulties of forecasting for so long a period.

Mr. Partee added that the figures for Federal expenditures in calendar 1973 shown in the budget document might earlier have appeared unrealistically low. However, the Administration had been unusually successful thus far in holding back on spending programs. Indeed, because of low defense expenditures, total Federal spending seemed to be running a little below budgeted levels.

In reply to a further question by Mr. Daane, Mr. Pierce said that for every $1 billion reduction in the assumed rate of Government expenditures, the model would project about a $2 billion

reduction in current-dollar GNP at the end of a 2-year period. As with monetary policy, however, a tighter fiscal policy would not have a large effect on prices within such a period. To illustrate the length of the lag implied by the model, he noted that the adjustment of prices following a change in the unemployment rate was spread over a 4-year period.

Chairman Burns said he would interpret the figures in Table 8 as suggesting that there would be a recession by the end of 1974, if not sooner, if M_1 were to grow at a constant 4 per cent rate. Noting that the Table 8 figures reflected judgmental adjustments, he asked how the results of the unadjusted model would differ, and what adjustments accounted for the main differences.

Mr. Pierce replied that the adjustments had the effect of raising the projected levels of GNP; the unadjusted model suggested that the recession would occur sooner. The main adjustments were in the projections for business fixed investment and consumer spending on durable goods. For both of those sectors, the expenditure levels projected by the unadjusted model had proved too low in the recent past and appeared likely to be too low in the projection period. Consequently, the unadjusted figures had been raised; for example, the projected level of business fixed investment in 1973 was increased by $2 billion to be in accord with the green book projection.

Mr. Partee added that, as the members knew, the GNP projections regularly provided to the Committee were judgmental in nature. The evidence suggesting that the unadjusted model's projections of business investment in 1973 were too low included the results of surveys of business plans for fixed investment spending and the latest data on new orders for capital equipment.

Mr. Brimmer said it was interesting to juxtapose the conclusions that could be drawn from two parts of the documentation prepared for today's meeting. First, Table 8 indicated that even if M_1 were to expand at a 5-1/2 per cent pace, a recession would be incipient by the second half of 1974; for that period the real GNP growth rates projected were declining to levels below long-run potential, excess capacity would undoubtedly be rising, and so forth. Secondly, according to the current red book, boom or near-boom conditions were prevailing in virtually every Federal Reserve District. Unless one discounted the findings of the red book, it would appear that GNP was already approaching a level that could not be sustained through the second half of 1974 if M_1 were to grow at a rate much below 7 per cent. He asked whether Mr. Partee would comment on the relationship between those conclusions.

Mr. Partee observed that the current red book had not been available at the time the projections were being prepared. However, the staff had anticipated the widespread strength in attitudes disclosed by the red book, particularly in light of the implications of recent data on new orders and business spending plans. Only a minor upward adjustment had been made from a month ago in the percentage increase from 1972 to 1973 in business fixed investment--from 15.0 to 15.8 per cent--because the 15 per cent figure shown last month was already very high by historical standards. If the increase in capital spending in 1973 was appreciably larger, activity in the second half of the year could be considerably stronger than projected--as he had suggested in his statement, although there he had been emphasizing the possibility of an inventory boom. In that event, the successful pursuit of some particular target growth rate for M_1--say, 5-1/2 per cent--would result in higher interest rates than projected. As Mr. Axilrod had noted, higher interest rates in the second half of 1973 would have important implications for the structure of financial flows. Moreover, disproportionately large increases in either capital spending or inventory investment would probably set the stage for a sharper than projected drop-off in economic activity sometime in 1974.

Mr. Pierce concurred in Mr. Partee's observations. He expressed the view that, given existing rates of inflation, it

would not be possible to sustain the kind of boom conditions under discussion with a 5-1/2 per cent rate of growth in M_1; sharply rising interest rates would choke off the expansion.

Mr. Bucher asked what assumptions had been made about the effectiveness of Phase III controls on wages and prices and how the results might be modified if the controls proved to be as effective as those under Phase II.

Mr. Partee replied that, in the absence of any firm knowledge on the point, the staff had taken as the most probable assumption a gradual withering away of Phase III controls and some catch-up in wage rates and prices as 1973 progressed. As he had also noted earlier, that assumption could prove entirely wrong; it was possible that the Phase III controls would in fact serve to limit wage and price advances significantly. In that case, of course, the rate of inflation would be lower than projected.

Mr. Pierce added that the catch-up was assumed to be completed in 1973. For 1974, therefore, the projections were based on an assumption of an essentially normal relationship between unemployment and prices.

Chairman Burns said he would like to pose a hypothetical question in the interest of understanding the workings of the model. He asked what evolving pattern of real output the model

would project if it were assumed that Phase III were suddenly to be succeeded by a "Phase IV" under which the rate of inflation were held to zero.

Mr. Pierce replied that it would be difficult to give a precise answer without running the model through the computer. Moreover, the assumption posited would be quite difficult for any kind of model to handle, partly because the economy had never experienced a period of long-lived effective price controls. However, given that assumption he would expect the model to project much stronger growth in real GNP in the short run, assuming the resources necessary to such an increase were available. That, in fact, had happened when Phase I was introduced in August 1971. The model probably would project that, after capacity was reached, real GNP would expand in line with growth in capacity in the longer run.

The Chairman remarked that his purpose in asking the question was to determine whether the model incorporated a business cycle process under which emerging structural imbalances would eventually lead to a decline in real output. One might expect, for example, that the tapering off in the growth rate that would occur when capacity was reached would result in a decline in the rate of inventory investment. The assumption he had posed was, of course, an implausible one, but he wondered whether the consequence described--of steadily growing real output--was not also implausible.

Mr. Pierce observed that the model did, in fact, incorporate a business cycle process; provision was included for relationships between the rate of growth in real output on the one hand and both the rate of inventory accumulation and the level of business fixed investment on the other hand. Indeed, the decline in the rate of growth in the second half of 1974 that had actually been projected by the model was attributable to an inventory cycle. However, such cycles were projected in an environment in which wages, prices, and output were all varying simultaneously, and the world would be very different if prices were suddenly fixed. For one thing, an end to inflation presumably would result in the disappearance of the inflationary premiums now incorporated in interest rates, and the level of rates would decline sharply. That in itself would provide a tremendous stimulus to investment.

In response to a question, Mr. Enzler said that if the model were run mechanically assuming a zero rate of inflation but no changes in other assumptions, including that regarding growth in the money stock, he would expect it to project a sharp decline in unemployment to the zero level and rapid--indeed, explosive--increases in output.

Mr. Partee remarked that if, in fact, the rate of increase in prices were to fall to zero other changes would no doubt

follow, including a slowing of the rate of advance in wages and a shift in monetary policy to lower target growth rates for the monetary aggregates. If assumptions regarding such associated developments were also incorporated into the model, he thought it would not yield the kind of explosive results that had been suggested.

Mr. Eastburn noted that the staff at his Bank had used the Board's model to make calculations similar to those described today, but they had obtained somewhat different results. For example, his staff had found that the M_1 growth rate would have to be reduced to 3-1/2 per cent, rather than to 4 per cent, to produce a decline in real GNP by the fourth quarter of 1974. Also, their results suggested that the lag in the effect of monetary restraint on prices was even longer than today's presentation indicated.

In reply, Mr. Pierce observed that the version of the model with which the Philadelphia Bank staff had been working did not include a judgmental modification made at the Board at a late stage in the analysis. That modification consisted of removing the assumption that wage increases in 1974 would still include some element of catch-up.

In reply to a question by Mr. Mitchell, Mr. Enzler said that, while no single "estimation period" had been used in

developing the equations of the model, most of the equations had been developed from data for the period from 1954 through 1968 or 1969.

Mr. Mitchell then observed that the timing and amplitude of responses in the financial sector would differ from those projected if banks and other financial institutions adopted modes of behavior different from those prevailing in the estimation period. Perhaps policy measures that would induce desirable changes in behavior could be suggested.

Mr. Hayes said it was his impression that the recent peak rate of increase in the consumer price index had been a bit higher than that of the fixed-weight GNP deflator. Moreover, it was the CPI, rather than the deflator, that tended to be cited in wage negotiations. He asked whether the staff had made any estimates of changes in the CPI over the projection period.

Mr. Partee replied that such estimates had not been made. However, by considering the projections for the components of gross private product which were also included in the CPI--consumer foods, other consumer goods, and consumer services, as shown in the middle bank of Table 4--one could make a rather good approximation; the only important CPI components not covered would be the price index for housing, which was based in the CPI on mortgage

costs and new house prices, and the index for used cars. As indicated in the table, it was expected that the rate of increase of prices of consumer foods would slacken after a sharp first-quarter increase; that of other consumer goods would rise from quarter to quarter; and that of consumer services would pick up gradually. He might note that current press reports of sizable rent increases, if correct, would produce a gradual rather than abrupt advance in the index for consumer services; under the measurement procedures employed, rents were included in the CPI in the form of a 6-month moving average. Taking the three components together, the projections would suggest that the rate of increase in consumer prices in the last three quarters of 1973 would remain substantial, but that it would be below the very high rate produced in the first quarter by the sharp advance in food prices.

Mr. Black remarked that on examining the Board staff's projections he had the same feeling of discouragement as he had had in reviewing similar projections prepared at the Richmond Bank; none of the alternative policy courses described seemed to yield a reasonable outcome. That raised the question in his mind of whether it would be appropriate to revise upward the level of unemployment aimed at as corresponding to "full" employment.

In reply, Mr. Partee observed that the target for the unemployment rate referred to in the Annual Report of the Council of Economic Advisers already seemed to have been increased from 4 to 4-1/2 per cent. As indicated in Table 8, however, the lowest unemployment rate projected under either the B or C policy alternatives was 4.7 per cent--the level indicated for the fourth quarter of 1973 under B. It should be noted that, according to the projections, even a 5 per cent unemployment rate would be associated with considerable continuing inflation in the short run.

In response to a further question by Mr. Black, Mr. Partee expressed the view that a sharp increase in the unemployment rate had to be avoided, since it would certainly be considered to be socially unacceptable. Perhaps a gradual updrift in the rate over a period of time would be acceptable. The problem obviously was a very sensitive one.

Mr. Hayes asked whether there was reason to expect that progress might be made during the next few years in attacking the problem of structural employment.

Mr. Partee remarked that businesses faced with labor shortages often hired unqualified workers and trained them for the jobs available. However, he was not aware of any plans for

large-scale public programs in the manpower training area. It was his impression that costly programs undertaken in the past had not been successful.

Chairman Burns agreed that the results of past manpower training efforts had been disappointing. To his knowledge the only possibilities under consideration at present were programs of the same type, but perhaps conducted in a more efficient way.

Mr. Brimmer noted that he had looked into the recent history and prospects for Federal manpower training programs in connection with a lecture he had given at UCLA in early March. As he had noted in his lecture, those programs were currently being reassessed, and some might be transferred to State and local governments. Following his address he had received a rather large number of comments from interested people. He might note in particular that officials of such organizations as the National Alliance of Businessmen and the National Urban Coalition were apprehensive about possible deterioration in programs that were transferred to local governments. For the most part, the latter could be expected to have less capacity than the Federal Government for directing manpower programs.

Mr. Balles remarked that the projections yielded by all econometric models were, of course, subject to error, and the track record of any particular model obviously was relevant in

deciding how much confidence to place in the projections it yielded. He asked how accurate the Board's model had proved to be in the recent past.

Mr. Partee said he might first give his general impressions on that point and then ask Mr. Pierce to make supplementary comments. He believed that the kind of mistake the model had made most often in the last few years was to underestimate the magnitude of the price advance that would be associated with any specific unemployment rate. About a year ago the staff had made a special adjustment in the model's structure, the effect of which was to yield a prediction of a higher rate of price advance relative to the level of unemployment. Subsequently, the model had performed rather well in the price area--but probably only because of special factors applying to the recent period. Because the latest projections extended so far into the future--through the end of 1974--the staff had moved the relationship in question back toward that which had been incorporated in the basic model before the special adjustment. Of course, that increased the chances that the model would again underestimate the rate of inflation.

Mr. Pierce agreed that the kind of error Mr. Partee had described had been the most common in recent years. With respect to the ability of the model to project business cycle developments, a run made in June 1969 had predicted the 1970 recession with a fair degree of accuracy.

Chairman Burns noted that he had not been with the Federal Reserve System in 1969. He asked whether the projection of a 1970 recession had been presented to the Committee, and if so, what the reaction had been.

Mr. Partee replied that while the model's projection had been mentioned, the staff's analysis in 1969--as now--was organized around judgmental projections. He believed, however, that the judgmental projections presented to the Committee in both June and November 1969, like those of the model, portrayed a significantly weakening economy, with real GNP growth minimal and the unemployment rate rising markedly. As he recalled the members' reactions, they recognized that there was a risk of inducing an economic slowdown but considered it necessary to incur that risk in order to curb an accelerating rate of inflation. He added that many of those present today had been Committee members in 1969, and their recollections of the Committee's view at that time might be different.

Mr. Hayes observed that his recollection was similar to Mr. Partee's.

Mr. Brimmer said he was sure the record would support the statement that the staff's projections during 1969 had indicated considerable weakness in the economy. As to the Committee's views, he recalled that some members had taken positions along the lines described by Mr. Partee in public speeches during that year.

Mr. Partee said it was perhaps worth emphasizing that the projections to which Mr. Brimmer had referred were of the judgmental type, and that the staff had not yet made that type of projection for 1974. The 1974 projections presented today were those produced by the model, tied on to the judgmental projections for 1973. In his opinion the model's projections were not implausible, and they served a useful purpose in facilitating Committee discussion of the longer-run implications of alternative monetary policies. It should be borne in mind, however, that when judgmental projections for 1974 were developed they undoubtedly would differ in many details from those of the model.

Mr. Morris reported that his staff also had made projections through 1974 on the basis of three alternative assumptions regarding the M_1 growth rate, using the econometric model of Data Resources Incorporated. Although the M_1 growth rates assumed--4, 5, and 6 per cent--were slightly different from those used by the Board's staff, the projections of GNP growth and unemployment had the same general configuration. The performance of prices projected by the DRI model was somewhat more favorable. On the whole, however, he had found the DRI projections nearly as disturbing as those presented today.

Mr. Brimmer observed that he had been receiving comments lately from officials of savings and loan associations and savings banks, as well as commercial banks, about the possibility of

sizable attrition in their deposits during the interest and dividend crediting period around the first of April. He asked Mr. Axilrod to amplify his comment that the alternative B course would place policy at the margin where an increase in the Regulation Q ceilings on consumer-type deposits could be required.

In reply, Mr. Axilrod said he considered plausible the financial flows projected in connection with the 5-1/2 per cent rate of growth in M_1 called for under alternative B. Given such flows, financial markets might operate rather smoothly. The bill rate, which was about 6.35 per cent today, might rise only to about 6.50 per cent or a little higher as the year progressed. In such a situation, the policy decision with respect to a possible rise in the Q ceilings on consumer-type deposits could go either way. If market interest rates behaved in the expected manner, savings inflows would probably drop off somewhat in the second quarter; the rates of increase in consumer-type deposits shown for the first half of 1973 in Table 7 were based on projected rates for the first and second quarters, respectively, of 9-1/2 and 7 per cent for banks and 12 and 9 per cent for nonbanks, assuming no increase in Q ceilings. Such projections might, of course, be optimistic. He should also note that the projections were particularly uncertain because of the recent growth in long-term time certificates, which now

accounted for about half of all deposits at savings and loan associations. Although it appeared that most such certificates were issued for two-year periods, figures were lacking on the distribution of original maturities and on the volume maturing each month. Moreover, there was no record of experience to suggest how the holders of such certificates might respond when market rates rose significantly above the 6 per cent rate now paid on them.

Chairman Burns asked whether Mr. Axilrod would recommend an increase in the Regulation Q ceilings at this time.

Mr. Axilrod said he would not. In his judgment, present ceilings would be providing a desirable degree of restraint on residential construction activity, and--as indicated in the staff's projections--that was the only sector in which any significant offset to the sharp expansion in business fixed investment was expected. If, however, the bill rate rose to the neighborhood of 7 per cent, retention of the present ceilings would create a real risk of a precipitate decline in mortgage commitments by savings and loan associations and an overreaction in the mortgage market--in other words, a risk of too much restraint. Under such circumstances an increase in the ceilings would clearly be desirable.

Mr. Brimmer referred to the staff projections showing declines in residential construction outlays over coming quarters and remarked that that prospect was the very one about which the people with whom he had talked recently had been complaining. They argued that unless the Q ceilings were raised to avoid attrition in savings flows, the housing industry would again carry the main burden of reduced spending on real resources that was required in the economy as a whole. While he recognized that value judgments were involved, he wondered whether it might not be desirable to have that burden shared by other economic sectors.

In reply, Mr. Axilrod said there was no question in his mind that it would be desirable to achieve some restraint in the business investment area as well as in housing. He might note, however, that the current level of residential construction was very high, and that even after cutbacks of the dimensions projected, housing starts would be at an annual rate of 1.9 million units in the fourth quarter of 1973. Obviously, the contemplated degree of restraint on the housing industry would not create a situation as burdensome and difficult as existed in, say, 1966. Secondly, housing activity tended to respond more rapidly to rising interest rates than did business fixed investment.

Consequently, an effort to spread part of the burden of restraint to the latter sector by raising Q ceilings probably would result in at least a marginally higher general level of interest rates.

Mr. Partee said it should be noted that not all of the projected decline in residential construction was attributable to an expectation of reduced inflows to savings institutions. A good part of the projected decline in the rate of housing starts--from 2.4 million units in the fourth quarter of 1972 to 1.9 million in the fourth quarter of 1973--reflected the staff's view that housing activity had recently been at an unsustainable level, that completions would be increasing rapidly relative to starts over the coming year, and that there would be clear indications by the latter part of the year of overbuilding in many communities. In short, it was expected that housing activity would tend to come down of its own accord. If inflows to savings and loan associations and other specialized mortgage lenders happened to slow moderately at the same time, little or no imbalance would be created. If inflows slowed sharply, however, many associations might suddenly stop making new mortgage commitments, just as they had done in the spring of 1966. He thought it would be important to raise the Q ceilings at the first signs that that type of reaction was in process of developing.

Mr. Sheehan remarked that the projected annual rate of 1.9 million housing starts, when added to mobile home production

at a rate of about 600,000 units, yielded a figure about 75 per cent above the corresponding yearly average figure in the decade of the 1960's.

Mr. Axilrod observed that, while he did not favor an increase in the Q ceilings now, he considered the situation a delicate one that should be watched closely even under the alternative B approach to policy. Mortgage commitments outstanding at savings and loan associations had risen markedly in recent years; in the fourth quarter of 1972, for example, they averaged $18.2 billion, compared with $12.8 billion a year earlier and $5.6 billion in 1969. Federal agencies stood ready to offer support to the mortgage market in the event of a sharp drop in savings inflows. However, if savings and loan associations were forced to increase borrowings from the Home Loan Banks substantially and to reduce liquid assets, they would begin to feel quite illiquid and probably would alter their commitment policies significantly. Under such circumstances, there might well be a sharp decline in new commitments in a short period, which could take on the dimensions of a crunch in the housing market.

Chairman Burns remarked that the staff's comments on the implications of the projected decline in housing starts from 2.4 to 1.9 million units appeared to be addressed to the question of the adequacy of the housing supply to meet the needs of the population. He agreed that the supply of housing would remain

ample even with a considerable reduction in starts from the recent high level. It should be recognized, however, that a reduction of the size projected would imply a serious depression in the residential construction industry. That would be a matter of concern not only to Congress but also to the Administration, and it was quite likely that new subsidy programs would be devised and existing programs expanded.

Mr. Axilrod observed that if it were not feasible to achieve the degree of restraint in housing activity suggested by the projections, the magnitude of the Committee's problem in attaining the desired over-all restraint would be considerably increased, and he doubted that the restraint could be achieved without higher interest rates than were being projected.

Mr. Kimbrel commented that the relations prevailing recently among different types of interest rates had led to some rather unusual types of transactions. For example, it was reported that some corporations in his District were borrowing from banks at the prime rate and using the funds to buy CD's from other banks. Such transactions evidently were profitable so long as the compensating balance required by the lending bank did not exceed 12 per cent--and some banks were requiring no compensating balances at all. It appeared that such arbitrage operations accounted for a good deal of the recent increase in bank loans

in the Sixth District. He might also note that New York agencies of foreign banks were making active inquiries in the District about the possible availability of funds that they could relend in the Euro-dollar market. To his knowledge no such transactions had as yet been consummated, but the inquiries were continuing.

Mr. Winn remarked that in view of the need for economic restraint he was disturbed by the tendency for automobile lenders to lengthen maturities at a time when sales were booming. As to the economic outlook, he noted that Mr. Partee had mentioned three possible sources of developments that could undermine the current prosperity--the rate of inflation, the international financial crisis, and the declining stock market. With respect to the stock market, he wondered whether there wasn't a more serious institutional problem than generally realized; the securities industry appeared to be critically ill. He asked how the projections might be modified if some major firms in the industry were to collapse.

Mr. Partee replied that a collapse of importance in any sector of the financial industry would no doubt have a very adverse affect on psychology. He did not believe, however, that he would be prepared to predict such an event within the period covered by the projections. With respect specifically to brokerage firms, he was not aware that any large firms were in truly serious

difficulties at the moment. He was aware that most such firms were not making money and might be losing money. However, their capital positions--which were watched closely by the Government officials with responsibilities in that area--had improved significantly in the last 2 or 3 years, so that they should be able to weather some losses. In addition, as the members might recall, the Securities and Exchange Commission introduced a requirement in mid-January that in effect prohibited a brokerage firm from financing speculative inventory positions with customers' money. Insofar as that requirement affected the behavior of firms in financial difficulty, it should help considerably. Finally, he might mention the Securities Investor Protection Corporation, of which he happened to be a director. While the existence of the Corporation would not prevent a brokerage firm from undergoing liquidation, it should serve to reduce the apprehension of brokers' customers about possible losses as a result of such liquidations. The Corporation had accumulated some $60 million in assets through its earnings to date. In addition, it had established lines of credit at major banks and it also had authority to borrow up to $1 billion directly from the Treasury. Thus, the resources available to it were considerable.

Mr. Hayes said there were increasing signs that the economy was beginning to come under strain, including the

shortages of skilled labor that were appearing and the rise in the number of overtime hours in manufacturing to the highest level in more than 6 years. Those strains, and the associated inflationary pressures, were the major economic problem at present. In his judgment, the amount of "headroom" available was much less than the over-all unemployment rate might indicate because of the distribution of unemployment.

Mr. Hayes added that he was extremely discouraged about the outlook for prices. Even in the area of food prices, where some observers believed there were grounds for expecting a turnaround, he thought one could not confidently predict a significant improvement in the next few months in view of the many uncertainties in the world supply and demand situation. The recent explosive price advances were likely to have an undesirable impact on the outcome of this year's major wage negotiations, and it was obvious that the food price situation by itself had already worsened inflationary expectations. He confessed that there was a great deal of gloom in his mind with respect to the major economic problem facing the country at the moment.

Chairman Burns then suggested that the Committee turn to the question of the appropriate targets for growth rates in the several monetary aggregates, particularly M_1, over the

longer run--that is, the coming 6 months. As the members would recall, at its December meeting the Committee had modified its longer-run target for M_1 from the 6 per cent rate previously in effect to a range of 5 to 6 per cent, which might be taken to correspond to a point-target of 5-1/2 per cent. The question now was whether to retain the 5 to 6 per cent range or to adopt some different target.

Mr. Mayo noted that Table 8 reflected the staff's best judgment about the existing trade-offs between GNP growth and unemployment rates on the one hand and rates of price advance on the other. Questions might, of course, be raised about various specific figures in the table. However, if the results shown for the three alternative policy courses were in the right general neighborhood, they lent support to Mr. Partee's view that the middle course, calling for a 5-1/2 per cent growth rate in M_1, came closest to meeting the Committee's objectives. While the table reflected the consequences of particular M_1 growth rates through the end of 1974, he saw no basis for distinguishing between the rates desirable for that period and for the next 6 months. Accordingly, he would favor retaining the present 5-1/2 per cent target for the latter period.

Mr. Francis said he thought the target rate for M_1 growth over the next 6 months should certainly be no higher than 5-1/2 per cent. Personally, he would prefer a target of 5 per cent.

Mr. Hayes remarked that, in view of the probable trend in velocity during an expansion like the present one and considering the relative risks on the sides of inflation and recession, he also would favor a longer-run target of 5 per cent.

Mr. Brimmer noted that over the 3- and 6-month periods ending in February M_1 had grown at annual rates of 6.3 and 6.5 per cent. Those rates were in excess of the Committee's recent longer-run targets for M_1. In his judgment, the chances of actually achieving M_1 growth over the next 6 months at a rate in the 5 to 6 per cent range now targeted would be enhanced if the Committee set a lower target. He favored a range of 4-1/2 to 5-1/2 per cent.

Mr. Kimbrel agreed with Mr. Brimmer that the recent pattern of misses argued for reducing the M_1 target. He favored a 5 to 5-1/2 per cent range.

Mr. Mayo expressed the view that a record of misses should lead the Committee not to change its target but to attempt to improve its aim.

Mr. Eastburn said he thought it would be desirable to shade the M_1 target down somewhat. However, he was becoming concerned about the risks of fine-tuning, with respect to both the Regulation Q ceilings and the aggregates, in a period that would be marked by a great many uncertainties. The Committee

would need to remain highly alert to developments, and it should proceed with considerable caution in its efforts to restrain monetary growth.

Mr. Balles observed that econometric projections made at his Bank had led to a conclusion similar to one reached by the Board's staff--namely, that a reduction in the growth rate of M_1 to 4 per cent would probably result in a recession by the end of 1974. It was clear in his own mind that the Committee should not seek a 4 per cent growth rate. However, he would favor aiming--over the next 3 or 4 months, at least--for a rate of growth closer to 5 than to 6 per cent, for some of the reasons already mentioned and also to compensate for what hindsight suggested had been too rapid a rate of growth in M_1 over the past 6 months.

Mr. Robertson concurred in Mr. Balles' statement.

Mr. Black expressed a preference for retaining the 5 to 6 per cent target range.

Chairman Burns then called for informal expressions of preference among the following possible longer-run targets for M_1: 5 to 6, 5 to 5-1/2, and 5 per cent. The number favoring the 5 to 5-1/2 per cent range was larger than that for either of the alternatives.

Mr. Holland noted that the staff would prepare estimates for the Committee's consideration tomorrow of the longer-run growth rates for the other monetary aggregates, and also the short-run operating constraints, that would be consistent with a longer-run target of 5 to 5-1/2 per cent for M_1.

Mr. Partee said he might report certain information that had just been received concerning the Commerce Department's first unpublished and confidential estimates of GNP in the first quarter of 1973. The figures were quite close to the Board's projections in every major respect except one. Whereas the Board staff had projected the first-quarter increase in the fixed-weight deflator at 5.1 per cent, the preliminary estimate of the Commerce Department was for a rise of 5.9 per cent.

Thereupon the meeting recessed until 9:30 a.m. the following morning, Tuesday, March 20, 1973. The attendance was the same as on Monday afternoon except that Messrs. Melnicoff, Zeisel, Kichline, and Enzler were not present and the following persons were present:

Mr. Reynolds, Associate Director, Division of International Finance, Board of Governors

Mrs. Sherman, Secretary, Office of the Secretary, Board of Governors

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, 1974, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, as the case might be, they would cease to have any official connection with the Federal Open Market Committee:

Arthur F. Burns	Chairman
Alfred Hayes	Vice Chairman
Robert C. Holland	Secretary
Arthur L. Broida	Deputy Secretary
Murray Altmann and Normand R.V. Bernard	Assistant Secretaries
Howard H. Hackley	General Counsel
Thomas J. O'Connell	Assistant General Counsel
J. Charles Partee	Senior Economist
Stephen H. Axilrod	Economist (Domestic Finance)
Robert Solomon[1/]	Economist (International Finance)
Leonall C. Andersen, Ralph C. Bryant, Robert W. Eisenmenger, George Garvy, Lyle E. Gramley, A. B. Hersey, John E. Reynolds, Karl A. Scheld, and Kent O. Sims	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, 1974.

1/ On leave of absence.

Chairman Burns noted that Committee members had received a memorandum from the Secretary dated March 12, 1973, and entitled "Recommendation that Committee establish positions of Deputy Manager and Deputy Special Manager."[1] He asked Mr. Holland to comment.

Mr. Holland noted that, as indicated in the memorandum, the Manager and Special Manager were sometimes absent from the New York Bank, or were unable to attend meetings of the Committee, because their duties so required or because of vacation or illness, and that Vice Presidents Peter D. Sternlight and David E. Bodner had been substituting for them on such occasions. The staff recommended that the Committee amend its Rules of Organization to provide for Deputies, in order to make explicit the authority of such associates to direct operations at the Desk and to report to the Committee in the absence of the Manager and Special Manager.

By unanimous vote, Section 5 of the Committee's Rules of Organization was amended to read as follows:

Manager, Special Manager, and Deputies

The Committee selects a Manager of the System Open Market Account and a Special Manager for Foreign Currency Operations for such Account, and it may also select a Deputy Manager and a Deputy Special Manager for foreign currency operations. All of the foregoing shall be satisfactory to the Federal Reserve Bank selected by

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

the Committee to execute open market transactions for such Account, and all shall serve at the pleasure of the Committee. The Manager and Special Manager, or their Deputies, keep the Committee informed on market conditions and on transactions they have made and render such reports as the Committee may specify.

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

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

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee on January 16, 1973, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee on January 16, 1973, was accepted.

Chairman Burns noted that the Federal Reserve System--through Messrs. Daane, Bryant, Coombs, and himself--had been actively involved in the conversations and the meetings abroad that had taken place in an effort to resolve the international monetary disturbance that had erupted in late February. Two formal meetings of the finance ministers and central bank governors of 14 countries had been held in Paris: one on Friday, March 9, and another on Friday, March 16. In the intervening week, the nine members of the European Community had met and formulated certain positions. He would attempt to provide the Committee with his general impressions of developments during the period of consultations and then would comment on the major conclusions that had emerged.

Concerning his impressions, Chairman Burns observed first that a dramatic change in attitudes about the exchange rate system had occurred quite recently. A year or two ago businessmen, commercial bankers, and central bankers generally were distrustful of floating exchange rates. Now, however, it seemed that floating exchange rates were widely accepted, and a number of central bankers had come to like, rather than merely to tolerate, floating rates.

Despite that dramatic change in attitudes, the Chairman continued, many people still believed that it would be highly

desirable to reestablish the par value system. However, that would not be easy to do; only a vestige of the system remained, and it might not last much longer. The Japanese situation illustrated the point. When Japan decided to float the yen on February 12, it was expected that a new parity would be established once the political issues surrounding the new Japanese budget were resolved. Now that the European currencies were floating, however, the Japanese would have difficulty in deciding what they should peg the yen to.

Another impression, the Chairman said, was that European businessmen and economists were more concerned than their American counterparts about the possible effects of the monetary disturbance on economic activity. Many of the Europeans felt that the dollar now was undervalued, that its undervaluation would tend to depress business activity in their own countries, and that at some time within the next few years their currencies would need to depreciate.

At the Paris meetings, Chairman Burns remarked, the European representatives apparently felt a sense of relief when they discovered that the United States was willing to cooperate in maintaining some degree of monetary order. The U.S. display of a willingness to cooperate--and even a willingness to lead in efforts to reform the international monetary system--was probably the most important development at the meetings.

With respect to the results of the meetings, Chairman Burns continued, six of the members of the European Community--France, Germany, the Netherlands, Belgium, Luxemburg, and Denmark--agreed to respect existing parities among their currencies, apart from an upward revaluation of the German mark by 3 per cent. Expectations in the exchange market of an upward revaluation of the Netherlands guilder and the Belgian franc along with the mark had been disappointed, but apparently such expectations persisted. The six countries agreed to maintain their exchange rates within bands of 2-1/4 per cent, intervening in their exchange markets to the extent necessary toward that end. Norway and Sweden then associated themselves with that arrangement, and discussions were proceeding with a few other countries that might eventually join. In effect, the group formed a nucleus for a reconstruction of the par value system.

The Chairman noted that the remaining three members of the European Community--the United Kingdom, Italy, and Ireland--decided to float independently for the time being. Although they indicated their intention to join the other six as soon as they reasonably could, the circumstances in which they might do so were unclear. Earlier, the British had laid down terms for participating in the joint float that had little chance of being accepted by the six countries on a strictly financial basis.

The Chairman said he would comment on those passages in the communique issued after the March 16 meeting[1/] that affected the United States most directly. The most critical passage stated that the participating countries "agreed in principle that official intervention in exchange markets may be useful at appropriate times to facilitate the maintenance of orderly conditions, keeping in mind also the desirability of encouraging reflows of speculative movements of funds." The market conditions that would lead to official intervention were not specified but rather were left to the individual central banks to determine. The U.S. representatives made it absolutely clear at the meeting that this country would intervene after consultation with the other country involved--consultations which could be initiated by either party--only if the United States decided that intervention at the particular time would be desirable in an effort to maintain orderly markets. The United States alone would decide on the scale of any intervention that it undertook. It was understood that the United States would intervene only in the New York market and the other countries would intervene only in their own exchange markets. Moreover, it was understood that the other countries would intervene to sell dollars whenever the price of

1/ The press communique is appended to this memorandum as Attachment B.

their own currency fell to the low end of the 4-1/2 per cent band around the official par values; in the case of at least one country, intervention would commence at a point a little higher in the band. Intervention in those circumstances would facilitate a return flow of dollars--should a demand for dollars develop--and would limit any depreciation of those currencies against the dollar. There were no other understandings about the rates at which intervention would be undertaken.

Chairman Burns said no agreements had yet been worked out as to how the exchange risks attendant upon any intervention by the United States would be handled. However, the United States had made unequivocally clear that it was prepared to assume an exchange risk only in the event of a future devaluation of the dollar; that was a proper and defensible degree of risk to assume. Having wanted that kind of agreement, he had accepted it in principle when it had been proposed to him by an official of one major central bank, but since there were no formal agreements as yet there was an opportunity for second thoughts. However, the Europeans were so delighted to have U.S. participation in these arrangements that they might well go along with the U.S. position. The risks seemed small on both sides: another devaluation of the dollar was unlikely; at the same time, the Europeans felt that their currencies would not be revalued further against the dollar--that current exchange rates were viable.

The communique also stated, the Chairman noted, that enlargement of some existing swap facilities was envisaged in order to ensure that resources for intervention would be fully adequate. Although that was not a flat assertion that the U.S. swap network would be enlarged, it was fair to say that the U.S. representatives had indicated a willingness to do that and had agreed to inclusion of the statement in the communique in the interest of strengthening confidence in fairly orderly exchange markets. No commitments had been made with respect to the amount of increase in the over-all network or in individual swap lines; on the contrary, U.S. representatives had endorsed no particular formula and had held all options open.

Chairman Burns observed that the communique contained a few other specific references to the United States. One stated that "U.S. authorities are also reviewing actions that may be appropriate to remove inhibitions on the inflow of capital into the United States." In fact, two proposals that had been advanced by Congressman Wilbur Mills were receiving special attention. One, as originally formulated by Congressman Mills, would suspend the withholding tax on payment of interest and dividends to foreigners. In the interest of attracting permanent rather than short-term capital, however, it would be preferable to eliminate the withholding tax altogether. The second proposal would alter

the estate tax so as to lighten its burden on foreigners and thereby remove another obstacle to foreign long-term investment in the United States.

Finally, the communique noted that the United States would "review possible action to encourage a flow of Euro-currency funds to the United States as market conditions permit." That was a reference to the reserve requirements on Euro-dollar borrowings of U.S. commercial banks. At present, as the members knew, the requirement was 20 per cent on borrowings above the reserve free base, and the Board had published for comment a plan to lower the requirement to 10 per cent, but obviously no commitment was made other than for a review. Meanwhile, the ministers and governors of the European countries indicated their willingness to reduce their own central bank deposits in the Euro-dollar market.

Chairman Burns commented that participants in the meetings had discussed the problem of reform of the international monetary system at length, and the U.S. representatives had worked hard to interest others in speeding up the process of designing a new system. At the moment there was considerable interest in greater speed, but how long it would last was uncertain. In his view, progress had been impeded by misunderstandings of the U.S. plan. The French, for example, had been opposed to early reform of the

system on the grounds that a new structure could not be put in place so long as the U.S. balance of payments remained in large deficit. However, the French apparently had not realized that the U.S. plan called for agreement on certain principles, for only partial implementation of the plan at the start, and for special treatment of those countries--including the United States--that had special problems with respect to the size of their reserves. Now that the French understood that the plan was intended to go into full operation only for some countries at the start, there was a chance that they would look with greater favor on more urgent conversations leading to lasting reform.

In conclusion, Chairman Burns said he might mention that in a private conversation the Japanese Finance Minister had indicated that Japan would not be willing to make any significant concessions on trade. That was a forthright statement, indicating clearly that the Japanese intended to be tough in their bargaining--just as the United States intended to be. Although no substantive progress had been made in the conversation, he thought a foundation of understanding had been laid that might lead to real accomplishments in the near future.

Chairman Burns then invited Mr. Daane to add his observations on the meetings in Paris.

Mr. Daane remarked that he could add little to the Chairman's excellent summary of the meetings. In comparison with other international conferences provoked by the several monetary disturbances over the years since the autumn of 1960, the Paris meetings were notable for the absence of tensions and antagonisms. In large measure, the better atmosphere on this occasion was due to the willingness of the United States to indicate that it would consider intervention in the foreign exchange market--on the terms the Chairman had outlined--if that appeared appropriate. Also, the Europeans--having been apprehensive that the United States intended to dismantle its capital controls abruptly--were reassured by the Chairman and Secretary Shultz that the controls would be dismantled responsibly, with full consideration given to market developments and to the U.S. balance of payments, and that reassurance was reflected in the communique.

Continuing, Mr. Daane observed that U.S. leadership at the meetings had provided a renewed sense of urgency about reforming the international monetary system. The C-20 Deputies were scheduled to meet in Washington on March 22-23, and the finance ministers and governors on March 26-27. In light of recent developments, the agenda for the Deputies meeting had been changed; instead of the link between SDR creation and

development aid, more immediate problems--such as capital movements and possible consolidation of official holdings of reserve currencies--would be discussed. Undoubtedly the Deputies would be focusing on the implications of recent developments for their work on reform, both procedurally and substantively.

Chairman Burns agreed that the atmosphere in Paris had been generally harmonious, particularly at the March 16 meeting. The sense of harmony was not as strong on March 9, when neither the U.S. nor the European delegations fully disclosed their expectations and plans. He might note that the essentials of the final agreement were worked out among the major countries involved in the period between the two meetings. It seemed likely that the Committee of 20 would have to employ a similar procedure if agreement was to be reached on international monetary reform.

The Chairman then asked Mr. Bryant for his views of the longer-run implications of the Paris meetings and other recent events.

Mr. Bryant remarked that he hoped to be able to make a more considered presentation at the next meeting of the Committee and that he would therefore make only a few comments at this time. First, the major countries had chosen to allow their exchange rates against the dollar to float for the time being

for three principal reasons: they felt a need to make life more difficult for speculators; they had to protect their economies from liquidity flooding in through the balance of payments; and a majority doubted that, in the present circumstances, they could maintain the parities established on February 12 or any other parities. The events of February and early March had weakened the credibility of governments. Credibility could have been damaged quite seriously if governments had decided last week to restore parities and intervene heavily in their defense, only to find subsequently--as was quite possible--that the parities had once again to be abandoned.

Looking ahead to the next few months, Mr. Bryant continued, the situation was likely to remain unsettled, exposing the world payments system to the danger of additional restrictions. Restrictive measures were more likely in such an unsettled period than in times when the ground rules of a system were agreed upon and fully understood. Another danger was that the ability of the six European countries to maintain their exchange rates within the agreed band of 2-1/4 per cent might be tested in the next few weeks. Should the agreement break down under pressure, confidence might be affected adversely.

On the other hand, Mr. Bryant said, the dangers of a floating exchange rate system could be exaggerated. It was

certainly possible that the arrangements agreed on in recent days could work rather well. Clearly the situation would have to be very bad to be worse than that of February and early March. Moreover, if it should transpire that the international system should not function very well in the next few months, governments would be under great pressure to develop an alternative and viable set of procedures. Such pressures, on top of the strains of the past two months, would galvanize governments into more intensive efforts to construct an international monetary system that would be desirable for the longer run. Financial markets were sufficiently resilient to provide time for the development of alternative arrangements.

In conclusion, Mr. Bryant commented that it was difficult at this early time to foresee how discussions on reform of the international system might proceed; what the future role of the International Monetary Fund might be; and what might be the future evolution of the balance of payments of the United States and of other countries. He would expect the staff to be presenting views on those subjects at future meetings of the Committee.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions

and on Open Market Account and Treasury operations in foreign currencies for the period February 13 through March 14, 1973, and a supplemental report covering the period March 15 through 19, 1973. Copies of these reports have been placed in the files of the Committee.

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

> Since our last meeting the international financial system has broken down so completely that it is difficult to describe even in general terms what is left of the system and how it may be expected to function in the future. The newspapers tend to give the impression that we have moved into a golden age of floating rates that are going to automatically solve all of our problems for us. But from where I sit, it looks somewhat more complicated.
>
> Formally, we still have the framework of a fixed parity system, involving the dollar, most of the European Continent, Latin America, Africa, and Asia, while Japan, Italy, Switzerland, and Britain have also committed themselves to return to new parities as soon as possible. Timing probably will depend on the trend of trade figures. Within the Common Market, the 2-1/4 per cent band--the so-called snake--continues to function, with intervention to maintain the band going on yesterday and again today. Sweden and Norway have joined, and others may follow.
>
> The big change that has occurred has been the Common Market decision just one week ago to eliminate the 4-1/2 per cent band against the dollar, thereby ending their formal commitment under the Smithsonian Agreement to buy and sell dollars in unlimited amounts at certain fixed ceiling and floor rates. This decision could have opened the way to a world of so-called "clean" floating rates among regional monetary blocs but no major government was prepared to face the risks involved. Consequently, the United States and other G-10 countries agreed in Paris last Friday that they would be prepared

to intervene, when necessary or desirable, to maintain orderly exchange market conditions--using, if necessary, existing or enlarged swap facilities. Meanwhile, the market has been trying to figure out just what this means; for that matter, so am I, together with my counterparts in the European central banks.

While the Paris agreement was in the negotiating stage, there was relatively little scope for technical discussions with the European central banks concerning intervention, and so far, I have had conversations on intervention techniques only with Bundesbank officials. I could, perhaps, summarize their tentative thinking roughly as follows:

(1) The dollar now appears to be clearly undervalued vis-a-vis most of the European currencies, and if the relative rates of inflation here and in Europe remain roughly unchanged, the undervaluation of the dollar will increase still further. This intrinsic strength of the dollar could be magnified many times over, as soon as confidence recovers, by the enormous short position in the dollar.

(2) Nevertheless, the risk of new shocks to confidence, with multinational companies and Middle East central banks still capable of shifting billions of dollars in a matter of hours, would counsel against intervention without limit to defend new ceiling and floor rates against the dollar. However, the Bundesbank will probably establish for internal policy guidance certain unofficial intervention points. In effect, maintaining orderly markets may be defined as cutting down the amplitude of the swings of the rate around parity. If flexibly conducted, such operations designed to herd the market back when it threatens to go too far in one direction or another should not prove unduly expensive.

(3) Over time, the swing of dollar rates need not significantly exceed the 4-1/2 per cent band established under the Smithsonian Agreement and could be substantially less. The Common Market agreement previously prohibiting dollar intervention except at the limits of the 4-1/2 band has now been scrapped, and we may well see European central banks begin to sell dollars as soon as the dollar rises 1 per cent or so above par.

(4) Finally, we should have an excellent opportunity--as soon as trade figures and other real factors justify a recovery of confidence in the dollar--of executing a bear squeeze on short positions in the dollar, which could bring about a massive return flow of dollars to this country and generally rehabilitate the international standing of the dollar.

Mr. Mitchell inquired how the method described by the Chairman for handling exchange risks in future U.S. drawings on the swap lines compared with past practice.

In reply, Mr. Coombs observed that under the revaluation clause of the original swap agreements, the United States was fully covered against any revaluation by a country to which it was indebted. When the German and Belgium swap lines were reactivated last July the central banks of those countries took the position that an upward revaluation of a group of currencies would be the practical equivalent of devaluation of the dollar, and it was agreed that the revaluation clause should apply only if their currency was revalued in isolation among the G-10 currencies. The arrangement described by the Chairman would represent a reversion to the practice under the original revaluation clause.

Mr. Hayes asked how the exchange risk might be handled if, during the period of floating exchange rates, the European currencies floated up against the dollar while drawings were outstanding. With the group of European currencies floating, it was difficult to determine what constituted equity in the

distribution of risk. Also, he wondered whether the Europeans were likely to accept the terms of the revaluation clause that the Chairman had described.

Chairman Burns replied that the exchange risk in the circumstances described by Mr. Hayes would not be borne by the United States; the United States would bear an exchange risk only in the event of some future devaluation of the dollar. As he had said before, that kind of arrangement--which had already been agreed upon within the U.S. delegation--was proposed to him by an official of a major European central bank. That official might have second thoughts about such an arrangement, but that was not likely for two major reasons: the Europeans were eager to have U.S. intervention in the market, and they did not expect further upward revaluations of their currencies any more than the United States expected a further devaluation of the dollar.

Mr. Mitchell asked about the rates at which swap drawings might be made in the current circumstances and with the kind of exchange rate guarantee that the Chairman had indicated.

Mr. Coombs replied that, as in the past, drawings would be made at prevailing market rates. Within the exchange rate margins that had prevailed before rates were allowed to float, relatively minor profits and losses had been made on repayment of the drawings. With European exchange rates floating, swings

in rates against the dollar were potentially larger than before. In his opinion, however, the dollar was now undervalued, providing greater scope for maneuver in the market; and in general, the risks involved in central bank intervention in the market were considerably diminished. In fact, the odds in favor of profits rather than losses had been lengthened. If speculative or other forces pushed up the German mark rate, for example, intervention could be delayed until the market thinned out and such intervention would be likely to drive the rate down.

In reply to a question by Mr. Brimmer, Chairman Burns observed that Mr. Coombs would be presenting a recommendation concerning a possible expansion of the System's swap network at a later point in the meeting.

Mr. Brimmer then asked how close consultation on intervention--as called for in the Paris communique--might be conducted with the six European countries participating in the joint float. Also, he wondered whether intervention by the United States would be wholly for the account of the System or whether the Treasury would be involved.

Chairman Burns noted that the communique said market intervention would be carried out "in close consultation with the authorities of the nation whose currency may be bought or

sold." Thus, it would be necessary to consult with only one country at a time, although there might be occasions when it would be desirable to broaden the consultations. If, after consultation, the United States should buy or sell the currency of one of the six countries participating in the joint float, that country might wish to consult with the other five. Concerning the Treasury's role in intervention, nothing had yet been decided. It was conceivable, although unlikely, that intervention would be conducted entirely by the Treasury through the Exchange Stabilization Fund.

Mr. Coombs remarked that when large-scale swap arrangements were involved, central banks generally preferred to deal with other central banks rather than with treasuries.

Mr. Brimmer commented that he was concerned that some of the remarks about intervention seemed to reflect attitudes and to assume operating techniques that were more appropriate to the old system of fixed rates than to the new system of considerable flexibility of rates, which he thought was a good system.

In response, Mr. Coombs said the new system might differ from the old both in form and substance. There was a widespread view that current exchange rates were realistic, apart perhaps from some undervaluation of the dollar. While he would not say

that any particular rate could be defended at some precise level, rates that did not stray too far from current levels seemed to be generally regarded by European finance ministries and central banks as appropriate to international trade. Divergent trends in rates of inflation from country to country could, of course, change the story. But nothing would be gained from sharp short-run fluctuations in response, say, to the desire of some large corporation to move funds from one country to another. For example, the recent large swings in sterling had not been beneficial. The objective of intervention would be to limit the amplitude of fluctuations in rates.

Mr. Brimmer remarked that his basic concern was about the extent to which public funds should be used to facilitate the transfer of funds by private parties.

Mr. Coombs commented that he was concerned primarily about the impact of large fluctuations in exchange rates on the cost of imports to consumers and on competitive positions of industries and firms. He believed a reasonable degree of stability in rates was necessary in the short run, whatever the degree of flexibility over the longer run.

Chairman Burns observed that the participants in the Paris meetings generally felt, as Mr. Coombs had said, that the

existing pattern of exchange rates was more or less viable. However, there were exceptions. The Swiss did not think that the current rate for the franc was sustainable, and there was some market uncertainty about the Dutch guilder and the Belgian franc because of the failure of those currencies to be revalued upward along with the German mark. Moreover, judgments could change with time. The pattern of rates agreed upon at the Smithsonian meeting in December 1971 was regarded as viable, and it was defended for a time, although without conviction. Now, the new pattern was regarded as viable, but in a few months it might be viewed differently. The essential point was that intervention would be conducted not for the purpose of protecting the existing pattern of exchange rates but rather to prevent destructive gyrations in rates. Operations directed toward that objective necessarily would be a matter of judgment.

Mr. Robertson commented that while the principle guiding intervention described by the Chairman seemed fine to him, there was always the possibility that intervention would be carried to the point of preventing the system of floating rates from functioning effectively. Central banks should not be poised to intervene at some slight provocation; official operations should be reserved for dealing with undue gyrations in rates.

Chairman Burns agreed. He added that among the central bankers meeting in Paris there was a widespread--although not necessarily universal--feeling that there ought to be little or no intervention for a time.

Mr. Black asked how the joint float of the six European countries would be operated. Specifically, he wondered whether a country with a strong currency might buy a weak currency without any swap drawings being involved.

Mr. Coombs replied that the six Common Market countries participating in the joint float would borrow one another's currencies when they found it necessary to intervene in order to preserve the 2-1/4 per cent band, and they would settle at the end of the following month. Intervention would be undertaken simultaneously by the countries whose currencies were at the top and the bottom of the band.

In reply to additional questions, Chairman Burns said there were no discussions at the Paris meetings concerning gold. The United States was not committed to maintain the new parity for the dollar for any particular period of time. There was no understanding with the Japanese as to a rate for the yen against the dollar at which they would intervene in the market, and he strongly doubted that there was any understanding among the six

Common Market countries concerning the rates at which they would intervene to buy or sell dollars. Interest rate relationships were discussed at the Paris meetings; one European proposal called for the United States to raise rates while the Europeans lowered their rates, simultaneously reducing their rates of monetary growth. In a separate consultation, however, the central bankers concluded that the proposal was not feasible for both economic and political reasons.

Mr. Balles, noting that he disagreed that the dollar was now undervalued, asked Mr. Coombs why he believed that it was.

Mr. Coombs replied that that was the informed judgment of most of the European central banks. Personally, he had a strong impression that prices in Europe, in terms of dollars, were now extraordinarily high. In time that was bound to affect trade and other items in the balance of payments.

Mr. Hayes noted that the Paris communique indicated that the G-10 countries would take the lead in gradually reducing their placements of official reserves in the Euro-currency markets, and it suggested that limitations might eventually apply to placements

by all member nations of the IMF. He asked Chairman Burns whether a concerted effort would be made to persuade other countries to reduce their placements and whether any consideration was being given to attracting some of the funds into special securities of the U.S. Treasury.

In reply, the Chairman observed that, despite the communique's reference to "studies" of limitations affecting all IMF members, he was not hopeful that a practical solution would be found to the problem of placements of official reserves in the Euro-currency markets by other than G-10 countries. Concerning the use of special Treasury securities, the possibility had been discussed informally. However, it was difficult for the Treasury to pay higher interest rates on securities sold to foreigners than on those sold in the domestic market.

Mr. Brimmer asked about the significance of the communique's reference to possible reserve requirements in the Euro-currency market "comparable to those in national banking markets."

The Chairman replied that there now seemed to be somewhat less opposition to such reserve requirements than there had been so that the possibility could be discussed further.

By unanimous vote, the System open market transactions in foreign currencies during the period February 13 through March 19, 1973, were approved, ratified, and confirmed.

Mr. Coombs reported that two System swap drawings on the National Bank of Belgium, totaling $65 million, would mature for the seventh time on April 19 and 26, respectively. If Belgian francs came on offer in the market before the maturity dates, he would hope to be able to acquire francs to repay part or all of those drawings. If any balances remained outstanding at maturity, however, he thought there would be no practical alternative to renewal. Since the Belgian swap line had been in continuous use for more than one year, specific Committee action to authorize renewal of the drawings was required under the terms of paragraph 1(D) of the foreign currency authorization.

By unanimous vote, renewal for further periods of 3 months of the two System drawings on the National Bank of Belgium maturing on April 19 and 26, 1973, was authorized.

Mr. Coombs then referred to the statement in the Paris communique regarding possible enlargement of some of the existing swap facilities and observed that he had had no discussions of that matter with officials of European central banks and only brief, general conversations with U.S. Treasury officials.

He might note, however, that there was a widespread feeling in international financial markets that official resources available under existing swap lines were inadequate, considering the potential for massive flows of private funds. In his judgment, selective increases in the Federal Reserve swap lines, adding up to a sizable increase in the total network, could make a major contribution to a revival of confidence in the international monetary system and to orderly market functioning. He did not have any detailed recommendations at the moment regarding the list of lines that should be increased or the amounts of increase. In general, he thought it would be desirable to raise the lines with certain central banks in the Common Market, such as the German Federal Bank, and he believed there was no need to increase certain other lines, such as that with the Bank of England. To achieve the desired impact on market confidence, the aggregate size of the network, which was now $11,730 million, might be expanded by roughly 50 per cent. That would imply an increase in the aggregate of about $5 billion or $6 billion. Specifically, he would recommend that he be authorized to negotiate increases in individual swap lines in amounts aggregating not more than $6 billion, on the understanding that no swap line increases would be effected without the approval of both the Chairman and the responsible officials of the U.S. Treasury.

Mr. Mitchell remarked that he had no objections to increases in swap lines on the basis of a realistic assessment of the likely needs. In the past, however, the relative size of the lines had sometimes been taken as a measure of the status of the countries concerned, and the System had come under pressure to increase particular swap lines simply because its lines with some other central banks were larger. He would be opposed to increases on that basis.

Mr. Coombs said he thought it would prove possible to resist any pressures that might arise to increase individual swap lines for reasons of prestige.

Chairman Burns remarked that, as had been emphasized repeatedly in informal conversations in Paris, there would be no automatic formula for swap line increases; an arrangement the System entered into with one central bank would not even remotely imply an intention to make a similar arrangement with another central bank. Nevertheless, he thought it was not possible to state absolutely that questions of international prestige would be ignored, since considerations of foreign policy might be involved. The System might well argue against some proposed swap line increase on purely financial grounds, but it should not insist on its position if the Treasury and the State Department were strongly in favor of the increase on other grounds.

Mr. Mitchell agreed with the Chairman's observation. At the same time, he thought it would be helpful to have some specific criteria in mind for deciding what swap line increases were warranted from the System's point of view.

Mr. Coombs observed that, since the proposed increases would be intended to facilitate borrowing, not lending, by the Federal Reserve, the desired criteria could be developed readily by asking what currencies the System would probably want to borrow. As he had suggested earlier, the main need was likely to be for certain Common Market currencies.

Mr. Robertson expressed the view that caution was needed in dealing with what he considered a delicate international political problem. He was more concerned with the use of the swap lines than with their size, and he was willing to authorize the Special Manager to engage in negotiations of the kind proposed. However, he wondered whether the System should take the lead in increasing the swap lines. The United States could cooperate in maintaining orderly exchange market conditions, as it had agreed to do, while leaving the initiative with respect to swap line increases with the other parties.

Mr. Mayo asked how Mr. Coombs had arrived at the figure of $6 billion for the proposed increase in the swap network.

In reply, Mr. Coombs said the question he had considered concerned the minimum increase in the network that could be relied upon to have an important positive effect on market confidence. While he had concluded that the network would have to be increased by at least 50 per cent, he recognized that any such figure was partly guesswork.

Mr. Brimmer observed that he had two questions about Mr. Coombs' recommendations. The first, and less important, related to the proposal that authority to approve increases in individual swap lines, given Treasury concurrence, be delegated to the Chairman. He wondered whether it might not be a better procedure to delegate that authority to the Subcommittee, consisting of the Chairman and Vice Chairman of the Committee and the Vice Chairman of the Board, which was named in the Committee's Rules of Procedure.

Chairman Burns said he would not object to such an arrangement if the Committee preferred it. He believed, however, that it would place an additional burden on him--that of securing the formal approval of the Subcommittee at each step of the discussions with the Treasury--without compensating advantage, since he would expect to keep the other members of the Subcommittee fully informed in any case.

Mr. Hayes remarked that, as a member of the Subcommittee, he would find the procedure proposed by Mr. Coombs to be agreeable.

The Chairman added that he would rely on Messrs. Coombs and Bryant to make sure that he did keep the members of the Subcommittee--and, for that matter, their alternates--fully informed of developments in his discussions with the Treasury.

Mr. Brimmer remarked that his purpose in raising that question was simply to call attention to a possible alternative procedure. His second, and more substantive, question related to the manner in which Mr. Coombs' recommendation had been presented to the Committee. He recognized that events had moved rapidly of late and that it was necessary for the Committee to act quickly to implement what was, in fact, foreign policy. Nevertheless, he was troubled by the proposal that the Committee authorize a 50 per cent increase in the swap network, the distribution of which was unknown, on the basis of an oral presentation it had heard for the first time today. He would have preferred an approach that afforded a better opportunity for deliberation, since the Committee bore a major responsibility in the area under discussion and since it was the Committee that would ultimately have to stand behind whatever action was taken. He asked whether the matter was of such urgency that action could not be postponed.

Mr. Daane commented that, as the Special Manager had noted, the primary purpose of the proposed swap line enlargement would be to have a positive effect on market confidence. From that standpoint, the sooner the increases could be announced the better it would be. In view of the fact that there was likely to be only limited, if any, use of the expanded facilities, and in view of the care that would be exercised in deciding which lines should be increased and by how much, he was not troubled by the suggestion that the Committee act today. He did have some question about the size of the aggregate increase proposed; if one were to consider only the effect on psychology, he could make a case for roughly doubling the network to the round figure of $20 billion. On balance, however, he would be prepared to move ahead with at least a 50 per cent enlargement.

In reply to questions by Mr. Sheehan, Mr. Coombs said it would be desirable, if feasible, to combine the announcement of the swap line expansion with an announcement of some other policy action--or perhaps make it coincide with the release of some favorable statistics in the balance of payments area, should such a release be impending. So coordinated, the several announcements would have a much greater impact on psychology than if they were made individually. He hoped the negotiations could proceed quite rapidly; the present market situation was a

fluid one that could be badly upset by a few pieces of bad news. While he appreciated Mr. Brimmer's view that the matter was a highly important one which warranted full documentation, he did not think it would be advisable to let it lay over until the mid-April meeting of the Committee. It was an unfortunate fact that the Paris agreement had been reached only last Friday, and that there had been no opportunity as yet to discuss it in detail with the Treasury--much less with the European central banks.

Mr. Sheehan remarked that he would like to see some analysis on the matter of the desirable increase in the swap network; like Mr. Daane, he thought there were arguments for doubling its size, rather than increasing it by only 50 per cent. The members might approve Mr. Coombs' recommendation today with the understanding that a memorandum would be distributed, on the basis of which the Committee might modify its decision--perhaps in a telephone conference meeting.

In response to questions by Mr. Mitchell, Mr. Coombs noted that the Committee's foreign currency authorization and directive did not require formal Committee approval of drawings on the swap lines. At the moment, however, neither the System nor its swap partners would be prepared to have drawings made until the matter of the revaluation clause was clarified. With respect to the proposed expansion of the network, one possible

procedure would be to ask the members to vote by telegram on recommended increases in individual lines.

The Chairman said he had some question as to how meaningful such a vote would be. It would come at a point after Mr. Coombs had completed negotiations with the foreign central bank and had secured the approval of the Treasury, and after he (Chairman Burns) had discussed the proposal with the Subcommittee and had agreed that it was desirable. Under such circumstances, a Committee vote would amount simply to _pro forma_ ratification, unless the members were prepared to repudiate the Chairman and Special Manager.

Mr. Brimmer remarked that since no member would want to repudiate the Chairman and Special Manager it appeared particularly desirable for the Committee to explore the issues fully and reach an understanding on the appropriate course before any final action was taken.

Chairman Burns said he might remind the members that he, along with the Treasury's representatives, had agreed to the statement in the Paris communique reading "To ensure fully adequate resources for such operations, it is envisaged that some of the existing swap facilities would be enlarged." The possibility that an enlargement of the network would come up at

the Paris meeting had been noted in the course of the telephone conference meeting of the Committee on March 7. He should add, however, that he would have agreed to that sentence in the communique even if the Committee had not held the telephone conference, because he thought it was in the interest of the United States to do so. It was now up to the Committee to decide whether or not it approved.

Mr. Hayes said he fully concurred in the Chairman's position. While the Paris communique did not make an explicit statement that the System's swap network would be enlarged by some amount, an increase of the size proposed certainly would be consistent with its spirit. This was a time of fast-moving events, and it might prove highly useful to have the enlargement of the network in place very soon. Accordingly, he favored approving the Special Manager's recommendation.

Mr. Mitchell remarked that Mr. Brimmer's concern--which he shared to some extent--might be met by approving the recommendation on the understanding that no drawings would be made on the additions to the swap lines without further discussion by the Committee. Since there was considerable leeway for drawings under the existing lines, it was likely that any necessary operations could be carried out in the interim; and any increases in the lines that were agreed upon could be announced publicly, if that appeared

desirable. At the same time, the Committee would be given an opportunity to study documentation and to deliberate on the conditions under which the increases in the lines might be activated.

In reply to questions, Mr. Mitchell said he would not expect the "hold" on use of the additions to the lines to extend beyond the next meeting of the Committee. Moreover, it would be understood that the members might be asked to authorize use of the additions before then, in the unlikely event that a need to do so suddenly arose.

Mr. Hayes expressed doubt that an elaborate procedure of the kind Mr. Mitchell proposed was necessary. More generally, he did not understand the reasons for hesitancy in approving an expansion in the swap network.

Mr. Robertson said it was his impression that there was little objection to the expansion of the network _per se_; indeed, some questions had been raised as to whether the expansion recommended was large enough. Personally, he was quite willing to delegate to the Chairman the responsibility for approving increases in individual swap lines; those increases would have to be negotiated, and it was clear that negotiations could be carried out more effectively by a single person than by a group. The question of main concern to him--and, he thought, to some

other members--related to the circumstances under which the swap lines would be activated. Unless it was understood that the Committee would have an opportunity to deliberate on that question he, for one, would vote against the proposal to enlarge the network.

Chairman Burns asked whether Mr. Robertson's impression regarding the absence of objection to expanding the network was correct.

Mr. Coldwell remarked that there was one question which the Committee might want to consider--namely, whether a large expansion of the network would be interpreted by the public as implying that the System was prepared to use the full amount in defense of the dollar.

The Chairman said he was unable to answer that question.

Mr. Brimmer expressed the view that the question of the public's interpretation was less important than that of the Committee's intent. He wondered, for example, whether it would be consistent with the Committee's intent to have the full $6 billion increase in the network applied to the swap line with the German Federal Bank, so that $7 billion would be available to defend the mark-dollar exchange rate. That extreme outcome would not be ruled out if the Committee approved the Special Manager's recommendation and placed no limits on the sizes of

individual swap lines. He thought the Committee should set limits to the increases that could be negotiated in individual lines--as it had done in March 1968, at the time of the last general expansion of the network--because of the danger that at some point the System would find itself throwing good money after bad exchange rates.

Chairman Burns observed that it was often necessary in the conduct of affairs to entrust individuals with authority to act, and it was always possible that those individuals would act in irrational ways. Accordingly, it was conceivable that Mr. Coombs would recommend a $6 billion increase in the German swap line and that he and the responsible Treasury officials would agree to it. But it was not very likely, since the people concerned were reasonable men.

The Chairman then suggested that it would be helpful if Mr. Coombs would review the Committee's past practice in connection with System drawings on the swap lines.

In reply, Mr. Coombs said that prior to August 1971 the System had drawn on the swap lines more or less automatically when it was asked by foreign central banks in the network to absorb their excess dollar holdings, because central banks taking in unwanted dollars had the alternative of buying gold from the U.S. Treasury. Since August 1971 that alternative had not been available to the foreign central banks, and System drawings had

been made only at its own initiative, after consultation with the Treasury. For example, at the time of heavy pressure on the mark in February, in the week preceding the announcement of the devaluation of the dollar, the System drew $104 million equivalent of marks for sale in the New York market. System operations in New York almost inevitably would be on a smaller scale than those of a European central bank in its own market, partly because of the time differential. In that particular period they were very small compared to those of the German Federal Bank, which took in $6 billion.

Chairman Burns noted that Mr. Coombs had the authority to activate the swap lines without prior consultation with the Committee, and had in fact not consulted with the Committee in February before making the drawings he had mentioned on the German Federal Bank.

Mr. Daane said he hoped the members would not lose sight of the primary purpose of the proposed expansion in the swap network, which was to have a positive impact on market psychology. If the possibility of activation should arise, the Special Manager no doubt would consult with the Chairman. In view of the likely need for quick action, however, he thought it would be a mistake to adopt a procedure under which Mr. Coombs was required to consult with the full Committee in connection with each proposed drawing.

Mr. Mitchell observed that, while he agreed with Mr. Daane, he thought the main question before the Committee related to the possibility of a large-scale activation of the network, involving use of some of the contemplated increases in the swap lines. He doubted that a need would arise for intervention on such a scale, but if it did he believed the Committee should be consulted.

The Chairman remarked that the problem could be resolved by setting limits on the amounts which the Special Manager would be authorized to draw on the individual swap lines without consulting the Committee.

A discussion then ensued of the limits that might be appropriate. In the course of the discussion Mr. MacLaury suggested that the Committee adopt the proposal Mr. Mitchell had made earlier. Under that proposal, the Special Manager would retain his present authority to draw on existing swap lines, but he would not be authorized to activate any increases that might be made in the lines until the Committee had had an opportunity to discuss the matter further.

Chairman Burns observed that the suggestion was acceptable to him if it was understood that circumstances might arise under which Committee members would be asked on short notice to authorize activation of the increases in some swap lines. He thought provision should be made for that contingency, even though it was not likely to arise.

There was general agreement with the Chairman's observation.

> By unanimous vote, the Committee authorized the Special Manager to undertake negotiations looking toward increases in System swap lines not exceeding $6 billion in the aggregate, on the understanding that increases in individual swap lines, and the corresponding amendments to paragraph 2 of the authorization for System foreign currency operations, would become effective upon approval by Chairman Burns, after consultation with responsible officials of the U.S. Treasury; and on the further understanding that any increases made effective would not be drawn on until after further consultation with the Committee.

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 13 through March 14, 1973, and a supplemental report covering the period March 15 through 19, 1973. Copies of both reports have been placed in the files of the Committee.

Chairman Burns suggested that, in the interest of time, Mr. Holmes summarize his oral statement and submit the full text for inclusion in the record.

Mr. Holmes summarized the following statement:

> Substantial pressures built up in the money market over the period since the Committee last met. International flows of funds precipitated another foreign exchange crisis and an explosion of demand for bank credit resulted from that outflow, from the strength

of domestic economic activity, and from the current constellation of domestic interest rates. Renewed fears of inflation and widespread expectations of an increase in the discount rate added to the pressures. Given the over-all strong performance of the aggregates, the Desk continued to be a reluctant supplier of reserves and the Federal funds rate moved quickly to the upper limits of tolerance set by the Open Market Committee at its last meeting.

In the statement week ended March 14, strong bidding for funds by banks under the pressure of burgeoning loan demand pushed the Federal funds rate above the 7 per cent level approved by Committee members on March 1. The same situation prevailed in the early part of the current statement week, although pressures abated yesterday. While the System was a reluctant supplier of nonborrowed reserves, the heavy absorption of reserves from market factors, especially the rise in the Treasury balance connected with the issuance of a large volume of nonmarketable debt to foreign central banks, required a massive provision of reserves on balance. Thus, by late last week we had used up all but $76 million of the $2 billion leeway granted the Desk to change the portfolio between Committee meetings. Given the continued uncertainties in the international situation we felt it prudent to request the Committee to authorize an additional $1 billion in leeway. Purchases of $82 million bills from foreign accounts brought the total change in System portfolio over the $2 billion level on Friday and we may want to buy bills from foreign accounts again today.

As the blue book indicates, M_1 and M_2 appear to be growing at rates within the Committee's ranges of tolerance for February and March, although M_2 is at the upper end of the range. RPD's, on the other hand, are expanding more rapidly than desired, and the credit proxy is growing at an 18 per cent annual rate, compared to the 6-1/2 per cent rate anticipated at the time of the last meeting. The strength of loan demand at banks--stemming from borrowing to finance international outflows, shifts from the commercial paper market, including anticipatory borrowing to take advantage of the spread between the prime rate and market rates, and from the general strength of the economy--put banks

under substantial pressure to raise funds through every instrument available to them, including Federal funds, CD's, commercial paper, and ineligible acceptances. As in January, dealer-placed commercial paper declined rather than rising as in recent years. The amount of the February decline, $1.7 billion, contrasted with gains of $150 to $800 million for the month in the preceding 4 years.

The pressure to secure funds, of course, pushed short-term interest rates substantially higher, with the rate on 89-day CD's--now the only meaningful maturity category--hitting 7-1/4 per cent by the end of last week. With the CD rate a full percentage point above the 6-1/4 per cent prime rate, there was some evidence of arbitraging by corporate treasurers. The demand for bank loans, given the current interest rate constellation, has caused the banks considerable consternation in the money market and no doubt contributed to yesterday's moves by a number of banks to a 6-3/4 per cent prime rate. On the more positive side, however, it has forced banks to liquidate assets and to tighten lending standards, particularly the making of new commitments.

Treasury bill rates also rose substantially, reflecting other rising short-term rates and the expectation that foreign activity would no longer be a plus factor in the market. In yesterday's regular Treasury bill auction, average rates of 6.33 and 6.76 per cent were established for 3- and 6-month bills, respectively, up about 90 and 108 basis points from the rates established in the auction just preceding the last Committee meeting. With the 6-month bill now yielding well over 7 per cent on a coupon basis--and other money market instruments even more--there is apt to be growing pressure on savings flows to the thrift institutions.

Longer-term rates have risen less dramatically, with foreign buying of intermediate Government and agency issues, the strong technical position of the Government market, and the light corporate calendar tending to restrain yield advances in those markets. Further upward pressures appear likely, however, unless money market pressures subside, with the municipal market particularly vulnerable given the decided waning of bank interest in that area.

As noted earlier, the System had to supply a substantial volume of reserves to the market, even though it was a reluctant supplier and the Federal funds rate pushed up significantly. In addition to a $2 billion supply of reserves by net outright purchases (almost exclusively from foreign accounts) reserves were also supplied on a temporary basis through $5 billion of RP's, while matched sale-purchase agreements amounted to over $2.5 billion.

Looking ahead, the reserve outlook is quite uncertain, mainly because of uncertainties about the Treasury balance, particularly since no decision has yet been reached about the possibility of cash financing in late March or early April. Developments in the exchange market could also be an important factor in the Treasury balance outlook. There is little question, however, that the Treasury will have to reduce its balance at the Reserve Banks substantially from the current $4 billion level, involving a large supply of reserves to the banking system. On some estimates this would require offsetting System operations to absorb reserves in excess of $2 billion. If this turns out to be the case, we may again have to recommend that the Committee approve a temporary increase in the leeway sometime before the next meeting. Latest New York Bank estimates indicate that, barring sizable redemptions of foreign specials, we may be able to squeak by.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period February 13 through March 19, 1973, were approved, ratified, and confirmed.

By unanimous vote, the action of Committee members on March 15, 1973, increasing the limit specified in paragraph 1(a) of the continuing authority directive on changes between meetings

of the Committee in System holdings of U.S. Government securities and agency issues from $2 billion to $3 billion for the period through the close of business March 20, 1973, was ratified.

Mr. Axilrod said he would not comment today on the alternative targets for monetary policy discussed in the blue book since the Committee had already decided on its longer-run target for the rate of growth in M_1--namely, 5 to 5-1/2 per cent over the second and third quarters combined. He might note, however, that the staff had distributed a sheet[1/] listing the longer-run targets for the other aggregates, and the short-run operating ranges, which it believed were consistent with the longer-run target for M_1 the Committee had agreed upon yesterday. That M_1 target rate was slightly below the rate--5-1/2 per cent--shown under alternative B in the blue book, and the specifications shown on the sheet involved a policy course a shade tighter than that of B. In particular, the lower end of the range for the Federal funds rate had been raised from 6-1/2 to 6-3/4 per cent, so that the range indicated was 6-3/4 to 7-1/2 per cent rather than 6-1/2 to 7-1/2 per cent. That narrowing of the range corresponded to a slight increase in the maximum likelihood estimate for the funds rate--from 7 per cent under the alternative B

1/ Appended to this memorandum as Attachment C.

specifications to 7-1/8 per cent or a bit higher under the specifications shown on the sheet.

Chairman Burns asked whether Mr. Partee had a policy recommendation to make to the Committee.

Mr. Partee said he would endorse the policy course implied by the specifications distributed today. Beyond that, he would simply mention the very sharp rise in interest rates over recent months and note that, like Mr. Holmes, he thought long-term rates were quite likely to be going up in the period ahead. The members no doubt would want to keep those considerations in mind.

The Chairman then remarked that, in the interest of focusing and perhaps expediting the discussion, he would offer certain short-run operating specifications for the Committee's consideration. With respect to the growth rates in the aggregates over the March-April period, his suggestions involved retaining the upper limits of the ranges shown on the sheet distributed today but reducing the lower limits in each case. Specifically, he suggested the following ranges: for RPD's, 12 to 16 per cent; for M_1, 4 to 7-1/2 per cent; and for M_2, 5 to 8-1/2 per cent. His proposal for the funds rate fell into two parts. First, he would suggest adopting a narrower than usual range--namely, 6-3/4 to 7-1/4 per cent. Secondly, he proposed that the Committee members agree to consult on policy--either by telephone

conference or by telegram--2 weeks from today and sooner if necessary. His reasoning was as follows: on the one hand, in view of the recent very sharp run-up in interest rates, it appeared desirable at present for the Committee to pause and give the market an opportunity to adjust. On thé other hand, he would not want a commitment to so narrow a range for the funds rate for more than a 2-week period.

Chairman Burns said he wanted to emphasize that the time had come for a pause in the process of tightening. The Committee had moved into a danger zone in which it could make a very serious mistake and he, for one, believed that some especially careful thinking was now needed.

Mr. Mayo observed that he agreed with all of the Chairman's suggestions except that for the Federal funds rate constraint. The funds rate had averaged 7-1/8 per cent in the week ending last Wednesday and its average for the current statement week was likely to be close to that level. Accordingly, an upper limit of 7-1/4 would give the Manager very little leeway on the upside. If a range no wider than one-half of a percentage point was desired, he would prefer setting it at 7 to 7-1/2 per cent.

In reply to a question, Mr. Holmes said the funds rate today was about 6-3/4 per cent.

Mr. Daane asked whether the Manager would consider the assignment to achieve the indicated aggregate growth rates with a funds rate no higher than 7-1/4 per cent to be an impossible one.

In reply, Mr. Holmes noted that in recent weeks the Desk had been operating under specifications that included an upper limit of 7 per cent on the weekly average funds rate, and the 7-1/8 per cent average recorded in the week ending March 14 had been the inadvertent result of special market pressures. In his view, a 7 per cent funds rate had been appropriate, given the Committee's objectives for the aggregates, and he had no reason to believe that it would not continue to appear appropriate for the next week or so, until more data were available on the aggregates. Consultation might well be required shortly--perhaps in less than 2 weeks--if those data indicated that the aggregates were stronger than anticipated.

Mr. Mitchell said he thought the Committee's preoccupation with M_1 and its tendency to pay little attention to the bank credit proxy would put it in a delicate position during the coming period, when the Treasury balance was expected to decline substantially. What concerned him in particular was the possibility that the decline in the Treasury balance would be associated with a sharp rise in private demand deposits.

Mr. Axilrod observed that the Treasury balance normally declined in the first part of April, reflecting an excess of payments over receipts during the period prior to mid-month tax collections. This year the decline was expected to be somewhat greater than usual because of the large volume of tax refunds. In any case, in the projection of M_1 an allowance had been made for the anticipated effects of the reduction in the Treasury balance. It was possible, of course, that the Treasury balance might fall in coming weeks for another reason also--namely, the redemption of special Treasury certificates by foreign monetary authorities as a result of reflows of funds from abroad. Such reflows, for which no allowance had been made in the projections, might have some transitory effect on private demand deposits. However, there was little evidence to indicate that the earlier outflows of funds had been financed to an important extent by drawing down demand deposits; apparently they had been financed mainly through borrowing and sales of securities. Accordingly, it seemed reasonable to expect that the bulk of any reflows that might develop would be applied to debt repayment and securities purchases.

Mr. Mitchell remarked that, while he was not opposed to the specifications suggested by the Chairman, he was disturbed by the narrowness of the proposed constraint on the Federal funds

rate. The risk that Treasury deposits might be monetized seemed to him sufficiently great to warrant giving the Manager a little more latitude.

Mr. Brimmer said he would prefer the 6-3/4 to 7-1/2 per cent range for the funds rate shown on the sheet distributed by the staff this morning.

Chairman Burns emphasized that he had suggested the narrower range--to govern operations for a period of 2 weeks and possibly less--because he thought a pause was desirable at this point.

Mr. Partee commented that if, in fact, there were a monetization of Treasury deposits, incoming data on M_1 would be stronger than projected. So long as the M_1 growth rate remained within the expected range no particular problem would be posed by a narrow funds rate constraint; if it exceeded the range, the Committee could decide how to deal with the problem in the course of the consultation the Chairman had suggested. Personally, he was sympathetic to the view that financial markets were likely to be in a disturbed state in the coming period as the structure of intermediate- and long-term rates adjusted to the recent sharp run-up in short-term rates.

In reply to a question by Mr. Daane, the Chairman said he thought the specifications he had suggested would be consistent

with language of alternative B for the operational paragraph of the directive.[1/]

Mr. Hayes observed that, despite the recent increase in short-term interest rates, he did not consider the present to be a good time for the Committee to interrupt its effort to achieve greater monetary restraint. With inflationary pressures accelerating, and with bank credit growing very rapidly, he thought the domestic situation alone clearly called for tightening policy another notch. International considerations reinforced that conclusion; it seemed to him quite important on international grounds that the Committee demonstrate a continuing strong interest in the anti-inflation effort.

Mr. Hayes said he had been troubled by the alternative B ranges for rates of growth in the monetary aggregates in the March-April period because their midpoints were above the longer-run growth rates sought by the Committee. The same was true of the ranges suggested by the Chairman today. He would prefer 2-month ranges for the monetary aggregates below those specified by the Chairman and, indeed, below the 5 to 7 and 6 to 8 per cent ranges shown for M_1 and M_2, respectively, under alternative C. At the same time, he would not want to set the funds

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

rate constraint as high as the 7 to 8-1/4 per cent range of alternative C, and he doubted that it would be necessary to do so. His preference for the funds rate constraint was 6-3/4 to 7-3/4 per cent, but an upper limit of 7-1/2 per cent would be acceptable to him. The average funds rate had been 7 per cent or above in the past two statement weeks, and he believed that an upper limit of 7-1/4 per cent would leave too little leeway on the firming side under present circumstances.

As for the operational paragraph of the directive, Mr. Hayes continued, he preferred alternative B to either A or C. However, in the statement calling for bank reserve and money market conditions "that will support somewhat slower growth" in monetary aggregates, he would favor substituting the phrase "that will allow slower growth." He believed that the modified language would convey better the sense of restraint in policy which he thought was appropriate at this time.

Mr. Hayes noted that the directors of the New York Reserve Bank had voted last week to increase the discount rate by 1 percentage point. He hoped that there would be early action by the Board. In his judgment such a discount rate increase was fully compatible with the realities of the domestic situation, as discussed in yesterday's session, and with the course of open market rates over the recent past. And in view of the present

international financial unsettlement, he thought it was quite important that some such increase in the discount rate be made soon.

Finally, Mr. Hayes remarked, he hoped the Board would give serious consideration to suspending the Regulation Q ceilings on large-denomination CD's of all maturities in order to avoid an unhappy situation of the kind that developed in 1966 and 1969. He saw no reason why the System could not cope adequately with any tendencies toward excessive credit expansion by means of the normal instruments of open market policy.

With respect to Mr. Hayes' concluding comment, Mr. Robertson observed that sole reliance on open market policy could well produce problems. He would prefer to place marginal reserve requirements on large-denomination CD's.

Mr. Hayes replied that that alternative was worth studying, and he would not rule it out. At the moment, however, he would be inclined simply to remove the CD ceilings.

Mr. MacLaury observed that there had been some discussion today of the implications of the expected rundown in the Treasury balance for the course of the monetary aggregates in the period ahead. However, no one had commented on the implications of the runup in the balance over the past month or so for the proper interpretation of rates of growth in M_1 and M_2 recorded then.

He believed the recent growth rates were misleading because monetary expansion had been artificially depressed by the rise in the Treasury balance. While he was cognizant of Mr. Axilrod's view that the outflows of funds associated with the increase in the Treasury balance had been financed to a greater extent by borrowing and sales of securities than by reductions in demand deposits, he thought the degree of success achieved in slowing the growth in the aggregates was less than the data implied. That magnified his concern about the course of the aggregates in the months to come. Like Mr. Hayes, at this point he would not want to adopt short-run operating ranges for the aggregates with midpoints that exceeded the Committee's longer-run targets. Specifically, he favored a 2-month range for the growth rate in M_1 of 4 to 6 per cent. For the funds rate constraint, he favored a range of 6-3/4 to 7-1/2 per cent.

Mr. MacLaury added that he joined Mr. Hayes in the hope that the Board would suspend the Regulation Q ceilings on large CD's. Also, he hoped that the existing marginal reserve requirements on Euro-dollar borrowings would be reduced or, preferably, rescinded for the time being.

Mr. Bucher remarked that he had concluded from the staff's excellent presentation yesterday that for the first time in the current economic upswing there were strong indications that the top of the hill might be in sight and perhaps

also that a glimpse of the other side might be possible. He also had received the impression--particularly from comments by business directors in the Reserve Bank board meetings he had recently attended--that executives of large corporations were beginning to worry about a tapering off of the upswing toward the end of 1973 and about a more substantial problem in 1974. While he agreed that the Committee could not ignore the overheating evident at the moment, it had to balance that consideration against the longer-run outlook.

Mr. Bucher observed that he had been struck by certain views of Professors Eckstein and Samuelson cited in the current red book. Professor Eckstein was quoted as expressing confidence that "we have learned how to apply the monetary brakes gently." He (Mr. Bucher) shared that hopeful view. The statement by Professor Samuelson which had particularly impressed him was that "cost-push inflation is not something that the monetary authorities can or ought to do a lot about." Both of those statements lent support to the suggestion that the Committee should exercise caution. Indeed, this was a time when the operations of the Desk should be monitored on a day-to-day basis. While he would not want to be cautious to the point of indecision, it was important that the Committee proceed carefully. Accordingly, he concurred with the Chairman's recommendations.

Mr. Francis remarked that in the interest of time he would simply note that his views were generally similar to those Mr. MacLaury had expressed.

Mr. Coldwell said he agreed basically with Mr. Hayes' position. He would add that, while the recent rise in short-term interest rates was having some impact, the full restraining effect of higher interest rates was unlikely to be achieved unless the discount rate was increased or some action was taken on the Regulation Q ceilings on large-denomination CD's. He hoped both possibilities would be given serious consideration. Meanwhile, in the effort to obtain funds to meet current large demands for business loans, banks were aggressively seeking to sell shorter-maturity CD's, and they were offering progressively higher rates on such certificates. If the other actions he had mentioned were not to be taken, he thought consideration might be given to some type of constraint on the volume of CD's outstanding--perhaps a quantity limit or an additional reserve requirement.

Mr. Balles remarked that the Committee was faced with a painful dilemma. On the one hand, as the Chairman had noted, short-term interest rates had increased sharply. On the other hand, there was a real danger of growth in the monetary aggregates at rates that were excessive in light of the Committee's longer-run targets. After careful consideration of the alternatives, he

concluded that the danger of overshooting the targets for the aggregates was the greater one. Therefore, he associated himself with the views expressed by Messrs. Hayes and MacLaury.

Mr. Black observed that his position on policy was similar to that of Mr. MacLaury. In view of the strength of demands for credit, there was a real risk that M_1 would spurt upward at rates in excess of those projected, even though there had been a sharp increase in short-term interest rates. Although it was obvious that the System could not control the growth in M_1 with a high degree of precision over short periods, the publication of figures revealing a large increase in M_1 could have a damaging effect on expectations at this point. Moreover, now that progress had been made toward a viable set of exchange rates, it seemed desirable for the System to take some positive action to demonstrate its willingness to cooperate in resolving the international financial problem.

Mr. Brimmer observed that his position was similar to that taken by Messrs. Hayes, MacLaury, Balles, and Black. As he had indicated earlier, he favored the 6-3/4 to 7-1/2 per cent range for the funds rate shown on the sheet distributed today; in his view, the narrower range suggested by the Chairman would give the Desk insufficient flexibility. And, as he had noted yesterday, he thought the Committee should hedge against the

tendency to overshoot its targets for the monetary aggregates by lowering those targets. Specifically, he agreed with Mr. MacLaury that the March-April range for growth in M_1 should be set at 4 to 6 per cent.

Mr. Robertson said he was inclined to agree with those who favored somewhat lower ranges than proposed by the Chairman for the 2-month growth rates in the monetary aggregates. For M_1 he could accept either a 4 to 6 or a 4 to 7 per cent range, and for M_2 he would favor a range of 5 to 7 per cent. On the other hand, he agreed with the Chairman that it would be desirable to set an upper limit of 7-1/4 per cent on the funds rate, with the understanding that the Committee would consult about that rate in 2 weeks--or sooner, if it appeared that the aggregates were growing at rates above their upper limits.

Mr. Axilrod remarked that it might be helpful to the Committee if he were to make a technical comment at this point. The Board's staff's best estimate of the M_1 growth rate in the March-April period, given the reserves likely to prove consistent with a funds rate of 7 per cent or a shade higher, was 6-1/2 per cent. If the Committee were to adopt a 4 to 6 per cent range for M_1 growth and a 7-1/4 per cent upper limit for the funds rate, it was likely--assuming the staff's estimate was accurate--that

a problem of inconsistency in the specifications would arise almost immediately.

Mr. Robertson observed that that consideration might argue for adopting a 4 to 7 per cent range for M_1.

Mr. Kimbrel commented that he certainly would want to lean against excessive growth in the aggregates in light of the near-boom conditions and the attitudes and expectations prevailing in the Sixth District. Yesterday, he had expressed a preference for reducing the Committee's longer-run target for M_1 to a 5 to 5-1/2 per cent range. He would support the specifications shown on the sheet distributed today, in view of the staff's judgment that those specifications were consistent with such a target. At the same time, he would be willing to accept somewhat tighter specifications if that turned out to be necessary to achieve the longer-run objective for M_1.

Mr. Sheehan said he concurred in the views expressed by Mr. Bucher. He had been quite disturbed by the economic outlook as portrayed by the staff yesterday, and he had planned today to cite the same two passages in the red book that Mr. Bucher had quoted. In his view a dramatic further tightening of policy would be undesirable at present; sharp increases in interest rates within short periods tended to contribute to uncertainty and to damage confidence. Short-term interest rates had risen considerably in

1972, but the advance had proceeded at a moderate pace over an extended period of time. Furthermore, the advance in 1973 to date had been quite sharp, and he was concerned that the policy course advocated by some members today would produce within 2 weeks the kind of rise in rates that might better be spread over 2 months. It would appear more appropriate to hold the present position until the next meeting.

Mr. Daane expressed the view that the Committee was on the right course in attempting to slow the growth in the aggregates. He favored continuing on that course, as implied by the alternative B directive language, and letting the consequences for interest rates show through. At the same time, he retained his basic skepticism about the Committee's ability to formulate specifications in as narrow and precise a manner as much of the discussion today implied. He did not believe that the choice between a 4 to 6 and a 4 to 7 per cent range for the 2-month growth rate in M_1 was critical, or that the difference of a quarter point in the level of the funds rate should constitute the be-all and end-all of policy. It was particularly undesirable at this point for the Committee to tie itself tightly to some particular relationships because of the uncertainties prevailing with respect to changes in the Treasury's balance and to international flows of funds.

Mr. Brimmer commented that in his judgment the key question was not one of the degree of precision with which the Committee specified its objectives but rather one of the direction in which

it wanted to lean. There seemed to be a substantial body of sentiment around the table today in favor of leaning in the direction of further restraint. The market consequence would be higher interest rates.

Mr. Daane said he was not persuaded that provision had to be made today for a rise in the Federal funds rate to 7-1/2 per cent in order to ensure the desired slowing in the growth of the aggregates. On balance, he favored the Chairman's recommendations, including the proposal that the Committee agree to consult about the funds rate constraint in 2 weeks.

Mr. Morris remarked that the publication of figures showing large increases in the monetary aggregates would obviously have an adverse psychological effect at this point. Accordingly, he would not have wanted to set the upper limit of the funds rate constraint at 7-1/4 per cent today if it were anticipated that the constraint would apply for the full 4-week period until the Committee's next scheduled meeting. However, he agreed that it would be desirable to let the markets settle down for a bit if that could be done without having the aggregates get out of hand. Since the Chairman's proposal included an understanding that the Committee would consult again in 2 weeks, it was quite acceptable to him.

Chairman Burns said he would like to remind the Committee at this point that it was attempting to achieve an objective that had never been accomplished before--that of keeping the economy from developing an inflationary boom but without releasing forces of a new recession. He might also remind the members that the Federal Reserve had a history of going to extremes. Finally, he might mention that at recent meetings of the Committee he personally had been inclined to seek somewhat more restraint than others had wanted.

As he had indicated earlier, the Chairman continued, he thought the Committee had reached a stage at which it was in danger of carrying restraint too far and bringing on a recession by next year and possibly by the end of this year. He had not argued against a policy of additional restraint; in his own mind he was setting no limits. He had argued, and firmly believed, however, that the time had come for a brief pause.

The Chairman then suggested that the Committee members be polled informally on the question of whether they favored the course he had recommended earlier. The poll indicated that seven members favored that course: Messrs. Burns, Bucher, Daane, Mayo, Mitchell, Morris, and Sheehan. The remaining five members--Messrs. Hayes, Balles, Brimmer, Francis, and Robertson--did not.

Chairman Burns noted that while the course in question was favored by a majority, it was a narrow one. He proposed that the

Committee consider possible modifications that might win the adherence of a broader majority.

Mr. Robertson said he would be prepared to join the majority if the upper limits of the ranges for the two-month growth rates in M_1 and M_2 were reduced somewhat.

Mr. Brimmer remarked that such a modification would make the proposal more acceptable to him, but that he would still prefer to have the upper limit of the funds rate constraint raised to 7-1/2 per cent. Mr. Hayes concurred in Mr. Brimmer's statement.

Chairman Burns then suggested that the Committee vote on a directive consisting of the staff's drafts of the general paragraphs and alternative B of the operational paragraph, on the understanding that it would be interpreted in accordance with the following specifications. The longer-run targets--that is, the annual rates of growth over the second and third quarters combined--would be taken as 5 to 5-1/2 per cent for M_1; 5-1/2 to 6 per cent for M_2; 8-1/2 to 9 per cent for the bank credit proxy; and 7-1/2 to 8 per cent for RPD's. The short-run operating ranges--that is, annual rates of growth for the March-April period--would be taken as 12 to 16 per cent for RPD's, 4 to 7 per cent for M_1, and 5 to 8 per cent for M_2. The range of

tolerance in the daily-average Federal funds rate for statement weeks in the period until the next meeting would be 6-3/4 to 7-1/2 per cent.

The Chairman observed that, given the changes from the specifications he had originally proposed, there was some question as to whether it was necessary for the members to agree unconditionally today to consult on policy in 2 weeks. He stated, however, that he would call for such a consultation if the funds rate were tending to rise above 7-1/4 per cent.

> By unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions for the System Account in accordance with the following current economic policy directive (later in this meeting retitled "domestic policy directive"):

The information reviewed at this meeting suggests continued substantial growth in real output of goods and services in the current quarter, although at a rate less rapid than in the fourth quarter of 1972. Over the first 2 months of this year, employment rose strongly but the unemployment rate remained about 5 per cent. The advance in wage rates moderated from the earlier rapid pace, while the rate of increase in prices accelerated. Prices of foods continued to rise sharply both at wholesale and retail; in February, moreover, increases in wholesale prices of industrial commodities were large and widespread. Another wave of speculative movements out of dollars into German marks and some other currencies developed at the beginning of March and led to a decision by a number of European countries to float their currencies jointly. On March 16, after a series of meetings, officials of leading industrial countries announced a program aimed at maintaining orderly international monetary arrangements.

The narrowly defined money stock expanded moderately in February, after having changed little in January, and growth over recent months remained at an average annual rate of about 6.5 per cent. The more broadly defined money stock continued to grow at a moderate rate in February as inflows of consumer-type time and savings deposits to banks slowed sharply. However, in the face of strong loan demand from businesses, and also from foreign banks, U.S. banks sharply increased their issuance of large-denomination CD's and the bank credit proxy expanded very rapidly. In recent weeks short-term market interest rates have risen substantially further while the rise in long-term rates has remained more moderate.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions consonant with the aims of the economic stabilization program, including abatement of inflationary pressures, sustainable growth in real output and employment, and progress toward equilibrium in the country's balance of payments.

To implement this policy, while taking account of possible domestic credit market and international developments, the Committee seeks to achieve bank reserve and money market conditions that will support somewhat slower growth in monetary aggregates over the months ahead than occurred on average in the past 6 months.

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

Secretary's Note: It had been agreed at the meeting on March 10, 1970, that certain authorizations among those that the Committee had reviewed annually in the past would remain effective until otherwise directed by the Committee, and would no longer be submitted routinely for review each year.

Instead, it was understood that these authorizations would be called to the Committee's attention before the first meeting in March of each year and that members would be given an opportunity to raise any questions they had concerning them. Accordingly, copies of the authorizations in question (listed below) had been distributed to the Committee on February 21, 1973, with a request that members advise the Secretariat if they wished to have any placed on the agenda for consideration at today's meeting. No such requests were received.

The authorizations in question were as follows:

1. Procedure for allocations of securities in the System Open Market Account.
2. Distribution list for periodic reports prepared by the Federal Reserve Bank of New York.
3. Authority for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account in case the New York Bank was 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.

Reference was made to the procedure authorized at the meeting of the Committee on March 4, 1955 (and most recently amended on March 9, 1971, to authorize the Secretary to act on the Chairman's behalf in considering proposals for the addition of members of the Board's staff to the list) whereby, in addition to members and officers of the Committee and Reserve Bank Presidents not currently members of the Committee, minutes and other records could be made available to any other employee of the Board of Governors or

of a Federal Reserve Bank with the approval of a member of the Committee or another Reserve Bank President, with notice to the Secretary.

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

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

Mr. Holland noted that a memorandum had been distributed from the Secretariat, dated March 12, 1973, and entitled "Proposed changes in titles of Committee policy instruments and amendments to foreign currency authorization."[1/] As noted in the memorandum, it was proposed that the Committee act on certain technical recommendations that had been made in the report dated January 16, 1973, of the *ad hoc* staff committee that had been appointed to review

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

the Committee's various Rules and its Regulation. Specifically, the staff committee had recommended that, in the interest of simplicity and logic, the Committee change the titles of certain instruments as follows: from "Continuing Authority Directive with respect to Domestic Open Market Operations" to "Authorization for Domestic Open Market Operations;" from "Current Economic Policy Directive" to "Domestic Policy Directive;" and from "Authorization for System Foreign Currency Operations" to "Authorization for Foreign Currency Operations." The changes would affect not only the captions to the instruments in question, but also certain text passages in which other instruments were referred to by title. The staff committee also had recommended two changes in the text of the Authorization for Foreign Currency Operations, to avoid duplication with material newly incorporated in the Committee's Rules. These consisted of a simplification of paragraph 6 and the deletion of paragraph 10.

While no objections were raised to these proposals, Messrs. Francis and Coldwell noted that they would transmit suggestions for certain other possible revisions in the instruments to the Secretary.

By unanimous vote, the Continuing Authority Directive with respect to Domestic Open Market Operations was retitled "Authorization for Domestic Open Market Operations," and was amended to read as follows:

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 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 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 $2.0 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 prime bankers' acceptances of the kinds designated in the Regulation of the Federal Open Market Committee 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; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed (1) $125 million or (2) 10 per cent of the total of bankers' acceptances

outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York, whichever is the lower;

(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 with maturities of 6 months or less at the time of purchase, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, or, if 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 $1 billion.

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

By unanimous vote the "current economic policy directive" was retitled "domestic policy directive."

By unanimous vote, the Authorization for System Foreign Currency Operations was retitled "Authorization for Foreign Currency Operations" and was amended to read as follows:

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 the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	200
National Bank of Belgium	600
Bank of Canada	1,000
National Bank of Denmark	200
Bank of England	2,000
Bank of France	1,000
German Federal Bank	1,000
Bank of Italy	1,250
Bank of Japan	1,000
Bank of Mexico	130
Netherlands Bank	300
Bank of Norway	200
Bank of Sweden	250
Swiss National Bank	1,000
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,000

3. Currencies to be used for liquidation of System swap commitments may be purchased from the foreign central bank drawn on, at the same exchange rate as that employed in the drawing to be liquidated. Apart from any such purchases at the rate of the drawing, all transactions in foreign currencies undertaken under paragraph 1(A) above

shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates and no attempt shall be made to establish rates that appear to be out of line with underlying market forces.

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

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

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

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

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

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

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

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

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(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 was amended to read as follows:

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 Special Manager reaches a judgment that they may help to reestablish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. In such cases, the Special Manager shall consult as soon as practicable with the Committee or, in an emergency, with the members of the Subcommittee designated for that purpose in paragraph 6 of the Authorization for Foreign Currency Operations; and

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

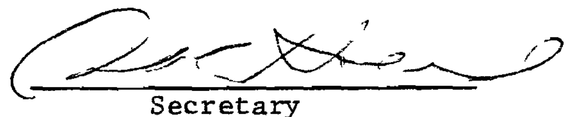
3. System drawings under the swap arrangements are appropriate when necessary to obtain foreign currencies for the purposes stated in paragraph 2 above.

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

In view of the lateness of the hour, it was agreed that two matters the Committee had planned to consider today--proposed revisions of the guidelines for operations in agency issues and release of the 1967 FOMC minutes--would be deferred until the next meeting.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, April 17, 1973, at 9:30 a.m.

Thereupon the meeting adjourned.



Secretary

ATTACHMENT A

Table 1

Changes in
Gross National Product and Selected Components
Billions of Dollars, at Seasonally Adjusted Annual Rates

	Q IV 1969 to Q III 1971	Q III 1971 to Q IV 1972	Q IV 1972 to Q IV 1973
Total Gross National Product	61.7	110.4	123.8
Cyclically Stable Components			
Consumption, Nondurable Goods and Services	35.2	48.2	61.7
State and Local Purchases of Goods and Services	12.1	15.6	19.0
Cyclically Volatile Components			
Durable Goods Consumption	8.4	11.8	12.2
Residential Construction	7.8	10.0	- 4.9
Business Fixed Investment	2.8	15.8	19.9
Inventory Investment	- 2.4	7.2	6.7
Other Components			
Federal Government Purchases	- 0.9	4.9	5.8
Exports of Goods and Services	5.3	8.9	17.4
Imports of Goods and Services (-)	6.7	11.9	13.9
	--------------Per Cent----------------		
Current Dollar GNP	6.5	10.4	10.3
Constant Dollar GNP	1.4	7.4	5.4

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Table 2

Selected Labor Market Data

	Change During Period (SAAR, in Millions)		
	Q IV 1969 to Q III 1971	Q III 1971 to Q IV 1972	Q IV 1972 to Q IV 1973 (Projected)
Civilian labor force	1.6	2.3	1.7
Total employment	0.4	2.6	2.1
Nonfarm payroll employment	-0.1	2.5	2.0
Manufacturing employment	-0.9	0.6	0.5

	Percentage levels in period (SAAR)			
	Q II 1965	Q III 1971	Q IV 1972	Q IV 1973 (Projected)
Total unemployment rate	4.7	6.0	5.3	4.7
Men 20 and over	3.3	4.4	3.6	3.0
Women 20 and over	4.6	5.7	5.2	4.8
Teenagers	15.4	16.9	15.6	14.6

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Table 3

Changes in Hourly Compensation, Productivity and Unit Labor Cost:
Private Nonfarm Economy

(Seasonally adjusted)

	(Quarterly changes at annual rates)								Change from a Year Earlier	
	1972				1973				1972	1973
	I	II	III	IV	I	II	III	IV	Q IV	Q IV
					--------Projected--------					-Proj.-
Compensation per manhour	9.1	4.6	6.1	7.6	9.3*	6.7	6.9	7.2	6.9	7.5**
Hourly earnings index***	8.0	5.6	5.0	7.5	6.1	6.4	6.6	6.9	6.5	6.5
Private nonfarm output	8.1	10.6	7.5	7.9	7.0	6.7	5.0	3.9	8.5	5.7
Output per manhour	5.2	5.1	6.6	3.6	3.8	3.6	3.0	2.4	5.1	3.2
Unit labor cost	3.8	-0.5	-0.4	3.8	5.5	3.1	3.9	4.8	1.6	4.3
Private fixed-weight deflator	4.5	2.5	2.9	3.1	5.1	4.0	4.3	4.6	3.3	4.6

* 6.3 per cent exclusive of increased employer costs for Social Security.

** 6.8 " " " " " " " " " "

*** Average hourly earnings of production workers adjusted for inter-industry shifts and, in manufacturing only, for overtime.

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Table 4

Price Changes in Gross Private Product and Selected Components[1/]

(Seasonally adjusted)

	1972				1973				Change from a Year Earlier	
	Q I	Q II	Q III	Q IV	Q I	Q II	Q III	Q IV	1972 IV	1973 IV
					Projections				Projections	
Private fixed-weight deflator	4.5	2.5	2.9	3.1	5.1	4.0	4.3	4.6	3.3	4.6
Consumer foods[2/]	7.4	1.7	5.2	6.3	14.0	4.5	3.5	3.0	5.3	6.4
Other consumer goods[2/]	2.9	2.2	2.2	0.9	2.9	3.3	3.7	4.6	2.1	3.7
Consumer services	2.6	3.0	3.0	3.3	3.6	4.2	4.6	4.7	3.0	4.4
Producers' durable equipment	6.6	3.0	2.2	- .7	3.0	3.0	3.5	5.0	2.8	3.7

1/ Based on 1967 expenditure weights.

2/ FRB estimates based on Dept. of Commerce and BLS data for 1972.

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Table 5

Alternative Monetary Policy Assumptions,
Estimated Impact on Selected Economic Measures
Quarter I 1973 to Quarter IV 1973

	Growth Rate in M_1 (SAAR)		
	5-1/2%[1/]	7%	4%
Increase in Nominal GNP			
Billions of dollars	83.0	89.0	77.0
Percentage annual rate	9.2	9.8	8.6
Increase in Real GNP			
Billions of 1958 dollars	31.0	34.5	27.5
Percentage annual rate	5.0	5.5	4.5
Rate of Price Increase[2/]			
Quarter I 1973	5.1	5.1	5.1
Quarter IV 1973	4.6	4.7	4.5
Unemployment Rate			
Quarter I 1973	5.0	5.0	5.0
Quarter IV 1973	4.7	4.6	4.9
Treasury Bill Rate			
Quarter I 1973	5.70	5.70	5.70
Quarter IV 1973	6.50	5.90	7.10

1/ Greenbook judgmental projection.

2/ Private GNP fixed weight index based on 1967 expenditure weights.

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Table 6

Selected Financial Flows
(Seasonally Adjusted)

	1973 ALTERNATIVES:			Earlier Years				
	A	B	C	1972	1971	1970	1969	1968
	Per cent changes							
Concepts of Money:								
a) M_1	7.0	5.5	4.0	8.3	6.6	6.0	3.6	7.8
b) M_2	8.5	6.0	4.5	10.8	11.4	8.4	2.6	9.3
c) M_3	10.0	7.5	5.5	12.9	13.5	8.0	2.9	8.3
d) Total time and savings deposits at commercial banks	17.0	14.0	13.5	15.5	18.2	17.9	-4.8	11.5
e) Consumer-type	10.0	6.5	5.0	13.3	16.7	11.1	1.4	11.2
f) Bank credit	12.5	11.0	10.0	14.0	11.3	8.1	3.9	11.0
g) Nonbank savings accounts	13.0	9.0	6.5	16.7	17.5	7.7	3.5	6.4
	Billions of Dollars							
h) Total funds raised in credit markets	179.0	175.5	173.5	168.1	156.3	101.6	91.7	97.8
i) Residential Mortgages	49.5	46.5	45.0	46.8	34.9	18.7	20.5	18.7
j) Financed by Federal agencies	6.0	11.0	17.0	5.3	3.0	7.0	8.8	3.7
k) U.S. Government & Federal agency securities	19.0	23.0	29.0	23.3	29.4	21.6	5.5	16.7
l) Financed by individuals	-5.0	5.0	11.5	-1.5	-22.6	-4.4	12.1	4.1
m) Corporate bonds	17.0	17.5	18.0	19.7	24.6	23.7	14.8	15.0
n) Financed by individuals	2.0	4.0	5.0	3.2	7.6	12.4	5.7	4.8
Short-term borrowing by business:								
o) Loans at banks	25.0	22.0	21.0	15.1	6.4	3.5	14.6	11.0
p) Commercial paper	.5	2.0	3.0	.7	-1.2	2.2	2.3	1.5

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Table 7

Selected Financial Flows, by Half Years
(Seasonally Adjusted Annual Rate)

	1972		ALTERNATIVE B 1973		ALTERNATIVE C 1973	
	H_1	H_2	H_1	H_2	H_1	H_2
	Per Cent					
Concepts of Money:						
a) M_1	7.7	8.5	5.0	5.5	4.0	4.0
b) M_2	10.8	10.3	6.5	5.0	5.5	3.5
c) M_3	13.0	12.1	8.5	6.0	6.5	4.0
d) Total time and savings deposits at commercial banks	15.4	14.5	18.5	9.5	17.5	9.0
e) Consumer-type	13.7	12.1	8.0	5.0	7.0	3.0
f) Bank credit	12.8	14.2	13.0	8.0	12.0	7.5
g) Nonbank savings accounts	17.3	14.8	10.5	7.0	8.5	5.0
	Billions of Dollars					
h) Total funds raised in credit markets	150.3	185.4	190.0	160.0	189.0	157.0
i) Residential Mortgages	42.7	50.8	49.0	44.0	48.0	42.0
j) Financed by Federal agencies	3.5	7.2	8.5	13.5	14.5	18.5
k) U.S. Government & Federal agency securities	18.5	28.1	32.0	14.0	38.5	19.0
l) Financed by individuals	-7.9	4.8	4.0	6.0	13.0	10.0
m) Corporate bonds	20.7	18.7	14.5	21.0	14.5	22.0
n) Financed by individuals	3.7	2.7	2.5	5.5	3.0	8.0
Short-term borrowing by business:						
o) Loans at banks	10.4	19.9	27.5	17.0	26.5	15.5
p) Commercial paper	3.0	-1.7	*	4.0	1.0	5.0

March 19, 1973

Table 8

Rates of Growth in Selected Economic Variables
Under Four Different Policy Alternatives

Annual Rates of Growth			Policy Alternatives 1	2	3	4
			Following a growth rate of 5.5% in 73QI, M_1 is assumed to grow at a steady annual rate of:			M_1 is assumed to grow at a 5.5% rate in 1973 and 7.0% in 1974
			7.0%	4.0%	5.5%	
Nominal GNP	1973	I	12.3	12.3	12.3	12.3
		II	10.4	10.0	10.2	10.2
		III	9.6	8.4	9.0	9.0
		IV	9.4	7.4	8.4	8.4
	1974	I	9.8	7.0	8.4	8.6
		II	9.6	5.9	7.7	8.2
		III	9.1	4.7	6.8	7.8
		IV	8.3	3.8	5.9	7.3
Real GNP	1973	I	6.5	6.5	6.5	6.5
		II	6.4	6.0	6.2	6.2
		III	5.2	4.1	4.8	4.8
		IV	4.7	2.9	3.9	3.9
	1974	I	4.2	1.6	2.9	3.1
		II	4.9	1.7	3.2	3.8
		III	4.3	.6	2.4	3.3
		IV	3.5	-.2	1.6	2.9
Fixed Weight Deflator	1973	I	5.1	5.1	5.1	5.1
		II	4.0	4.0	4.0	4.0
		III	4.4	4.3	4.3	4.3
		IV	4.6	4.4	4.6	4.6
	1974	I	4.6	4.2	4.4	4.4
		II	4.6	3.9	4.2	4.3
		III	4.7	3.7	4.2	4.3
		IV	4.7	3.5	4.0	4.2
Unemployment Rate	1973	I	5.0	5.0	5.0	5.0
		II	4.9	4.9	4.9	4.9
		III	4.9	5.0	4.8	4.8
		IV	4.6	4.9	4.7	4.7
	1974	I	4.6	5.2	4.9	4.9
		II	4.5	5.5	5.0	4.9
		III	4.5	5.8	5.2	5.0
		IV	4.5	6.2	5.4	5.1

March 19, 1973

ATTACHMENT B

March 16, 1973

PRESS COMMUNIQUE
OF THE MINISTERIAL MEETING OF THE GROUP OF TEN
AND THE EUROPEAN ECONOMIC COMMUNITY
PARIS, FRANCE

The Ministers and Central Bank Governors of the ten countries participating in the general arrangements to borrow and the member countries of the European Economic Community met in Paris on 16th March, 1973 under the Chairmanship of Mr. Valery Giscard d'Estaing, Minister of the Economy and of Finance of France. Mr. P. P. Schweitzer, Managing Director of the International Monetary Fund, took part in the meeting, which was also attended by Mr. Nello Celio, head of the Federal Department of Finance of the Swiss Confederation, Mr. E. Stopper, President of the Swiss National Bank, Mr. W. Haeferkamp, Vice President of the Commission of the European Economic Community, Mr. E. Vann Lennep, Secretary-General of the Organization for Economic Co-operation and Development, Mr. Rene Larre, General Manager of the Bank for International Settlements and Mr. Jeremy Morse, Chairman of the Deputies of the Committee of Twenty of the I.M.F. The Ministers and Governors heard a report by the Chairman of their Deputies, Mr. Rinaldo Ossola on the results of the technical study which the Deputies have carried out in accordance with the instructions given to them.

The Ministers and Governors took note of the decisions of the members of the E. E. C. announced on Monday. Six members of the E. E. C. and certain other European countries, including Sweden, will maintain 2-1/4 per cent margins between their currencies. The currencies of certain countries, such as Italy, the United Kingdom, Ireland, Japan and Canada remain, for the time being, floating. However, Italy, the United Kingdom and Ireland have expressed the intention of associating themselves as soon as possible with the decision to maintain E. E. C. exchange rates within margins of 2-1/4 per cent and meanwhile of remaining in consultation with their E. E. C. partners.

The Ministers and Governors reiterated their determination to ensure jointly an orderly exchange rate system. To this end, they agreed on the basis for an operational approach towards the exchange markets in the near future and on certain further studies to be completed as a matter of urgency.

Thet agreed in principle that official intervention in exchange markets may be useful at appropriate times to facilitate the maintenance of orderly conditions, keeping in mind also the desirability of encouraging reflows of speculative movements of funds. Each nation stated that it will be prepared to intervene at its initiative in its own market, when necessary and desirable, acting in a flexible manner in the light of market conditions and in close consultation with the authorities of the nation whose currency may be bought or sold. The countries which have decided to maintain 2-1/4 per cent margins between their currencies have made known their intention of concerting among themselves the application of these provisions. Such intervention will be financed, when necessary, through use of mutual credit facilities. To ensure fully adequate resources for such operations, it is envisaged that some of the existing "swap" facilities will be enlarged.

Some countries have announced additional measures to restrain capital inflows. The United States authorities emphasized that the phasing out of their controls on longer-term capital outflows by the end of 1974 was intended to coincide with strong improvement in the U.S. balance-of-payments position. Any steps taken during the interim period toward the elimination of these controls would take due account of exchange market conditions and the balance of payments trends. The U.S. authorities are also reviewing actions that may be appropriate to remove inhibitions on the inflow of capital into the United States. Countries in a strong payments position will review the possibility of removing or relaxing any restrictions on capital outflows, particularly long-term.

Ministers and governors noted the importance of dampening speculative capital movements. They stated their intention to seek more complete understanding of the source and nature of the large capital flows which have recently taken place. With respect to Euro-currency markets, they agreed that methods of reducing the volatility of these markets will be studied intensively, taking into account the implications for the longer-run operation of the international monetary system. These studies will address themselves, among other factors, to limitations on placement of official reserves in that market by member nations of the IMF and to the possible need for reserve requirements comparable to those in national banking markets. With respect to the former, the ministers and governors confirmed that their authorities would be prepared to take the lead by implementing certain undertakings that their own placements would be gradually and prudently withdrawn. The United States will review possible action to encourage a flow of Euro-currency funds to the United States as market conditions permit.

In the context of discussions of monetary reform, the ministers and governors agreed that proposals for funding or consolidation of official currency balances deserved thorough and urgent attention. This matter is already on the agenda of the Committee of Twenty of the IMF.

Ministers and governors reaffirmed their attachment to the basic principles which have governed international economic relations since the last war as the greatest possible freedom for international trade and investment and the avoidance of competitive changes of exchange rates. They stated their determination to continue to use the existing organizations of international economic co-operation to maintain these principles for the benefit of all their members.

Ministers and governors expressed their unanimous conviction that international monetary stability rests, in the last analysis, on the success of national efforts to contain inflation. They are resolved to pursue fully appropriate policies to this end.

Ministers and governors are confident that, taken together, these moves will launch an internationally responsible program for dealing with the speculative pressures that have recently emerged and for maintaining orderly international monetary arrangements, while the work of reform of the international monetary system is pressed ahead. They reiterated their concern that this work be expedited and brought to an early conclusion in the framework of the Committee of Twenty of the IMF.

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ATTACHMENT C

March 20, 1973

In the staff's judgment the following specifications would be consistent with the 5 to 5-1/2 per cent longer-run target for M_1 agreed upon by the Committee in its discussion yesterday afternoon:

Longer-run targets
(Represented by annual rates of growth for the 2nd and 3rd quarters of 1973)

M_1	5 to 5-1/2
M_2	5-1/2 to 6
Credit Proxy	8-1/2 to 9
RPD	7-1/2 to 8

Associated ranges for March-April 1973

RPD	14 to 16%
M_1	5-1/2 to 7-1/2%
M_2	6-1/2 to 8-1/2%
Federal funds rate	6-3/4 to 7-1/2 per cent

ATTACHMENT D

March 19, 1973

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 20, 1973

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests continued substantial growth in real output of goods and services in the current quarter, although at a rate less rapid than in the fourth quarter of 1972. Over the first 2 months of this year, employment rose strongly but the unemployment rate remained about 5 per cent. The advance in wage rates moderated from the earlier rapid pace, while the rate of increase in prices accelerated. Prices of foods continued to rise sharply both at wholesale and retail; in February, moreover, increases in wholesale prices of industrial commodities were large and widespread. Another wave of speculative movements out of dollars into German marks and some other currencies developed at the beginning of March and led to a decision by a number of European countries to float their currencies jointly. On March 16, after a series of meetings, officials of leading industrial countries announced a program aimed at maintaining orderly international monetary arrangements.

The narrowly defined money stock expanded moderately in February, after having changed little in January, and growth over recent months remained at an average annual rate of about 6.5 per cent. The more broadly defined money stock continued to grow at a moderate rate in February as inflows of consumer-type time and savings deposits to banks slowed sharply. However, in the face of strong loan demand from businesses, and also from foreign banks, U.S. banks sharply increased their issuance of large-denomination CD's and the bank credit proxy expanded very rapidly. In recent weeks short-term market interest rates have risen substantially further while the rise in long-term rates has remained more moderate.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions consonant with the aims of the economic stabilization program, including abatement of inflationary pressures, sustainable growth in real output and employment, and progress toward equilibrium in the country's balance of payments.

Alternative A

To implement this policy, while taking account of international developments, the Committee seeks to achieve bank reserve and money market conditions that will support growth in monetary aggregates over the months ahead at about the average rates of the past 12 months.

Alternative B

To implement this policy, while taking account of possible domestic credit market and international developments, the Committee seeks to achieve bank reserve and money market conditions that will support somewhat slower growth in monetary aggregates over the months ahead than occurred on average in the past 6 months.

Alternative C

To implement this policy, while taking account of possible domestic credit market and international developments, the Committee seeks to achieve bank reserve and money market conditions that will support substantially slower growth in monetary aggregates over the months ahead than occurred on average in the past 6 months.