

MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, August 21, 1973, at 9:30 a.m.

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

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

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

Mr. Broida, Secretary
Messrs. Altmann and Bernard, Assistant
Secretaries
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Bryant, Gramley, Reynolds, 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. Coyne, Assistant to the Board of Governors
Mr. O'Brien, Special Assistant to the Board
of Governors
Messrs. Wernick and Williams, Advisers,
Division of Research and Statistics,
Board of Governors
Messrs. Gemmill and Pizer, Advisers, Division
of International Finance, Board of Governors
Mr. Ettin, Assistant Adviser, Division of
Research and Statistics, Board of Governors
Mr. Wendel, Chief, Government Finance Section,
Division of Research and Statistics,
Board of Governors
Miss Pruitt, Economist, Office of the Secretary,
Board of Governors
Mr. Crow, Staff Assistant, Board Members' Offices,
Board of Governors
Mrs. Peters, Secretary, Office of the
Secretary, Board of Governors
Mrs. Stanier, Secretary, Office of the
Secretary, Board of Governors

Messrs. Parthemos and Doll, Senior Vice
Presidents, Federal Reserve Banks of
Richmond and Kansas City, respectively
Messrs. Hocter, Brandt, and Green, Vice
Presidents, Federal Reserve Banks of
Cleveland, Atlanta, and Dallas, respectively
Messrs. Kaminow and Kareken, Economic Advisers,
Federal Reserve Banks of Philadelphia and
Minneapolis, respectively
Miss Greenwald and Messrs. Cooper, Thunberg, and
Balbach, Assistant Vice Presidents, Federal
Reserve Banks of Boston, New York, New York,
and St. Louis, respectively

Chairman Burns welcomed Mr. Black, who was attending his first Committee meeting since being named President of the Federal Reserve Bank of Richmond, and on behalf of the Committee he wished Mr. Black well as he undertook his new responsibilities.

By unanimous vote, the minutes of actions taken at the meetings of the Federal Open Market Committee on June 18-19 and July 9, 1973, were approved.

The memoranda of discussion for the meetings of the Federal Open Market Committee held on June 18-19 and July 9, 1973, were accepted.

Chairman Burns called for a staff report on international monetary and trade developments, and Mr. Reynolds made the following statement:

Since late July, there has been a marked reversal of tendencies and attitudes in foreign exchange markets, as Mr. Coombs will be reporting in more detail. The dollar has strengthened pretty steadily, and major foreign central banks have sold off about \$1 billion of their dollar reserves in just the past 3 weeks.

This reversal seems to have been triggered by changes in interest rate relationships--by the easing of an unintended late-July liquidity squeeze in Germany, and by the sharp further advance in U.S. interest rates, including the administered rates to which Europeans pay more attention than we do, namely, the prime rate and the discount rate. But more fundamentally, the strengthening of the dollar has been based on a growing recognition that the U.S. trade balance and over-all payments position are improving rapidly.

The improvement is clear from recently published statistics. The trade deficit in the second quarter of 1973 was at an annual rate of only \$1.2 billion, compared with \$6.9 billion for the year 1972, an improvement of nearly \$6 billion. The balance on goods and services showed a surplus in the second quarter of nearly \$3 billion at an annual rate, compared with a deficit of \$4-1/2 billion in the year 1972, an improvement of nearly \$7-1/2 billion. We do not yet have the second-quarter figures for the balance on current and long-term capital transactions; the so-called "basic" balance will be published in mid-September. But we do have an estimate and we think that that balance may have been a deficit at an annual rate of less than \$3 billion, compared with nearly \$10 billion for the year 1972, representing an improvement of \$7 billion.

Our most recent assessment of the outlook suggests that the improvement in our payments position will continue through 1974, and at an even more rapid rate than we had earlier supposed. We now think the trade balance may be about zero for the second half of 1973, and may show a surplus of as much as \$4 billion in 1974. On goods and services combined, we expect that the surplus may rise to a rate of nearly \$4 billion in the second half of 1973, and to as much as \$9 billion in 1974. We are hesitant to project the basic balance so far ahead because of the great uncertainties attaching to capital flows during a period when U.S. controls are scheduled to be relaxed. But there does seem to be a good possibility that the basic balance could even be in surplus next year for the first time since 1957.

While the fact that the U.S. payments position is improving, and will continue to improve, is now increasingly recognized, the nature of the improvement seems to me to be somewhat misunderstood. I would like this morning to try to clarify it a little, and also to comment on some related developments in international commodity markets.

As we pointed out in the June chart show, there are three main forces currently working to improve the U.S. trade balance. The most fundamental is the

exchange rate changes that have taken place since 1970. These work persistently and powerfully, but only slowly and with a very considerable lag. Evidence that they are indeed working is found in the recent leveling off in the volume of U.S. imports, despite the domestic boom, and in the increasing U.S. share in world exports of manufactures. But nothing startlingly new is happening here. Just as it seemed to me wrong in 1972 to say that the adjustment to exchange rate changes was coming much more slowly than should have been anticipated, so it seems incorrect now to say that the adjustment is now coming faster than had been anticipated. I think the adjustment to exchange rate changes is about on schedule, and much of it is still to come, in 1974 and on into 1975.

What does seem to be coming somewhat faster than we earlier anticipated is the change in relative business cycle conditions here and abroad. Whereas in 1972 much of the deterioration in our trade balance was attributable to a worsening cyclical position, with strong recovery at home and delayed recovery abroad, much of the recent improvement is attributable to an improving cyclical position, with the boom abroad still gathering steam while ours is beginning to slacken. We would expect cyclical conditions to be favorable to us over the next year or so, with the expansion of activity slowing much less abroad than at home.

Finally, the third factor--and the factor that at the moment is quantitatively most important in improving our trade balance and outlook--is what we used to refer to as the temporary bulge in agricultural exports, which is related more to acts of God than to policy actions, although prosperity abroad and dollar devaluation have certainly contributed to it. That bulge in agricultural exports now shows signs of being prolonged until at least mid-1974, whereas earlier we had expected it to subside in late 1973. Large--perhaps record--crops are still in prospect around the world for the crop year that has just begun, but crop prospects are not quite so good as earlier expected, and carryovers are dangerously low, so that total supplies are both lower than had been hoped and low in relation to prospective demand even at current high prices.

It is a close question whether world supplies will prove to be just adequate to meet demands for current consumption or whether they will fall somewhat short. In this uncertain setting, with low carryovers, market prices have recently been bid up to dizzy heights, and it seems clear that even if they later fall off a good deal, the average prices for U.S. agricultural exports will remain much higher than they were last year, while export volumes will remain at about the past year's high levels.

Possibly the United States will find it necessary to reimpose controls on agricultural exports. But such controls should not greatly affect our projections, since their purpose would be to hold down U.S. prices while permitting export volumes of just about the levels projected. We are currently projecting the value of agricultural exports to hold at a \$16 to \$17 billion annual rate range through mid-1974, whereas last June we had been projecting a \$13 to \$14 billion rate. Even our latest estimates may be too low; we have assumed average export prices well below recent market prices, though, of course, above the export prices of last year. The figure of \$16 to \$17 billion may be compared with \$9-1/2 billion for calendar 1972, which we then thought of as a pretty good year.

Incidentally, if further export controls are judged to be necessary, I would hope we might make international efforts of some sort to share the shortages as equitably as possible. It looks as if any world shortages will be only marginal, and it does great damage to our long-run export promotion effort to keep harping on our desire to put U.S. consumers' interests ahead of everyone else's.

In summary, because of crop shortfalls abroad and our own good fortune in having supplies available for export, we have recently been getting a much more rapid balance of payments improvement than would have resulted from exchange rate changes alone. Later, when agricultural exports subside, as they surely will, the exchange rate changes will be working their full effects, and with prudent domestic management we ought to be able to sustain the better payments position that we expect will be achieved in 1974. Thus, both

the short-term and medium-term outlooks for our balance of payments seem to me to be very strong. There may still be occasional setbacks, but the trends are encouraging.

The enormous rise in agricultural prices has, of course, done great damage to domestic price stability, and we would not have needed anything like the large price increases that occurred to achieve an acceptable rate of balance of payments improvement. Similarly, the boom in world market prices of nonfood commodities has also contributed greatly to domestic inflation, and has somewhat damped the payments improvement by the added cost of imports.

Commodity price increases--both for foods and for raw materials--have reflected, I believe, not only genuine supply shortages, but also a good deal of speculative activity. The latter has included not only speculation on the possibility of shortages but also more generally an effort to beat inflation by getting out of financial assets into goods. This speculative bubble on top of the commodity boom may now, it seems to me, be on the verge of bursting. That would be helped by the recent strengthening of the dollar and by the very high cost of borrowing money to maintain speculative positions. We have in recent days seen some hesitation in the market prices of cocoa, copper, and rubber, as well as in prices of grains and soybeans. And wool prices peaked as long ago as last March.

Since earlier increases in the prices of raw materials have not yet been fully reflected in the prices of finished products, it may be some months before any decline in spot commodity prices will be reflected in slower increases in broad price indexes. But by the end of the year, we may well be getting some relief on the price front from declining commodity prices as well as from the improving foreign exchange value of the U.S. dollar compared with the lows reached in July.

Over the past year, the rapid expansion of U.S. exports put added pressure on an already buoyant domestic economy and thus intensified somewhat our domestic

problems. But over the year ahead, if our projections of flagging domestic demand are realized, the stimulus of further advances in exports will be a more welcome, sustaining influence.

Chairman Burns then invited Mr. Daane to report on developments at the meeting of the Ministers of the Committee of Twenty, which had been held in Washington on July 30-31.

Mr. Daane observed that the meeting had been billed in advance as a working meeting designed to permit an exchange of views on the key issues and not intended to produce a communique. He thought an excellent summary of the major issues had been prepared for the Finance Ministers and Governors by the C-20 Deputies prior to the meeting. The meeting itself was a very good one in his judgment. The prevailing atmosphere was one of forward motion and of willingness and desire to cooperate in finding solutions to complex issues. Mr. Wardhana, chairman of the meeting, in both his public and private remarks at the end of the meeting rightly praised the constructive spirit in which the participants had faced the difficult issues before them.

Mr. Daane reported that three major sessions were devoted to substantive issues. One half-day session was concerned with the adjustment process and convertibility, and in his opinion, it was the most significant. It seemed to develop a greater narrowing of differences with a general recognition of the need

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for symmetry in the burden of the adjustment process. Secretary Shultz made clear the United States' position in favor of a system with strong enforcement features. The ensuing discussion helped to clarify differences which still remained regarding the desirability of a system involving more of a presumption of action or one relying more on an assessment or appraisal process by a revamped Executive Board of the International Monetary Fund. There appeared to be general agreement on the need for some sort of graduated pressures but the nature and degree of the pressures were still unresolved issues.

The second substantive session dealt with primary reserve assets, Mr. Daane said, and he thought there was less narrowing of differences on this issue. The Ministers and Governors seemed to take the position that SDR's should be the primary reserve asset, but they were uncertain about the characteristics that SDR's should have in a reformed system. Those characteristics involved technical questions which required some further study. One, for example, concerned maintenance of the value of the SDR--whether it should be tied to an average market basket of currencies or to something else. Another question was the appropriate rate of interest on SDR's. All those questions were far from being resolved. On the issue of gold, there was really no pressure

to increase its price except from one or two representatives. Secretary Shultz expressed the U.S. position that gold should be phased out. The thrust of the European position, as he (Mr. Daane) interpreted it, was that there was no need for an official price of gold and that nations should have the freedom to buy and sell gold and to settle their accounts in gold at market-related prices. The U.S. view was that it might be desirable to amend the March 1968 agreement to permit selling but that the United States was skeptical about the usefulness, and was unsure about the implications, of a complete severing of the official link.

Mr. Daane indicated that the third major substantive session was concerned with development assistance. As expected, the developing countries wanted to be exempted from any constraints in the adjustment process and they were very much in favor of a link between development assistance and SDR creation. Chairman Burns spoke with a single but very strong voice in opposition to the link. He gave a stirring defense of the U.S. view that neither development assistance nor the SDR would be helped by such a link. It was his (Mr. Daane's) impression that the Chairman's remarks, while perhaps not convincing to the developing countries, were received with a great deal of sympathy outside the meeting by a number of his European counterparts.

Mr. Daane said he felt that progress at the recent meeting had been greater than had been anticipated. The C-20 Deputies were scheduled to hold a meeting in Paris on September 5 to 7. They would try to develop further the draft outline that the Ministers and Governors would consider at their meeting in Nairobi now scheduled for Sunday, September 23.

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 July 17 through August 15, 1973, and a supplemental report covering the period August 16 through 20, 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:

Between July 10 and 31 we intervened fairly frequently to restrain a declining tendency in the dollar rate. During this period we did a total of \$273 million equivalent in German marks, French francs, and Belgian francs, all financed by drawings on the swap line. Of this total, \$220 million was in marks and I am glad to say our intervention was strongly supported by coordinated purchases of dollars in the market totaling \$355 million by the German Federal Bank. More or less concurrently the British Government became thoroughly alarmed

over the inflationary risk of a further depreciation of sterling and authorized the Bank of England to intervene forcefully, which they did to the extent of \$635 million, while the Common Market central banks spent \$245 million in defending their parities vis-a-vis each other. The Bank of Italy intervened even more strongly for a total of roughly \$1 billion. This intervention added up in my view to a fairly convincing demonstration of central bank determination to restore orderly conditions in the exchange markets, although the scale and forcefulness of our own operations were, comparatively speaking, fairly constrained.

Towards the end of July, I requested and secured Chairman Burns' approval to switch, if we got a favorable opportunity, from purely defensive tactics to a more aggressive approach, designed to push the dollar rate up toward more realistic levels. After some delay, the Treasury also concurred. We were hoping to exploit through such operations the favorable trade figures for June, released on July 26. Unfortunately, this operation was totally frustrated by a credit crunch that developed in the German money market. As a result we ended up that day, instead of undertaking an aggressive operation, spending \$53 million in purely defensive operations despite the good news on the trade side. Together with other central bank representatives in Europe, Governor Daane and I appealed to the German Federal Bank to temper their credit squeeze, and they responded in a very cooperative way. As the German money market subsequently eased, we began to nudge the dollar up gently. But just as we were about to operate more forcefully, the dollar suffered a new setback on the news that some Congressman had filed a resolution to impeach the President.

Early in August, however, the situation turned completely the other way and the dollar was suddenly favored by a whole series of events--in particular a sharp decline in the London gold price, unusually stringent conditions in our own money market, and the development of abnormally easy conditions in the German and French markets. We were naturally tempted to seize this opportunity to drive the dollar rate up,

but we concluded that too much of its buoyancy at that moment was probably attributable to temporary factors, and that if we did go into the market with aggressive tactics, we could get more results than we really wanted in the sense of generating an unduly sharp rise in the rate which might subsequently prove costly to sustain. The German Federal Bank agreed fully with our analysis of the situation. Accordingly, we decided that it was best to take advantage of the temporary factors pushing up the dollar to reduce our outstanding debt as much as we could. As the dollar continued to rise strongly each day, we succeeded by August 15th in completely covering the \$273 million of swap drawings made in July, with an over-all profit on the operation of nearly \$8-1/2 million.

I think it was just as well that we got this debt cleaned up when we did, because yesterday the market suddenly turned sour. The weekend European press put out a lot of dire warnings about the resurgence of inflation in the United States; rumors began to circulate that the German trade surplus for July would move up to record levels; and, finally, the Secret Service revealed knowledge of a plot against President Nixon and cancelled the presidential motorcade in New Orleans. We let the dollar rate gradually fall back by about 2 per cent from Friday's close, and then as the Secret Service report began to attract wide attention, we went back into the market and began to operate fairly forcefully--more forcefully than before--by repeatedly hitting bids for marks. By mid-afternoon, the demand for marks seemed to be tapering off and we then proceeded to try to restore a little buoyancy to the dollar rate by placing offers in the market. We finished the day with the rate significantly above the low point at a cost of \$45.5 million equivalent in the way of intervention. We appealed to the German Federal Bank to follow through in Frankfurt this morning, and they did, with secret intervention of \$30 million. The rate has now moved up by another 1/2 per cent or so. We hope that the market is now stabilizing but much will depend upon the German trade figures for July as well as our own, both of which are due to be published at the end of this week.

Reviewing our market experience since July 10, I am inclined to think that our operations, in conjunction with those of other central banks, have done quite a bit to restore a fairly orderly market, although the market remains pretty jumpy and I don't like the sharpness of rate movements in response to whatever is the latest item on the ticker. We have, I think, introduced to some extent a feeling of risk in the market that the dollar can go up as well as down. But most market traders still remain persuaded, I'm afraid, that we will probably tend to back off as soon as selling pressure develops against the dollar, and on balance the market still remains more fearful of a decline than of a rise in the dollar rate. As a result I am more than ever inclined to the judgment that when we do operate, we should operate on a larger scale and in a more forceful and visible manner than we have hitherto, if we want to change market psychology for the better. If Mr. Reynolds' forecast holds up, the risks inherent in more forceful operations should be much reduced.

The second point I would like to stress is the importance, at the earliest possible moment, of getting clearance to operate in the London gold market in conjunction with one or two other central banks. For better or worse, sharp increases or declines in the London gold price exert an important influence on market confidence or lack of confidence in the dollar. We urgently need to reinforce our exchange operations with periodic operations in the gold market, where the Treasury would, incidentally, realize profits of around 200 per cent on any gold sold.

Finally, our experience of the past month has demonstrated the abnormally strong influence on the external value of the dollar of relative changes in credit conditions here and abroad. All of the major money markets, including our own, are now so tight that any further intensification of stringency in one of them or easing in another tends to set off big movements of short-term funds with inevitable effects on exchange rates.

Chairman Burns commended Mr. Coombs on the skill with which he had conducted the System's foreign currency operations in recent weeks.

Mr. Mayo noted that Mr. Reynolds had not commented on the problem of growing fuel imports. He asked whether the staff anticipated serious balance of payments repercussions only over the longer run or whether intermediate-term difficulties were also foreseen.

Mr. Reynolds replied that the staff had allowed for a very large increase in fuel imports in the projection period, but since other imports were expected to level off, total imports did not rise as fast as exports. The problem of fuel imports would require more attention in projections of 5 or 10 years ahead, but it needed to be kept in mind that oil exporting countries would have very large dollar earnings to invest and some of those funds might well be channeled back to the United States. In fact, such investments were already occurring. The question, therefore, was how the two flows would balance out, and it was not clear that the over-all balance of payments would be worsened by rising oil imports.

Mr. Brimmer asked Mr. Coombs whether current conditions in international financial markets made it advisable in his judgment to drop the reference to international developments

in the operational paragraph of the directive, as the staff had suggested.^{1/}

Mr. Coombs replied that such developments could have a significant influence on the System's operations and on that basis it might be desirable to retain the reference.

Mr. Brimmer referred to Mr. Coombs' suggestion that the System participate in the London gold market for the purpose of fostering greater stability in that market and indirectly in the external value of the dollar. He (Mr. Brimmer) had thought that the direction of causality ran the other way, that the gold market was a barometer of expectations for the dollar and that a strengthening in the dollar would have a tranquilizing effect on the gold market.

Mr. Coombs replied that the two markets tended to interact. A strengthening in the dollar tended to weaken the market for gold. On the other hand, a sudden rise in gold prices, as had occurred the day before, tended to be construed as an indication of developing weakness in the dollar. What concerned him was that speculators in the gold market were in a position to influence the behavior of the dollar in the exchange markets. He believed it would be helpful if the System were in a position to counter the activities of the speculators.

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

Mr. Francis said he had found Mr. Reynold's report useful and realistic. In view of that report and of the success of relatively modest transactions in the exchange markets, he did not understand why Mr. Coombs was recommending larger operations.

Mr. Coombs remarked that although there was a fair chance that the projections made by Mr. Reynolds would materialize, setbacks to confidence in the dollar could be expected from time to time under current circumstances. It would be unfortunate, in his view, if the improvement in the fundamental position of the dollar were to be frustrated by speculative sprees generated by temporary influences. He had the feeling that to date the Desk could not intervene by much more than \$50 million on any given day without weakening the Treasury's willingness to support the System's operations. On certain days it would have been helpful if operations could have been larger. The scale he had in mind would involve transactions ranging up to \$100 million or \$125 million. Such intervention would be closer to the tactics employed by European central banks when they encountered temporary difficulties.

By unanimous vote, the System open market transactions in foreign currencies during the period July 17 through August 20, 1973, were approved, ratified, and confirmed.

Chairman Burns then called for the staff report on the domestic economic and financial situation, supplementing the written reports that had been distributed prior to the meeting. Copies of the written reports have been placed in the files of the Committee.

Mr. Partee made the following statement:

Fairly firm figures now indicate that the expansion in economic activity slowed more sharply during the second quarter than we had been expecting. Real GNP rose at only a 2-1/2 per cent annual rate, while the pace of inflation quickened further, to an 8 per cent rate in terms of the fixed-weight private deflator. The reported slowing in real output growth may have overstated the underlying adjustment that has been taking place, however, because of measurement problems associated with farm output, rapid price inflation, and seasonal factors. Thus, gross private nonfarm output increased in real terms at a 4 per cent annual rate--considerably better than for over-all GNP. And the industrial production index, which avoids the problems of making adjustment for price change, rose at a 5-1/2 per cent annual rate--down markedly from the first quarter but still a respectable showing.

Moderation in real growth, of course, is a desirable development in the current economic setting. Output has been pressing against capacity in many lines, and there is undoubtedly a good deal of upward price pressure stemming from the strength and intensity of market demands, as well as from special supply constraints in foodstuffs and basic commodities and from the inexorable upward march in unit labor costs. If some of these pressures can be relieved, so much to the good, as long as the adjustment doesn't go too far. And at present, there is no evidence I know of that the slowdown is beginning to cumulate. Industrial production is

estimated to have risen at a 7 per cent rate over the past 2 months; retail sales rebounded in July, following the relatively weak second-quarter showing; and new orders for durable goods have remained at peak levels with backlogs continuing to rise.

Looking ahead, we continue to expect that growth will be moderate for the remainder of the year and that it is likely to slacken further in 1974. As before, the main elements in this pattern of slower growth are the expected sharp decline in housing starts and continued moderation in real consumer demands. Indeed, we have reduced our projections in both areas somewhat since the last meeting of the Committee. In the case of housing, the recent restriction in the availability of mortgage credit seems likely to cut somewhat further into housing starts than we had been projecting, particularly in the first half of next year. And in the case of consumption, sharply higher prices--especially for food--are likely to squeeze the budgets of many urban families, thus tending to force reductions in outlays for consumer durables and other postponable items. Higher prices will have the effect of transferring income to farmers, businesses and--through tax revenues--to governments, where the stimulus to current spending is apt to be much less than the purchasing power impact of lower real incomes on urban families.

Despite the clear prospect of additional weakness in these major sectors, it is important to recognize that the economy still has in it the potential for a substantial further rise. Capital spending, inventory investment, and export demand, in particular, could all increase markedly further in the period to come. And, in each instance, it is difficult to know how far the expansion might go or how long it might last.

First, as to capital spending, we have already witnessed a major upsurge over the past 2 years. Physical output of business equipment is up by nearly 30 per cent from the lows of early 1971 and fully 10 per cent above the pre-recession peak, while non-residential construction expenditures in real terms have also been tending upward. Nevertheless, new

orders for capital goods continue very strong, and there seems to be no prospect of a slackening in the months immediately ahead. Capacity limitations in many industries, opportunities for profitable substitution of equipment for high-cost labor, and an ample internal cash flow all suggest a further uptrend in capital spending, probably extending well into 1974 and possibly of major dimensions. The fall surveys of spending intentions for 1974 will tell us more about prospects in this area.

The situation with respect to inventory investment seems to point even more dramatically in the direction of expansion. Stocks are currently very low relative to sales and order backlogs, and many business firms complain of shortages and delivery delays. There is every evidence that business desires to rebuild inventory positions to more comfortable levels, and as the pressure eases from expanding final demands, they should have the opportunity to do so. Production facilities might remain under considerable pressure for some time as a result of this restocking process, and we would expect that inventory accumulation will take up most of the available slack well into the winter and perhaps beyond.

Finally, there is the prospect that export markets may remain much stronger than we have been accustomed to in recent years. Mr. Reynolds has discussed the marked improvement in the foreign trade outlook that appears to be taking place, and we have incorporated the new numbers in our GNP projections. Suffice it for me to say that this is an entirely new factor affecting the strength and character of demand for U.S. production. If, at something like current exchange rates, we have in fact become the cheapest source in the world for a wide array of basic commodities--both agricultural and industrial--then demands for our output could be much better sustained than in past periods when there has been some domestic slack. Not only would foreign buyers be available as a source of demand external to our domestic environment, but those U.S. buyers who in recent years have obtained supplies from abroad

would tend to shift back as domestic production of such materials as steel, chemicals, textiles and paper became available. This might mean a considerably longer run of capacity operations for the basic materials industries, relative to the remainder of the economy, than has been typical in past cyclical episodes.

It is not my intention, by emphasizing these potential sources of strength, to depart from the staff GNP projection presented in the green book.^{1/} That projection represents our view as to the most probable course of economic developments, and it points to a very moderate expansion in real demands, fading next year to the point where unemployment begins to move appreciably upward. What I do mean to underscore is the fact that there is a good deal of uncertainty surrounding that "highest probability" projection. Substantially higher capital spending, inventory investment, and foreign demand than we now anticipate would not only raise the expenditure figures directly, but would also tend to lift employment and consumer incomes and expenditures, and would increase pressures on employers for more liberal wage settlements. The dilemma that the Committee faces, in my view, is in deciding how to weigh the very real prospect that growth in the economy will be slowing to minimal levels against the very real risk that there may be enough remaining strength to keep unacceptable pressure on critical resources and hence on our structure of costs and prices. The way that difficult question is decided will have an important bearing on whether the Committee maintains the pressure on credit markets for a while longer or whether it should be prepared to slacken off a bit as the long-sought objective of achieving much slower growth in the money supply comes into view.

In response to a question by Mr. Francis, Mr. Partee indicated that the staff was projecting a relatively small increase in real product of 1.2 per cent from the fourth quarter

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

of 1973 to the fourth quarter of 1974. That increase was about 3 percentage points below the normal potential growth rate of the economy over the longer run. On the basis of that projection the staff anticipated some rise in unemployment after the fourth quarter of this year.

Mr. Black observed that inventories had remained unusually low in relation to sales and other pertinent measures, partly because of the increased use of computers in inventory management and partly because of supply shortages. Recently, however, the Richmond Bank had been getting the impression from businessmen in the District that the rising cost of carrying inventories was contributing to considerable reluctance to build up their stocks. He noted that the Board staff was projecting a large pickup in inventories and he wondered whether Mr. Partee was inclined to modify the projection in light of the rise in short-term interest rates.

Mr. Partee remarked that the current high cost of money was in itself a restraining influence on the accumulation of inventories. However, he had been impressed by the many references in the red book^{1/} to shortages of materials and component parts, and his own observations suggested that the selection of many items available in retail stores was poor. Those impressions of

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

shortages were consistent with the available statistics, which showed that the inventory-to-sales ratio was lower than it had been in a long time. Accordingly, he still anticipated a strong burst of inventory restocking as supplies became available, but he believed high interest rates would be a moderating influence.

Mr. Black referred to a table in the supplement to the green book which contained calculations of before-tax profit margins in manufacturing industries. The table suggested that only a few industries--including primary metals, motor vehicles, and petroleum--would have much opportunity to raise prices under the Phase IV ceilings. In that situation he wondered if those ceilings might have a greater dampening effect on price increases than might otherwise be expected.

Mr. Partee replied that the data referred to were very hard to interpret. They did indicate that a large number of industries were at or above their Phase IV profit margin ceilings in the second quarter and those industries did not seem to be in a good position to pass on increased costs. However, he was not sure what would happen in practice. One consideration to bear in mind was that nearly all industrial prices had been frozen since mid-June. Since costs could be assumed to have

continued to rise in the interim, many firms might well report lower third-quarter margins. In that event they would have more leeway to raise prices after the freeze was lifted.

Mr. Hayes commented that the staff at the New York Bank viewed the economic outlook in much the same way as did the Board staff. He was impressed by the intensity of current demand pressures in the economy and by the pervasive shortages of materials and skilled labor. On the other hand, he saw evidence that aggregate demand might be moderating, in part because of a slackening in over-all consumer demands--despite the recent spurt in retail sales, which apparently was stimulated in part by the temporary freeze on prices. There was no evidence, however, that business demands were cooling off.

Continuing, Mr. Hayes observed that the Phase IV stabilization program was subject to a number of uncertainties. He wondered, for example, whether the controls would be administered flexibly enough to correct existing distortions, and if the latter were corrected, whether price advances would be so large as to worsen inflationary expectations and provoke excessive wage demands. In the financial area, he did not see much evidence that high interest rates were in themselves bringing demand pressures under control thus far. At some level, presumably, interest rates would have a retarding impact, and he hoped it would be felt soon.

Mr. Hayes added that the most certain aspect of the economic outlook was the inevitability of continued high rates of inflation for some time to come. As Chairman Burns had pointed out on a number of recent occasions, the current inflation had been greatly aggravated by factors beyond the direct influence of domestic monetary policy. Nevertheless, he believed that if the System could help restore moderate demand conditions before the recent price increases had begun to work themselves fully into the wage-cost process, monetary policy could make a major contribution in the fight against inflation.

Mr. Coldwell asked Mr. Partee whether there was much evidence that consumers were presently buying heavily in anticipation of future price increases, especially in the food area.

Mr. Partee observed that the July retail sales figures were based on the advance report and therefore had to be interpreted with caution. However, he believed the data showed some evidence of speculative buying. There was a major increase in food store sales during the month, and auto sales also were surprisingly strong. Ford and General Motors had held major sales contests, which might have helped to account for the spurt in auto sales, but it was also clear that buyers were

anticipating higher prices on 1974 models. More generally, the indexes of consumer confidence were now at their lowest point in quite some time. Consumers were cautious and were particularly concerned about the outlook for food prices. In the period ahead, the character of markets for consumer goods would be influenced by those concerns as well as by the speculative buying that had occurred.

With respect to the projections, Mr. Partee noted that the staff expected relatively little increase in retail sales in the remaining months of 1973. The stockpiling of foods that might have occurred in July probably would have only short-run effects and would be followed by reduced buying for a month or two. However, the outlook for sales of durable goods was distinctly weaker than it had appeared a month or two ago. In fact, there had not been much growth in sales of durable goods since the surge in the first quarter.

Mr. Coldwell remarked that his contacts in the Dallas District suggested that anticipatory buying of both foods and other goods was substantial. Consequently, some decline in retail sales volume in September was expected. On the other hand, shortages of inventories were delaying the receipt of goods already ordered and deliveries in the period ahead would help to maintain sales volume.

Mr. Winn inquired whether the recent reports of business profits might not be misleading because of both profits on foreign exchange dealings of multinational firms and inventory profits in a period of rapid advances in prices. If his suspicions about the quality of earnings were correct, one could expect price increases in the period ahead that would be approved under the controls. Capital spending might also be affected. One large manufacturing company in the Cleveland District was reported to be operating with marginal facilities, and because of the resulting squeeze on profit margins, the company planned a major capital expenditure program despite the high cost of money.

Mr. Winn added that capital spending would also be stimulated by political and social forces. An obvious example was the petroleum industry where capital spending for refining facilities had fallen noticeably behind growing needs in the last 2 or 3 years. Executives in the steel industry had maintained that they would not undertake major capital spending programs despite capacity operations, but their attitudes now seemed to be changing rapidly. One company alone was reported to be contemplating a capital spending program of \$3/4 billion, and other companies were likely to follow, culminating in a major capital expenditure boom in the industry.

Mr. Partee remarked that the staff report on corporate profits in the second quarter, contained in the green book supplement, indicated a considerable increase in foreign dividends and branch profits, presumably due in part to foreign exchange profits. More importantly, the elimination of inventory profits would serve to reduce the year-over-year gains rather substantially. With respect to the question that Mr. Black had raised earlier, companies might argue before the Cost of Living Council that after adjustment for inventory profits, profit margins were low enough to justify increases in prices. With regard to capital spending, some staff members saw a potential for a major expansion in several basic industries. The current projections suggested only a rather moderate increase next year, but actual expenditures could be substantially higher.

Mr. Kimbrel commented that shortages of materials in the Atlanta District were leading to delays in the completion of both residential and industrial construction projects that were pushing some construction firms close to bankruptcy because of the high costs of funds. Steel producers in the District also were hard pressed; demands for domestic steel were especially strong--because imports from Europe had fallen off--at the same time that supplies of steel scrap were being diverted to other markets.

Mr. Kimbrel added that the staff at the Atlanta Bank had studied the relationship between rates of capacity utilization and price changes over the past 15 years. They had found a significant relationship between the level of unused capacity and the behavior of prices.

Mr. Partee remarked that various other studies had shown a strong relationship between the degree of capacity utilization and the degree of pressure on prices.

Mr. Eastburn, noting that the staff projections suggested a substantial decline in residential construction, inquired about the staff's assumptions concerning interest rates. He also asked how Mr. Partee would assess the probabilities that the staff projections for real GNP would prove to be too low rather than too high.

In response, Mr. Partee noted that growth in the money supply was assumed to be relatively low throughout the projection period, and consequently, short-term interest rates were assumed to drift upward in the remainder of 1973 and then to level off. However, those assumptions did not have much effect on the projections for residential construction because of the relatively long lag in the impact of mortgage availability on housing starts. The staff had reduced somewhat its projections of housing

starts in 1974 in view of the unfavorable prospects for flows of funds through the specialized mortgage lenders, given the current high level of interest rates.

With respect to the over-all projections of real growth, Mr. Partee said he believed the probabilities were greater that they would prove to be too low for the period through the second quarter of 1974. The economy might well get more support than was now expected from capital spending, inventory investment, and exports. Beyond that, in the second half of 1974, those sectors would tend to lose their momentum, and he was inclined to believe that the projections were too high. Personally, he found it difficult to believe that an actual recession would not develop around the end of 1974.

Mr. Morris indicated that he had been a little disturbed by the apparent upsurge in retail sales in July. A resurgence in consumer spending could obviously upset the scenario of a slowdown in real economic growth. Accordingly, he had asked his staff to do some research on recent developments in retail sales, and with the help of the Cleveland and Chicago Federal Reserve Banks, a number of major nonfood retailers had been contacted. Interestingly, none reported an acceleration in the growth of their sales in July and early August, and one nationwide firm reported a decline from the April-May pace.

Chairman Burns commented that such evidence had to be interpreted with caution; retailers invariably made comparisons with year-earlier developments and did not make use of seasonally adjusted movements, which would be much more revealing.

Mr. Morris said he agreed, but there was other evidence to be considered. For example, one reason for the sharp upturn in retail sales in July was the downturn in June, on a seasonally adjusted basis. Reports now suggested that the June figures would be revised upward owing to a revision in the data for sales by automobile dealers. In that event, part of the July gain would be eliminated. Moreover, about one-fourth of the total increase in sales in July was due to foods, which at least in part reflected price increases and anticipatory buying. The conclusion from his staff's review of the evidence was that no general upsurge in consumer buying had occurred.

Mr. Partee said he agreed with the thrust, if not all the specifics, of that evaluation. The general merchandise category, which included the retailers that had been contacted in the survey, had not shown much increase in July following poor sales in June. Over the 2 months combined sales probably had grown little after adjustment for price increases. More generally, he did not feel that over-all consumer spending had rebounded in recent weeks and he therefore was fairly confident that consumer demand would be relatively slack in the autumn months.

Mr. Brimmer asked whether the staff had made any allowance in the projection for the possibilities of strikes and other disturbances. The green book indicated that some 2-1/2 million workers would be affected by contract negotiations later this year, including workers in the automobile and farm machinery industries. A major strike and its attendant disruptions could have a significant influence on the course of economic activity.

Mr. Partee replied that the staff had assumed that there would be no major strike. Prospects appeared good for a settlement in the automobile industry, and if one was reached there, settlements in the farm machinery and other industries were likely to follow.

Mr. Brimmer commented that an important question before the Committee was the likely course of economic activity 6 to 9 months ahead. As he looked at the underlying forces, he saw strength in State and local government expenditures and in business investment. The outlook for housing was clearly weak. There was greater uncertainty about the course of net exports and consumer expenditures for durable goods. In his view that combination of developments was very likely to lead to a downturn before the last quarter of 1974; he concluded that the economy was close to an actual turning point, not just an inflection point. Given the lags

with which monetary policy exerted its influence, he believed the time was approaching when the issue before the Committee would be not whether but how soon monetary policy should be eased.

Mr. Partee noted that the staff projections suggested that real GNP would grow at a moderate rate in the second half of 1973 and a slow rate in the first half of 1974. As he had indicated, he was inclined to believe that growth over that period would be somewhat higher, and he did not believe that a recession was an early prospect. He was particularly impressed by the major change taking place in the foreign trade situation in part because of the shifts in exchange rate relationships; it was a factor in the economic situation without precedent in the postwar period. It had implications not only for the over-all level of activity but for the structure of output. Thus, within the context of slow growth in the economy next year, operations in certain basic industries might be at capacity and demands for foods might remain very strong, generating price pressures in particular sectors. With respect to business fixed investment, major expansion programs might be getting underway in the chemical, paper, cement, steel, and petroleum industries--industries which had not had major expansion programs since the mid-1950's and were now experiencing pressures on their facilities. If such expansion programs developed, the capital spending boom would be larger and would

last longer than suggested by the recent surveys and by the staff projections.

Chairman Burns observed that there also was a clear potential for a large expansion in inventory investment over the next 6 to 9 months.

Mr. Axilrod remarked that the expected rate of inflation generally was higher now than it had been not very long ago, and that might influence many business decisions in favor of making capital expenditures without delay; not only would the cost be lower than later on, interest rates in real terms were not high.

Chairman Burns observed that increases in wage rates had accelerated in the non-unionized industries, and the probabilities were high that they would accelerate in the unionized industries as well, especially because of the sharp advances in the consumer price index that had already occurred and those that were in prospect. From the first quarter to the second quarter of the year, wage rates in wholesale and retail trade rose at an annual rate of 7.2 per cent, a far larger increase than in any other quarter over the past 2-1/2 years. The annual rate of increase in the service trades was 7.3 per cent--a significantly higher rate than in most other quarters since 1970. The annual rate of increase in wage rates for farm labor--which was a very sensitive measure--was 17.5 per cent from April to July; over the year from July 1972

to July 1973, the increase was 9.2 per cent, which was substantially higher than the rate of increase over the preceding 18 months.

Concerning fiscal policy, the Chairman remarked that the reported figures did not tell the full story because the unified budget excluded the activities of governmentally sponsored corporations. In fiscal 1973--the year ending last June--the unified budget showed a much smaller deficit than had been anticipated, but during that fiscal year net borrowing by such corporations was almost \$8 billion. If the corporations were included, the recorded deficit would be \$22.2 billion--not much smaller than the deficits of \$28.2 billion and \$24.1 billion in fiscal years 1972 and 1971, respectively, calculated on the same basis. For calendar year 1973, the deficit was estimated to be \$27.5 billion--with deficits of \$9.1 billion in the first half and \$18.4 billion in the second half, not seasonally adjusted. Therefore, the frequently heard conclusion that the impact of the Federal budget was neutral did not take into account the large expansion in net borrowing by those corporations. Over the four fiscal years 1970 through 1973, the cumulative deficit in the unified budget was \$63.4 billion, but with the governmentally sponsored corporations taken into account, the deficit was \$88.1 billion. It was clear that fiscal policy had played and would continue to play an important part in the inflationary developments of the period.

In response to a question by Mr. Brimmer, Mr. Partee noted that the Federal government sector in the national income accounts-- which, on the high employment basis, was projected to move from deficit in the second half of 1973 into progressively larger surpluses in 1974--also did not include the activities of such corporations.

Mr. Brimmer remarked that he agreed with the Chairman's assessment of wage rate developments. In his own earlier remarks, he had meant to call attention to the lags with which monetary policy affected economic activity. His own view--although he was not fully persuaded of it--was that the pace of economic activity would slow sooner rather than later, resulting in increased amounts of unused resources. Nevertheless, the Committee might decide to accept that cost and retain a restrictive policy for a time in order to make a further contribution to checking the rate of inflation. That, however, depended on a value judgment rather than an analytical conclusion.

Mr. Hayes commented that he agreed that there were lags in the effects of monetary policy, but if one thought that real weakness in the economy was as far in the future as the last quarter of 1974 or the first quarter of 1975, the clear and present pressures on prices and wages would rate a higher priority.

Chairman Burns remarked that forecasting difficulties should never be underestimated, but on the basis of the evidence at hand, a judgment of an early recession would be premature.

Mr. Sheehan noted that the staff projections in the green book suggested that real GNP would grow only 1.2 per cent from the fourth quarter of 1973 to the fourth quarter of 1974. The staff projection might prove to be too high and a mild recession might develop, but he questioned whether a mild recession would have much impact on the rate of inflation. It seemed to him that only a deep recession for a protracted period would have a significant effect on inflation. Therefore, he suggested that the Committee should focus on what it might do to help bring about a higher rate of real growth in 1974.

In response, Mr. Partee commented that the staff had said a number of times that it would take a long period of slack in the economy to have an enduring effect on price developments, chiefly because sizable increases in wages tended to persist for a time and the rate of advance in productivity slowed in a period of little growth in output. His own preference would be for the Committee to aim at a moderate rate of economic growth--around 2 to 3 per cent--for a protracted period. It was highly important that pressures not be increased in those industries that were already operating at capacity. In his view, therefore, the difference between 3 per cent and 5 per cent growth in real output was large in terms of the inflationary impact whereas the difference between 3 per cent and 1 per cent was relatively small. In effect, there was a threshold that should not be crossed.

Mr. Sheehan remarked that growth of 1.2 per cent in real GNP from the fourth quarter of 1973 to the fourth quarter of 1974 would be too low, that it was projected to result in an increase in the unemployment rate from 4.9 per cent to 5.5 per cent over the same period. Although that was not a dramatic increase and a rate over 5 per cent was not as worrisome as it had been some years ago, because of structural changes in the economy, he would prefer to aim for growth of 3 per cent in real GNP in 1974. As far as inflation was concerned, the Committee ought not to feel too responsible in view of the international developments that had contributed to it. He wondered what the rates of increase in the GNP deflator and the consumer price index would be if foods and petroleum products were removed.

Concerning capacity expansion in basic industries, Mr. Sheehan agreed with Mr. Partee that it was getting started, but he observed that it was a long-range development--extending, perhaps, over 2 to 5 years. Construction of new plants in the cement and chemical industries required a minimum of 2 years; in the steel industry, where expansion was already under way, it took as much as 5 years.

Mr. Partee commented that removal of foods and petroleum products from the price measures surely would lower their rates of increase. He would judge, however, that even after allowance for special influences, the rate of inflation was on the order of

4 to 5 per cent. Moreover, the rise in prices of nonfood commodities, excluding the petroleum products, had accelerated sharply in the first half of 1973, and the rise in service prices was showing some tendency to accelerate.

Chairman Burns said he thought the rate of inflation after allowance for special influences was at least 5 per cent. Average hourly compensation in the private nonfarm economy rose 7.4 per cent in the year ending in June. If growth in output slowed as projected, the advance in productivity would be relatively low. Assuming that the advance in wage rates did not become even more rapid and that profit margins were constant, he would estimate that the rate of increase built into the consumer price index was 5 to 5-1/2 per cent. Reduction in the rate of inflation would require an environment of tighter budgets and a relatively restrictive monetary policy, and it would take time. An attempt to deal with the problem quickly would probably not be successful and could do permanent damage to the economy.

Mr. Francis observed that in his judgment the recent weakness in retail sales and consumer spending was overemphasized. If capital spending continued to expand as had been suggested, some easing in consumer spending and residential construction would not be an unfavorable development. He did not foresee a recession in the near future.

Mr. Mayo remarked that the figures the Chairman had cited concerning the role of fiscal policy were very revealing. Considering the implications for Treasury borrowing, he would remind Committee members that financing the deficit was facilitated in 1971-72 by acquisitions of Treasury securities by foreign monetary authorities in association with the large outflows of funds from the United States. Projections of the U.S. payments balance suggested that foreign monetary authorities were more likely to be sellers than buyers of Treasury securities in the period ahead, so that the Treasury would have more difficulty in financing deficits of the size in prospect.

Mr. Daane, with reference to Mr. Sheehan's remarks, observed that there was an expectational dimension to the current policy problem that had to be taken into account. Over the years he had been with the System, there had been times when policy actions had more of an impact on expectations in the short run than on the course of economic activity over the longer run. Perhaps Mr. Partee would disagree, but he believed this was one of those times when the Committee needed to be especially concerned about the impact of its policy decisions on expectations. While he did not think that System policies could quickly slow the inflation, an overt easing could intensify inflationary expectations.

Mr. Partee observed that the country was experiencing a runaway inflation that was a source of widespread concern. Anything that could be done to suggest that inflation would be brought under control would be beneficial. Of greater benefit than anything else, perhaps, would be a halt to the rise in food prices. Although he could not say whether inflationary expectations of the public in general would be affected much by the sorts of gradations in monetary policy that the Committee contemplated, an apparent easing in policy would have a significant impact on participants in financial markets and on businessmen and bankers. The unfavorable effect on attitudes could spread and become an important factor in the economic situation.

Mr. Sheehan remarked that he would like to see growth in real GNP from the fourth quarter of 1973 raised to about 3 per cent from the 1.2 per cent projected by the staff, if that could be done without significantly affecting inflationary expectations.

Mr. Brimmer commented that in the late 1950's the Committee had been deeply concerned about inflationary expectations and it had pursued policies that were still a source of controversy. One view was that monetary policy had been too restrictive for too long and thus had brought on the stagnation of the early 1960's.

Chairman Burns observed that there was another interpretation of developments in that period which was just as partial as the first: precisely because of the restrictive policies pursued in the late

1950's, the price level was stable from 1958 until mid-1965. With reference to Mr. Sheehan's remarks, he noted that in light of the margins of error in projections of real GNP and the uncertainties about the effects of policies, the two figures of 1.2 per cent and 3 per cent were not very far apart. Given the choice between the two, all other things being equal, he would prefer the higher figure. However, no one could say what policies would be needed to achieve precisely 3 per cent.

Mr. Partee remarked that the staff projections for the second half of 1974 were not very firm and that it would be better to focus on the four quarters through the second quarter of next year. Growth of 2.3 per cent was projected for that period, and as he had indicated, any deviation was likely to be on the high side. Thus, growth might prove to be in the 3 to 3.5 per cent range.

Mr. Black noted that he shared Chairman Burns' view regarding the outlook for labor costs and prices. Considering that the cost-push element in the inflation was likely to continue, with or without demand pull, he asked whether some kind of wage board was likely to be created to deal with the problem after the end of Phase IV.

The Chairman replied that such an approach to the problem was likely to develop sooner or later. However, he could not say whether it would be early next year or in 1974 at all.

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 July 17 through August 15, 1973, and a supplemental report covering the period August 16 through 20, 1973. Copies of both reports have been placed in the files of the Committee.

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

The period since the Committee last met was one of frantic movement in the securities markets on both the down and up sides as market expectations shifted wildly. It was a period of near disaster for Treasury financing as the bond offering in the August refunding failed and the Treasury had to borrow directly from the Reserve Banks on August 15. And it was a period in which the monetary aggregates behaved in a widely disparate fashion, with M_1 for the July-August period coming in below the lower limit of the Committee's range of tolerance and M_2 and RPDs coming in at or above the upper limit of their respective ranges. Bank credit was very strong.

Interest rates rose sharply in all sectors of the capital markets as market expectations shifted from a view that interest rates would peak in late summer to a view that the Federal Reserve really meant business and would sustain and perhaps intensify its efforts to restrain monetary expansion. As a result, we had one of the sharpest rises in interest rates in history. Treasury bill rates moved up by a full percentage point and yields on long-term securities rose by $1/2$ to $3/4$ of a percentage point. Last week a strong rally took place, with the market as near to being disorderly on the up side as I can recall.

Illustrative of the wild gyrations in interest rates over the period was the behavior of the two issues offered in the Treasury's August refunding. The 4-year, $7-3/4$ per cent notes--reopened in the financing--were trading at about a $7-3/8$ per cent yield around the time of the last Committee meeting. By the time of the auction on July 31,

when the issue was just barely covered in the auction, the average issuing rate was set at 8 per cent. During last Friday's frenetic trading the yield sank as low as 7-1/8 per cent; it then bounced back to just under 7-1/2 per cent; and today it is just about where it was when the Committee last met. The 7-1/2 per cent bond seemed very fairly priced at the time of the financing, and as you know, that issue was only about half covered by public subscriptions--with the price established in the Dutch auction at 95.05, a yield of 8 per cent. On Friday, that issue closed at about par, a 5-point premium over issue price and a full 1/2 percentage point lower in yield.

Short-term interest rates, while subject to similar gyrations, were generally substantially higher over the period, spurred particularly by aggressive bank demand for CD's to replace declining Treasury tax and loan accounts and heavy short-term financing by the Home Loan Banks. In yesterday's auction, average rates of 8.91 and 8.86 per cent were established for three- and six-month Treasury bills, up about 95 and 85 basis points from the auction just before the last meeting.

Open market operations over the period were devoted to a firm restraint on reserve availability, resulting in an increase in the Federal funds rate to around the 10-1/2 per cent level. Early in the period, we were supplying reserves to keep the funds rate from staying up above 11 per cent. Later in the period--when market factors, particularly the decline in the Treasury's balance at the Reserve Banks, were supplying reserves--the Desk had to absorb reserves in considerable volume, setting volume records on both the last two Wednesdays for outstanding matched sale-purchase contracts. On August 3, as you know, a majority of the Committee concurred in a recommendation to increase the upper limit of the Federal funds rate to 11 per cent from 10-1/2 per cent. But with M_1 apparently growing at a rate well below the Committee's range of tolerance and the securities markets in considerable disarray, we have been trying to manage reserve availability so as to produce a steady funds rate at around the 10-1/2 per cent level. Last Friday, I might add, the Federal funds rate was the only rate in the market to display any sort of stability.

As you can well imagine, this has been a hard period for the Treasury. During the financing period, it felt obliged to support its new issues with market purchases by the Desk for trust accounts. All in all, we purchased

about \$350 million in securities; trust accounts also had to take down \$240 million of the \$500 million bond issue. It was an amazing coincidence that the trust accounts placed subscriptions for that exact amount in the auction just before the 1:30 p.m. closing time. As a result of this cash drain--and a tendency for cash receipts to fall short of expectations--the Treasury has been short of cash and on August 15 had to borrow \$351 million from the Reserve Banks. Fortunately, Congress had passed a temporary extension of the authority for such borrowing.

The Treasury had been expecting a low point in cash on September 6, but it had hoped that passage of the gold bill, which would have permitted monetization of about \$1 billion of gold, would help it to squeeze through; that hope never materialized. It appeared late last week that in early September the Treasury could be running an overdraft at the Reserve Banks of around \$2 billion. Consequently, the Treasury announced yesterday that it would raise \$2 billion in cash with the auction of a September 30, 1975 note on Friday, August 24. This Treasury decision, while it may have been painful, will be a major help for open market operations since it will obviate the need for substantial reserve absorption that would have occurred had the Treasury been forced to borrow such an amount from the System. Some borrowing may be necessary in any case, but present cash projections suggest that it should be quite moderate.

The sharp rally in the bond market last week had a number of causes. First of all, the technical position of the market, with dealers and many banks and institutional investors having short positions, was highly conducive to a rally in light of the large recent rise in interest rates and the relatively light calendar in the corporate and municipal markets. In addition, the good performance of the dollar in the exchange market and better news on the trade and payments deficit were generally encouraging. Moreover, there was growing sentiment among some market participants that the Federal Reserve had gotten the monetary aggregates under control and that this would lead to stability, or even a decline, in the Federal funds rate after the sharp rise of recent weeks. And finally, on Friday there were all sorts of rumors about an extremely large order received by one or more New York banks to buy Government securities with funds arising out of Middle East oil operations. By yesterday, a somewhat better sense of balance had been achieved

after Friday's frenetic trading, and the announcement of the Treasury's cash financing tended to cool things off further; in fact virtually all of Friday's gains were lost.

The experience of the last 4 weeks demonstrates how sensitive the markets have become under a prolonged period of monetary restraint. You can be sure that the market will be following the weekly M_1 data with hawklike intensity and watching the Federal funds rate minute by minute for clues to the System's policy posture. I am afraid that we will have to live with erratic markets until the course of the economy and the outlook for inflation--which are of course the basic factors--become more clear.

Looking ahead, the blue book^{1/} indicates that under alternative B the Federal funds rate might show some decline from its current 10-1/2 per cent level, given the forecasts of M_1 in August-September. Even a minor decline would almost certainly be interpreted in the market as a shift in System posture, and it would be most helpful to have the Committee's views on the importance it wants to attach to the Federal funds rate in this sensitive period. While growth in M_1 for August-September is expected to be very moderate, growth in M_2 and the credit proxy is expected to be far above the Committee's long-run targets for the third and fourth quarters. In light of the disparate forecasts for the aggregates, it would be helpful if Committee members indicated what weight they would like to put on the individual series.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period July 17 through August 20, 1973, were approved, ratified, and confirmed.

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

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

The background material presented to the Committee indicates that progress has been made in securing control of growth in the narrowly defined money supply (M_1). But growth in the more broadly defined money supply (M_2) has been running above the Committee's range of tolerance, and the bank credit proxy has been expanding faster than expected.

M_1 behavior is probably beginning to reflect the cumulative impact of monetary restraint, but recently, as explained in the blue book, the growth of M_1 may also have been dampened to some extent by one-time readjustments of asset holdings by the public to the new regulations on interest rates payable by banks and thrift institutions. Thus, there may have been some shifts out of demand deposits to time deposits at banks. However--and perhaps more importantly--there also seem to have been shifts from thrift institutions to banks.

To help the Committee evaluate past and prospective trends in money growth in a transition period involving substantial shifts among money-like assets, we have included projections of M_3 , along with M_1 and M_2 , in the blue book. The weak experience of the thrift institutions in late July and early August will hold growth of M_3 in August to a rate below that for M_2 , and we estimate the gap at about 2-1/2 percentage points at an annual rate. As the public's one-time stock adjustment wears off, we expect the gap to close somewhat in September. This would be likely to reflect both a more moderate growth in consumer-type time deposits at banks and a somewhat more favorable experience for thrift institutions.

A further point to keep in mind in evaluating this complex of money supply measures is that M_2 and M_3 now include a growing amount of quite long-term certificates. I am referring of course to the 4-year and over savings certificates that are not subject to interest rate ceilings. These certificates do have a money quality because the principal is not subject to capital loss and is readily obtainable. On the other hand, the holder has determined that he is willing to make a 4-year or more commitment and is subject to a substantial interest penalty for withdrawal before maturity. On these grounds, a movement of demand deposits or savings deposit funds into the certificates would reflect a reduction in liquidity in somewhat the same sense as do movements out of cash into market securities in a period of rising interest rates.

Certificates maturing in 4 years or more increased by \$1.3 billion at weekly reporting banks between mid-year and August 8, and increased by about \$1.4 billion at a sample of savings and loan associations between mid-year and July 31. Comparable information is not yet available for nonweekly reporting banks and for mutual savings banks. On the basis of a conservative extrapolation of this fragmentary information, it looks as if the increase in these certificates would contribute at the least 3 percentage points, at an annual rate, to the 9 per cent rate in M_2 projected for August. It also appears that the long-term certificates issued by both banks and thrift institutions would contribute at least 4 percentage points to the slower 5-1/2 per cent rate in M_3 . In judging M_2 and M_3 growth, I would not subtract the whole 3 or 4 percentage points because of the money-like qualities of the certificates, but I would keep in mind that in both July and August there is some considerable overstatement in both M_2 and M_3 .

While the precise relationship of longer-term time certificates to money is debatable, both assuredly provide a source of lendable funds to banks. The good experience of banks with consumer-type time deposits and continued aggressiveness in the large CD market are leading to a very sharp expansion of the bank credit proxy in August; in September growth in the proxy is expected to be more moderate, though still very sizable.

There is no need for me to repeat the pro and con arguments well known to Committee members with regard to the role that might be assigned bank credit as a policy guide in comparison with other monetary aggregates. I would point out, though, that the current expansion in bank credit is being accompanied by restraint in other areas--in particular at nonbank savings institutions. Any credit growth at thrift institutions to meet outstanding commitments in recent weeks would have been based entirely on advances from the Home Loan Bank System; and in consequence of stringent credit availability, thrift institutions are reportedly cutting back sharply on their mortgage commitments.

Under existing institutional circumstances, a substantial cutback in the pace of bank credit expansion

in August-September would require sharply higher costs of liabilities to banks--sufficiently high to stiffen bank lending terms further and thereby discourage borrowers, and sufficiently high to persuade banks to cut back further on their participation in securities markets. This would, of course, mean further advances in market interest rates on a broad front.

On balance, the developments of the past few weeks do not seem to me to have seriously reduced the role of M_1 as one important guide to policy, although they may have at the same time brought other aggregates more into prominence. The recent large-scale shifts in financial flows have probably involved some movement out of demand deposits, but I believe that for the most part shifts have occurred among time and savings deposits at banks and other institutions and between time and savings deposits and market instruments. Thus, I would argue that no substantial readjustment is needed in the Committee's longer-run M_1 path as a result of recent financial experience. However, because higher time deposit rates do lower the demand for M_1 in some degree and because recent experience is not inconsistent with a view that the impact could have been underestimated, a quite slow growth in M_1 --even one somewhat below path--might be acceptable to the Committee for a few months for this reason alone, provided that M_2 growth does not also become unduly low.

While reasonable men may disagree on the weight they wish to assign to the various M 's or bank credit, I believe most would agree that the latest figures do reflect an uneven impact of monetary restraint on institutions and types of borrowers. This is an almost perennial problem that is not easily handled by open market policy. At the moment, however, the Committee may wish to consider its policy stance for the next few weeks against the background both of large-scale shifts in fund flows that have not fully worked themselves out and of highly sensitive credit markets prone to large interest rate swings. In particular, the Committee may wish to consider modifications in the fairly wide funds rate ranges shown in the blue book; specifically, it may wish to consider narrowing the range while the current institutional and market situation settles down.

Mr. Black noted that--as had been reported--a substantial portion of growth in thrift deposits recently was accounted for by certificates with maturities of 4 years or more and that staff projections in the blue book suggested that in the August-September period growth in M_2 and in M_3 would be at higher rates than that in M_1 . At the same time, according to staff assumptions in the green book, market interest rates would rise further in the months ahead. He wondered, therefore, whether disintermediation might not become an increasing problem as banks and other institutions approached the limit set on the issuance of the longer-term certificates--or if an interest rate ceiling should be imposed on them--and whether, consequently, the projected ranges of growth for RPD's were not too high. If over-all growth in time and savings deposits at commercial banks proved to be lower than projected, more of the reserves supplied would be available to support expansion in M_1 at rates higher than those projected.

In reply, Mr. Axilrod observed that, arithmetically, if the reserves were supplied and time and savings deposits did not expand as much as projected, demand deposits would expand more rapidly than projected. However, that would not be the actual result because the Committee specified a Federal funds rate constraint as well as a range of tolerance for growth in RPD's. Thus, if time and savings deposits grew at rates much lower than projected,

the provision of the reserves would bring about a sharp decline in interest rates--unless the demand for money were much stronger than he thought it was. In practice, reserve-supplying operations would be constrained by the lower limit set for the funds rate, and growth in RPD's would fall below the specified range.

Mr. Daane, noting that both Mr. Holmes and Mr. Axilrod had commented on the sensitive state of the financial markets, asked whether market participants were not assuming that the System had carried its policy of restraint about as far as it would--although it might maintain that restrictive posture--so that any overt policy move in either direction would have a major impact on interest rates, particularly long-term rates.

Mr. Holmes responded that some market participants had thought last Friday that System policy was beginning to ease, but developments on Monday disabused them of that idea, and at present some market participants thought that the System would maintain its current posture of restraint while others believed that the System would tighten further. In his view, market reactions to an overt policy action would depend on what action was taken. Considering that over the past 4 weeks markets had adjusted to the substantial rise that had occurred in the Federal funds rate, a small further rise in the rate probably would not have a major impact on long-term rates. However, a substantial increase in the funds rate--say, to around 12 per cent--probably would have a major impact.

Mr. Brimmer asked what the Committee might do if it wished to assure that growth in RPD's in the August-September period did not exceed whatever range was adopted, as it frequently had.

In response, Mr. Holmes observed that in the past the Committee had given the greatest weight to M_1 among its targets and that RPD's had been the operating handle used in the pursuit of the M_1 target. Therefore, when M_1 had tended to move outside the specified range of tolerance, he had given major weight to M_1 in the conduct of operations and had tended to ignore RPD's. In the latter part of the period since the last meeting, for example, the data had indicated that M_1 would grow at a rate below the range specified for the July-August period, and operations had been influenced more by that development than by indications that RPD's and M_2 were growing at rates above their ranges of tolerance. If the Committee wished to place greater emphasis on achieving a rate of growth in RPD's within the specified range, he would not then look through RPD's to M_1 and the other aggregates. In that event, however, operations might very quickly run into the funds rate constraint. With respect to the recent period, the unsettled state of the securities markets also had made him hesitant to push the funds rate all the way to the upper end of the range.

Chairman Burns commented that the Committee's focus on M_1 had been unfortunate in the most recent period because its meaning had been altered by the changes that had been made in Regulation Q.

The Chairman then said that the Committee was ready for its general discussion of monetary policy and the directive. By way of introduction, he would make two brief observations. First, the Board was considering the desirability of raising the marginal reserve requirement on large-denomination CD's, and any views the Presidents wished to express would be helpful to the Board in reaching its decision.

Secondly, the Chairman continued, the Committee had to recognize that its failure to bring the monetary aggregates under control in recent months fundamentally resulted from a failure to control RPD's; in most recent periods, RPD's had grown at rates close to or above the specified ranges as the Desk had acted in accordance with the Committee's over-all instructions and had given more weight to M_1 than to RPD's and the other aggregates. However, the meaning of the several targets of policy had changed recently. It was his view that for the next month or two, the Committee would need to pay more attention to RPD's, bank credit, and M_3 and less attention to M_1 .

Mr. Eastburn observed that he had come to the meeting prepared to argue for a small increase in the longer-run target for M_1 --which would place it between the targets specified under alternatives A and B in the blue book--and there were some arguments to be made for that course of action. First, inflation was a

difficult and persistent problem requiring a considerable period of time to overcome, and monetary policy could not be expected to have quick and decisive effects. Secondly, the projections suggested that the economy would move very close to an actual recession, even though the expected rates of inflation had been raised. And finally, experience indicated that not only were there lags in the effects of monetary policy, there were delays in recognizing turning points in economic activity and in taking appropriate policy actions. However, the reports presented by Messrs. Partee and Reynolds inclined him to favor the longer-run target of alternative B-- which was consistent with a rate of growth in M_1 of 5-1/4 per cent from the March level estimated at the time of the March meeting.

Continuing, Mr. Eastburn remarked that there were dangers of severe effects in the credit markets in the short run if the Committee attempted to get back onto that longer-term growth path too rapidly. He would hope to avoid major increases in interest rates, and he would not attempt to get back on the path by the end of the year if doing so entailed such increases in rates. Achieving the longer-run targets without excessive effects on the money markets would require a great deal of agility and discretion on the part of the Manager.

Concerning the marginal reserve requirement, Mr. Eastburn said he thought an increase would help banks in rationing credit. From conversations with bankers, he had the impression that the larger banks found it difficult to ration credit, particularly when they had commitments to good customers. As an approach to additional restraint, the marginal reserve requirement was more like a rifle than a shotgun and was appropriate to the current situation.

Mr. Hayes said the problem of formulating appropriate monetary policy had been getting more complex in recent weeks because of increasing evidence of possible weakening in the current boom and also because of the risk that the lagged effect of the very sharp rise in interest rates could be an excessive slowing of money growth. Those considerations suggested to him that the Committee should be cautious about further tightening moves, recognizing that it had already established a posture of rather severe restraint. However, he hastened to add that in his judgment it was even more important that the System avoid any move that might suggest it was backing away from its firmly restrictive policy. The most important goal was still to contribute to cooling the overheated economy, given a record of excessive credit demands and too rapid money growth over a considerable period of months. The improvement in the dollar's international position,

which was certainly encouraging, could be rapidly eroded if the inflation were to continue unchecked, and a firm interest rate structure in itself was, of course, a real help.

Mr. Hayes observed that it looked as if the System was beginning to make progress in slowing the growth of the monetary aggregates--or at least M_1 --but it was well worth maintaining the present degree of restraint until the improvement had clearly persisted for 2 or 3 months. Certainly, bank credit continued to expand rapidly, and it demanded close attention. For that reason, he found it hard to try to set a meaningful 2-month range of tolerance for M_1 , since he would be willing to see the rate drop to zero or even to a negative number for a month before deliberately moving to drop back from a Federal funds level of around 10-1/2 per cent. Thus, for the period between now and the next meeting he could see a very strong case for a directive couched in terms of continuing to restrain reserve availability in such a way as to keep money market conditions about where they were, perhaps with a proviso that unexpectedly rapid growth of the aggregates might justify slightly firmer conditions. To reflect that approach, he proposed that the operational paragraph of the directive say, "To implement this policy, the Committee seeks to restrain the growth of bank reserves and to maintain the firm money market

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conditions achieved in the preceding interval in the expectation that this will result in a significantly slower growth in the monetary aggregates than has occurred thus far this year."

With respect to specifications for the aggregates, Mr. Hayes favored the longer-run targets and the short-run ranges of tolerance shown under alternative B. For the funds rate, he preferred the 10 per cent lower limit shown under alternative C but would not set the upper limit as high as 12-1/2 per cent.

Mr. Hayes remarked that the directors of the New York Bank probably would have voted for a 1 percentage point increase in the discount rate, instead of 1/2 of a point, had it not been for the extremely sensitive state of the market following the Treasury's disappointing refunding operation. Although market conditions had improved greatly in the past week or so, he was inclined to think that it was still too soon to raise the discount rate another notch to 8 per cent. However, such a move--as well as an increase in marginal reserve requirements on certificates of deposit--might well become desirable in the next few weeks if the aggregates should appear to be getting out of control again on the upside. An increase in the reserve requirement might be desirable in any case, and as he had indicated in a letter to the Board, he would suggest that any increase be accompanied by a modification in the base.

Mr. Coldwell observed that conversations with both bankers and borrowers in recent weeks had convinced him that increases in interest rates had not yet been effective in restraining expansion in business loans; probably because of inflationary expectations and rising costs, businesses continued to be willing to borrow. In addition, there was a disturbing report that some business borrowers were engaging in interest rate arbitrage--borrowing at one bank and depositing the funds at another. The availability of bank credit was still relatively high, and as he had said in a recent letter to Chairman Burns, he was concerned about the availability of credit and about growth in RPD's at rates in excess of the ranges of tolerance specified by the Committee.

With respect to the policy decision, Mr. Coldwell said he would virtually ignore M_1 , which had become subject to a number of difficulties of interpretation, and would concentrate on achieving a reduction in the rate of growth in RPD's. To reflect that objective, he would have the operational paragraph of the directive say, "...the Committee seeks to achieve bank reserves and money market conditions consistent with a significantly slower rate of growth in RPD's than has occurred on average thus far this year." He could accept Mr. Hayes' formulation of the operational paragraph, but if the Committee wished to concentrate its efforts on an RPD target, it would be desirable to say that in the directive.

Mr. Coldwell remarked that an increase in the marginal reserve requirement on large-denomination CD's would be acceptable, assuming that it was intended to lead to a reduction in the availability of bank credit and would not be offset by open market operations. As he had indicated, higher interest rates had not been effective in discouraging borrowing and reducing inflationary pressures, and it was necessary to limit the availability of bank credit.

Mr. Bucher noted that at the preceding meeting he had expressed his concern about the danger of overreacting to the current economic situation with monetary tools that would have their major impact in a future period about which there was considerable uncertainty. Strong arguments could be made both for strength and for weakness in the economy in the period ahead. However, he was influenced by the staff projections, which caused him to be concerned about a slowing in economic growth into next year. In similar periods in the past, it seemed to him, the Federal Reserve had overreacted and its actions had led to undesirable shocks in the economy. His concern was reinforced by current problems in some segments of the credit market and the resulting effect on housing in particular.

Continuing, Mr. Bucher observed that the effects of the degree of restraint already achieved were not yet known. As Mr. Holmes had said, the rise in interest rates that had occurred

in the period since the last meeting was one of the sharpest on record. Treasury bill rates, commercial paper, and large-denomination CD's had risen 100, 115, and 125 basis points, respectively. Consequently, he would want to hold the current position, being sure that the market understood that the System was not easing. Although a difficult task, it could be done, and the Committee might assist the Desk in the effort by narrowing somewhat the range for the Federal funds rate.

Concerning the aggregates, Mr. Bucher said he still had a fair amount of confidence in M_1 as a target of policy; current problems of interpretation were transitory. There were reasons to pay attention to additional aggregates, especially M_3 , but he would not discard M_1 . Like Mr. Eastburn, he would tolerate a temporary departure of M_1 growth from the longer-term path of 5-1/4 per cent in order to avoid increases in the Federal funds rate and in interest rates generally of a sort that would be harmful in the longer run.

Mr. Francis remarked that the boom was continuing and that a slowing in growth was to be expected when capacity limits were reached; real GNP could not continue to grow at annual rates of 6 and 8 per cent. Following such high rates, a falling off in growth to a rate of 2 or 3 per cent could hardly be characterized as a recession.

Concerning policy, Mr. Francis said he favored the general outlines of alternative B. He would continue to place primary emphasis on M_1 among the aggregates. Since the last meeting, a great deal had been accomplished in slowing growth in the aggregates, and he would interpret alternative B as continuing that progress. If the alternative B projections of M_1 for the rest of 1973 were realized, growth from December 1972 to December 1973 would be 4.9 per cent; from the average in the fourth quarter of 1972 to the average in the fourth quarter of 1973, growth would be 5.6 per cent--only slightly above the longer-run target of 5-1/4 per cent--and that rate was acceptable in view of the danger of overkill. He continued to believe that the Committee could dispense with the specification of a range for the Federal funds rate. In any event, he would not favor a range any lower or any narrower than that of alternative B. With respect to the marginal reserve requirement on large-denomination CD's, there was no need for an increase if the Committee accomplished its goal of limiting growth in the monetary aggregates.

Mr. Holland observed that on the basis of his review of the economic and financial situation he believed that the current position of monetary policy was just about as it should be to make what constructive contribution it could to an orderly cooling of the economy. With respect to the operation of monetary restraint in the

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current period, he differed somewhat with Mr. Coldwell; it was both inevitable and desirable to think in terms of monetary restraint being executed to a greater degree than in the past through interest rates and to a lesser degree through nonprice restraints. The way the financial system was evolving made such a program inevitable, and having put its hand to that plow, the System would be wise to try to avoid looking backward.

Continuing, Mr. Holland remarked that the greater emphasis on interest rates was a little better tailored to deal with the current kind of inflation problem. A fairly long period would be required to try to bring price increases down within an acceptable range, and a policy that worked more through interest rates could be held and adjusted better over a longer period of time than could a policy that relied more on nonprice restraints. By their nature, the latter tended to have a kind of stop-go effect. Moreover, the review of the economic situation today suggested that business inventories and plant and equipment were the principal spending categories that could be favorably influenced by the application of more monetary restraint. Therefore, if the System wished to move toward more restraint, he would prefer to use an increase in the marginal reserve requirements on large-denomination CD's than the more general policy instruments. The impact on interest rates generally might be somewhat less, and in addition, there would be some structural effects.

Mr. Holland noted that there were analytical problems currently arising from stock adjustments affecting rates of growth in the various monetary aggregates, but the nature--although not the degree--of the shifts among the various forms of deposits had been foreseen. That suggested that the disturbance was temporary and that for a time projections of the aggregates would be subject to wider-than-usual margins of error. In the circumstances, he would continue to use the Committee's existing framework for formulating policy and would adjust it to reflect the analytical problems and the concerns of the moment. Starting with alternative B, which he generally favored, he would add M_3 to the longer-run targets, not only because of the shifts taking place among the various types of deposits but also because the System ought to be concerned about changes in flows into the savings and loan associations and the mutual savings banks. Although deposits at those institutions were not subject to the System's reserve requirements, they were as relevant for monetary policy as were time and savings deposits at nonmember commercial banks. The greater-than-usual uncertainty about the projections could be dealt with by widening the 2-month ranges of tolerance for M_1 and M_2 . He could accept a range for M_1 that stretched from the low end of alternative C to the upper end of alternative A and a range for M_2 from the bottom of alternative C up to about 10 per cent. Thus, the ranges for M_1 and M_2 would be

1-1/2 to 4-1/2 per cent and 7 to 10 per cent, respectively. He would retain a narrower range for RPD's and would narrow the range for the Federal funds rate, specifying a range of 10 to 11 per cent. The wider ranges for M_1 and M_2 would help the Committee to deal with shifts taking place in deposit flows while the narrower range for the funds rate would guard against giving any undesired signals to the market. In the circumstances, the Manager might need to consult with the Chairman and some form of communication with the Committee might be required before the next meeting. He fully expected that Committee members would be willing to authorize a movement of the funds rate above or below the narrow range in the event that the evidence becoming available suggested either course.

Mr. Daane remarked that at this juncture he was more concerned about the System's posture showing through to the market, because of its impact on expectations, than about trying to choose specifications for the aggregates. The specifications probably could not be achieved in any case. At the last meeting, he had been unhappy despite his agreement with the restrictive stance of the policy adopted because of the emphasis placed on M_1 and the effort to use it as a guide to operations; he had had a strong desire to play down M_1 and to lay stress on bank reserves and money market and credit conditions in order to give the Manager

the latitude to hold back on the provision of reserves. Now, he held that position even more strongly. He could accept Mr. Hayes' proposal for the language of the operational paragraph of the directive, although he would add a reference to international developments and might suggest some minor modifications. Altogether, he would direct operations toward holding steady and letting the market know that the System was maintaining a restrictive posture.

Mr. Mayo remarked that Messrs. Daane and Holland had expressed some of his views, which he might characterize as "don't rock the boat." He would retain the longer-term target for M_1 that the Committee had adopted. He favored alternative B, except that he would retain the existing 9 to 11 per cent range for the Federal funds rate. Such a policy stance would let the market know that the System was allowing adjustments to occur without attempting to tighten further. With respect to the aggregates, he would go somewhat further than Mr. Holland had and would specify a short-run range of tolerance for M_1 of 1 to 5 per cent. Although he agreed with the Chairman's comments concerning M_1 , financial reporters and market interpreters were so focused on that aggregate that the Committee could not influence them by saying that it would give somewhat more emphasis to RPD's and less to M_1 . With respect to the language of the operational paragraph of the directive, he would not incorporate a reference to RPD's; the broader reference to monetary aggregates

encompassed M_3 , about which the Committee was concerned. Like Mr. Daane, he would restore the reference to international developments. Moreover, he would restore the reference to domestic financial market developments because the economy might be closer to a turning point than could be foreseen.

The Committee agreed that the operational paragraph of the directive should contain references to international developments and domestic financial market developments.

Continuing, Mr. Mayo said he had mixed feelings about an increase in the marginal reserve requirement on large-denomination CD's, although he would prefer that to a further rise in the funds rate. An increase in the reserve requirement would have adverse effects on the desirability of membership in the System. Moreover, it was not consistent with his basic policy position of allowing market adjustments to occur without tightening further. The markets were still in the process of adjusting to the tightening actions that had been taken, and he would expect--barring a drastic change in psychology--that the prime rate would go to 10 per cent by the time of the September meeting of the Committee; a discount rate of 8 per cent would not be out of line. Like Mr. Hayes, he did not believe an increase in the discount rate was needed in the next week or two, but he regarded it as an inevitable part of the adjustment taking place. That view was held by bankers and by participants

in financial markets abroad. While the dollar had strengthened, it was still subject to sinking spells and was not yet back to what he would regard as its true value.

Mr. Balles observed that in terms of trying to steer a proper course between Scylla and Charybdis it was important that Committee members' views on the outlook be clear. His own expectation was that there would be no more than a temporary slowdown in growth later this year and into early 1974 rather than a fullblown recession. Given that expectation, he was particularly concerned about the growth of inflationary expectations, which were widely evident. For example, in a lead article in the Wall Street Journal for the day before, entitled "Many Economists Think Government Gives Up On Fighting Inflation," it was said that "The Federal Government obviously doesn't want to see the economy suffer either a recession or more inflation. If there is a choice, however, federal officials lean heavily toward more inflation. That, at any rate, is the assessment of many private economists as they watch developments in Washington." Inflationary expectations were growing, and their effect on business and consumer behavior had not yet been fully assessed. In the months ahead, one could expect to hear the sort of references--familiar in business circles a few years ago--to looking across the valley of a brief downturn in economic activity. In his view, a growing belief in persistent inflationary pressures

in the years ahead would strengthen business spending for fixed capital and have other similar effects. Given those attitudes about inflation and those expectations concerning Government policies, the System needed to be cautious about giving any intentional or accidental signals to the market that monetary restraint was being relaxed.

Mr. Balles commented that not very much progress had been made in slowing growth in the aggregates; although it had slowed for M_1 , it remained in excess of targets for the other aggregates. Apparently the latter would continue to grow at rapid rates in the third and fourth quarters, and the slowdown in M_1 growth was likely to be transitory. In the circumstances, he favored alternative B, but he would point out that it was not so restrictive as it might appear to be. Growth rates based on quarterly averages rather than terminal months gave a different and more meaningful impression of prospective developments in the second half of the year. Thus, the expected rate of growth in M_1 from June to December was 3.75 per cent, but the rate from the second quarter to the fourth quarter was 5.5 per cent, which was close to the longer-run target of 5.25 per cent. Noting that the blue book contained a very helpful appendix showing growth rates for M_1 based on quarterly averages, he expressed the hope that in the future the staff would include similar calculations for the other aggregates.

Mr. Balles commented that it seemed to him that the lack of success in bringing the aggregates under control stemmed from setting a range for the funds rate that was too narrow, and therefore, differing with Mr. Holland, he would retain the 2 percentage point range for the rate. Because of the danger of giving a false signal to the market, however, he would be very cautious about approaching the lower limit of the range. Concerning what was sometimes referred to as the great experiment of placing greater reliance on the price mechanism and less on nonprice measures to ration credit, he supported Mr. Holland's view. That had been a useful step, and he would not like to see the System back away from it.

Mr. Morris said he agreed with the view that it would be premature to make monetary policy on the assumption that a recession would occur in 1974. However, the rate of growth had slowed--as had been forecast on the basis of a decline in housing starts and a slowing of the expansion in consumption expenditures--and it would be imprudent to take any steps toward a more restrictive policy. Believing that the current degree of restraint should be maintained, he favored alternative B, although like some others, he would continue the upper limit for the Federal funds rate at 11 per cent. Hopefully, pursuit of the alternative B targets for the aggregates would be accompanied by some downward drift in the funds rate, as suggested in the blue book, but should the aggregates grow faster

than projected, he would support an increase in the upper limit to 11-1/2 per cent. With respect to the marginal reserve requirement on large-denomination CD's, he would favor an increase. Although it appeared that the high level of interest rates was not inhibiting demands for funds, the high marginal cost of funds was inhibiting bankers in seeking out loans, and a further increase in the marginal cost would be desirable. He would not raise the requirement on Euro-dollar borrowings.

Mr. Morris observed that he agreed with Mr. Holland's view that the Committee should pay more attention to M_3 in the months ahead. Because of the structure of policy in the current period, monetary restraint tended to affect the thrift institutions promptly, whereas in 1969 restraint tended to affect commercial banks first.

Mr. Kimbrel remarked that inflationary expectations remained a serious problem; shortages of labor and materials were interfering with various kinds of projects in the Atlanta District; and developments in foreign exchange markets continued to be a source of concern. Nevertheless, there was a danger of excessive monetary restraint, particularly as it might be reflected in high interest rates. He had come to the meeting prepared to back away cautiously from the degree of restraint that had been achieved, if for no other reason than that so many restrictive measures had been taken since April. In the period ahead, he would focus somewhat less on M_1 and more on

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RPD's and the Federal funds rate, with specifications in line with those of alternative B. Hopefully, the funds rate would not need to rise above 11 per cent and might actually ease from the current level. Concerning the marginal reserve requirement for the large-denomination CD's, he would favor an increase.

Mr. MacLaury said he was somewhat less sure than a month or two earlier that the economy was moving quickly into a period of no real growth, although, like Mr. Partee, he saw a recession developing at some stage. However, even the rates of growth in real GNP projected in the green book were undesirably slow, and the present degree of monetary restraint--as reflected in the interest rates over which the System had some direct control--bordered on being excessive. That was especially so in light of recent revisions in rates of M_1 growth projected for the July-August period. Accordingly, he would not have concurred in the inter-meeting increase in the upper limit of the range for the funds rate and was glad that, for whatever reason, the additional 1/2 percentage point of the range had not been used. As had been said many times, monetary policy could not do the whole job, and it was appropriate to repeat that at present because of the behavior of basic commodity prices; a strongly restrictive monetary policy could not have as much impact on the general level of prices as Committee members might wish. At the same time, he would not want to give a signal of overt easing.

For those reasons, Mr. MacLaury continued, he favored alternative A. However, he would widen the 2-month ranges for the aggregates by reducing the lower limits. He would not mind slow growth in M_1 and, like Mr. Mayo, could accept a range of 1 to 5 per cent. Because of his view that the System should not be seen to be easing, he would set the lower limit for the funds rate at 9-1/2 per cent. For the upper limit, a return to 10-1/2 per cent could be justified on the grounds that the additional 1/2 point leeway that had been approved since the last meeting had not been used. Thus, the range would be narrowed to 9-1/2 to 10-1/2 per cent. He would not increase the marginal reserve requirement on large-denomination CD's because it would be interpreted as another overt move toward restraint, but like Mr. Holland, he would prefer an increase in the reserve requirement to a further rise in the funds rate.

Mr. MacLaury remarked, with respect to interpretation of the aggregates, that he did not agree that M_2 and bank credit had become more important. On the contrary, they might be misleading because of the process of re-intermediation that was occurring as a result of the increases in interest rates on time deposits. In his view, the rate of growth in M_2 reflected shifts from time deposits at the thrift institutions to time deposits at commercial banks rather than shifts out of demand deposits, so that the observed slowing in M_1 growth was real. On the basis of the levels to which short-term

interest rates had risen, he would have expected the slowing in M_1 and did not discount it. Closer attention than heretofore to the rate of growth of M_3 was desirable, but he would not lessen the emphasis on M_1 .

Mr. Brimmer observed that the key policy issue was whether or not to provide an environment in which inflationary pressures would be dampened somewhat even though that would be accompanied by higher levels of unused resources than would otherwise prevail. Noting Mr. Balles' remark that many people believed that the Government had given up the fight against inflation, he suggested that policy-makers faced with the choice between more or less inflation and more or less unemployment were inclined to accept a little more inflation. As Mr. Partee had suggested, moreover, demands and economic activity were likely to be stronger in late 1973 and early 1974 than indicated in the green book. Within the context of overall stabilization policy, therefore, the System ought to hold the present degree of restraint--leaning, if necessary, in the direction of a little more restraint. In one sense, the current level of interest rates was not particularly high, and the role of interest rates in the present environment was very different from that in 1969-70. He favored an increase in the marginal reserve requirement on large-denomination CD's in order to shift the focus of policy a little, with the hope that it would have some sectoral impact.

Mr. Brimmer said he would put more emphasis on dampening growth in RPD's and would pay less attention to M_1 . The range for the Federal funds rate would have to be wide enough to lessen the risk of continued overshoots in RPD growth, and he favored the range of 9-1/2 to 11-1/2 per cent specified in alternative B. He also preferred the aggregate targets of alternative B. He would not favor Mr. Hayes' language for the operational paragraph because the change from the language the Committee had been using would suggest that it was innovating with respect to policy as well.

Mr. Brimmer remarked that Committee members should be cautious about the weight they attached to M_2 and M_3 because of the removal of Regulation Q ceilings on consumer-type time deposits having maturities of 4 years or more and because of other regulatory changes. With respect to M_3 , he would follow its behavior along with that of other variables, but it would not be appropriate to attempt to use general credit and monetary policy to attempt to affect the behavior of deposits at the savings and loan associations. To do that would require specialized instruments.

Mr. Winn commented that any change in System policy was likely to have a considerable impact on psychology, which would be undesirable. In view of the uncertainties about the course of economic activity in the period ahead, a steady policy was appropriate, and he favored alternative B. Considering that some observers

watched RPD's as an indicator of System policy, it was desirable to limit its rate of growth.

Mr. Winn observed--with reference to the reserve requirement on large-denomination CD's--that in the latest month banks in the Cleveland District had not increased the outstanding amount of CD's but had turned to other sources of funds. They had borrowed more in the Euro-dollar and Federal funds markets and had used sale-repurchase agreements on their securities to a greater extent than normally.

Mr. Sheehan noted that the staff's projections suggested that the rate of growth in real GNP would diminish for the next five quarters through the third quarter of 1974. Considering that monetary policy operated with a lag, he would associate himself with other members of the Committee who had said that policy was restrictive enough, and he would maintain the current degree of restraint. He was glad the Desk had not used the additional leeway of 1/2 percentage point in the upper end of the funds rate range approved during the inter-meeting period, and like Mr. MacLaury, he would set the upper limit at 10-1/2 per cent for the period until the next meeting.

Mr. Black observed that the first order of business was to demonstrate to the market that the System had achieved and would maintain control over the aggregates. While sharing the feeling that the significance of M_1 among the aggregates had changed, he agreed

with Mr. Mayo that the market was not aware of the change. For the next couple of months, therefore, it would be desirable to publish rates of growth for M_1 of around 2 or 3 per cent; that would have constructive effects on domestic financial markets and the foreign exchanges and also on business psychology in general. He would retain the Committee's longer-run targets for the aggregates-- adding M_3 to the list, as Mr. Holland had suggested. He favored alternative B as the best way to achieve those targets. However, the lower limit for the August-September range for RPD's should be reduced from that indicated in alternative B in order to allow for the possibility that time and savings deposits at banks would grow less rapidly than projected, possibly tending to bring about a decline in the funds rate. For the period until the next meeting, he would not object if the System concentrated on maintaining the funds rate at about the level of recent weeks. He would not increase the reserve requirement on the large-denomination CD's.

Mr. Clay said inflationary pressures were strong and there was little evidence to suggest a significant slowing in real growth in the period ahead. Policy should be formulated with care in order to avoid either aggravating inflationary pressures or bringing about a serious slowing in growth. The longer-run targets adopted at the preceding meeting were about right. In the August-September period, however, it appeared that growth in M_1 would be low while growth in

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M_2 and RPD's would be high relative to the longer-run targets. A range of 9-1/2 to 11-1/2 per cent for the Federal funds rate appeared appropriate. Altogether, he favored alternative B. Because he would avoid any additional overt move of restraint at present, he would not raise the reserve requirement on CD's.

Chairman Burns observed that the Committee had had a full discussion. The conclusion that emerged--and he believed it was the correct one--was that over the next few weeks the System should seek to maintain about the existing degree of monetary restraint and should avoid any relaxing or liberalizing moves. The Chairman then suggested that the members indicate informally whether they favored the language that Mr. Hayes had proposed for the operational paragraph of the directive.

In the subsequent poll, three members expressed a preference for that language.

Chairman Burns then proposed for consideration an operational paragraph that would place slightly greater emphasis on RPD's. It would read as follows: "To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to limit RPD growth and achieve money market conditions consistent with slower growth in monetary aggregates over the months immediately ahead than has occurred on average thus far this year."

After discussion of the appropriate placement of the reference to RPD growth, an informal poll indicated that a majority of the

members favored such an operational paragraph, but that a larger majority preferred the language of alternative B as amended to incorporate references to international and domestic financial market developments.

The Chairman then suggested that the Committee retain the longer-run target for M_1 agreed upon at the last meeting--namely, an annual rate of growth of 3-3/4 per cent over the third and fourth quarters combined--and that it accept the associated longer-run targets for M_2 and the credit proxy indicated under alternative B in the blue book. He suggested an informal poll to determine whether Committee members wished to include M_3 among the longer-run targets.

The poll indicated that a majority of the members did not favor including M_3 among the targets. It was agreed, however, that information on M_3 should be included in the next blue book in the section dealing with prospective developments.

Chairman Burns suggested short-run operating ranges--that is, annual rates of growth for the August-September period--of 11 to 15 per cent for RPD's and 1 to 4 per cent for M_1 . The upper ends of the ranges were those of alternative B; the lower ends had been reduced by 2 percentage points for RPD's and one point for M_1 . The range of tolerance in the daily-average funds rate for statement weeks in the period until the next meeting would be 10 to 11 per cent, which was narrower than the alternative B range of 9-1/2 to 11-1/2 per cent. The staff would supply an operating range for M_2 that would be consistent with the other specifications.

Mr. Francis remarked that he liked all of the suggested specifications except the range for the Federal funds rate, which was too narrow. He did not understand the reason for narrowing the range, especially since in recent inter-meeting periods the upper limit had been increased whenever the rate pressed against it.

In response, Chairman Burns said a moderately narrow range for the funds rate seemed to be consistent with the preferences of Committee members at present, although they might wish to change the range before the next meeting. A narrow range was necessary to maintain about the existing posture of monetary restraint, as it would be interpreted in the market. A decline in the funds rate to 9-1/2 per cent would be interpreted by the market as a major shift in policy, and it was clear that Committee members believed such a reaction would be undesirable. He noted also that he had suggested reducing the lower limit for the 2-month range for RPD's from that shown under alternative B in order to lower the central value of the range. In his judgment the Desk should try to avoid a rate of growth in RPD's in the upper half of the range.

Mr. Daane observed that the suggested range of 11 to 15 per cent for RPD's, when compared with the range of 11-1/2 to 13-1/2 per cent adopted at the preceding meeting, did not appear consistent with the emphasis that the Chairman and other Committee members had given to slowing the rate of growth in reserves.

The Chairman suggested that members indicate informally whether reducing the RPD range to 11 to 13 per cent would be acceptable.

In the subsequent poll, a majority of the members indicated that the range of 11 to 13 per cent for RPD's was acceptable.

The Chairman then proposed that the Committee vote on a directive consisting of the staff's draft of the general paragraphs and alternative B of the operational paragraph amended to include the references to international and domestic financial market developments--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 third and fourth quarters combined--would be taken as 3-3/4 per cent for M_1 , 6-1/2 per cent for M_2 , and 9-3/4 per cent for the credit proxy. The short-run operating ranges--that is, annual rates of growth for the August-September period--would be taken as 11 to 13 per cent for RPD's, 1 to 4 per cent for M_1 , and 6-3/4 to 9-3/4 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 10 to 11 per cent.

With Mr. Francis dissenting, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions for the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that growth in real output of goods and services, which slowed in the second quarter from the exceptionally rapid pace of the two preceding quarters, will be moderate in the third quarter. Increases in nonfarm employment also have slowed in recent months, but the unemployment rate has declined. The rate of rise in wage rates has remained relatively moderate. The exceptionally rapid advance in prices was interrupted in July by the temporary freeze imposed in mid-June. However, farm and food prices adjusted sharply upward after mid-July, when the freeze was lifted on most such products. The U.S. merchandise trade balance improved in June, and the balance on goods and services was in surplus in the second quarter for the first time in nearly two years. Since the end of July the dollar has strengthened markedly in foreign exchange markets, and the price of gold has dropped sharply.

Both the narrowly and more broadly defined money stock, which had increased rapidly in May and June, grew more slowly in July. Inflows of consumer-type time and savings deposits strengthened again at banks in late July and early August, while net outflows were experienced at nonbank thrift institutions. Expansion in bank credit has continued at a substantial pace. Since mid-July short-term market interest rates have advanced considerably further on balance. Long-term rates also rose substantially for much of that period, but most recently they have declined in the course of a sharp market rally. On August 13 increases were announced in Federal Reserve discount rates from 7 to 7-1/2 per cent.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to abatement of inflationary pressures, a sustainable rate of advance in economic activity, and progress toward equilibrium in the country's balance of payments.

To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with slower growth in monetary aggregates over the months immediately ahead than has occurred on average thus far this year.

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Mr. Francis indicated that he favored the targets for the aggregates being adopted by the Committee. He had dissented, however, because he could not accept the narrow range of tolerance for the Federal funds rate included among the specifications.

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

It was agreed that the next meeting of the Committee would be held on September 18, 1973, at 9:30 a.m.

Thereupon the meeting adjourned.


Secretary

ATTACHMENT A

August 20, 1973

Drafts of Domestic Policy Directive for Consideration by the
Federal Open Market Committee at its Meeting on August 21, 1973

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that growth in real output of goods and services, which slowed in the second quarter from the exceptionally rapid pace of the two preceding quarters, will be moderate in the third quarter. Increases in nonfarm employment also have slowed in recent months, but the unemployment rate has declined. The rate of rise in wage rates has remained relatively moderate. The exceptionally rapid advance in prices was interrupted in July by the temporary freeze imposed in mid-June. However, farm and food prices adjusted sharply upward after mid-July, when the freeze was lifted on most such products. The U.S. merchandise trade balance improved in June, and the balance on goods and services was in surplus in the second quarter for the first time in nearly two years. Since the end of July the dollar has strengthened markedly in foreign exchange markets, and the price of gold has dropped sharply.

Both the narrowly and more broadly defined money stock, which had increased rapidly in May and June, grew more slowly in July. Inflows of consumer-type time and savings deposits strengthened again at banks in late July and early August, while net outflows were experienced at nonbank thrift institutions. Expansion in bank credit has continued at a substantial pace. Since mid-July short-term market interest rates have advanced considerably further on balance. Long-term rates also rose substantially for much of that period, but most recently they have declined in the course of a sharp market rally. On August 13 increases were announced in Federal Reserve discount rates from 7 to 7-1/2 per cent.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to abatement of inflationary pressures, a sustainable rate of advance in economic activity, and progress toward equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPHS

Alternative A

To implement this policy, while taking account of the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with somewhat slower growth in monetary aggregates over the months immediately ahead than has occurred on average thus far this year.

Alternative B

To implement this policy, while taking account of the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with slower growth in monetary aggregates over the months immediately ahead than has occurred on average thus far this year.

Alternative C

To implement this policy, while taking account of domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with significantly slower growth in monetary aggregates over the months immediately ahead than has occurred on average thus far this year.

ATTACHMENT B

August 21, 1973

Points for FOMC guidance to Manager
in implementation of directive

Specifications
(As agreed, 8/21/73)

- A. Longer-run targets (SAAR):
(third and fourth quarters combined)
- | | |
|----------------|--------|
| M ₁ | 3-3/4% |
| M ₂ | 6-1/2% |
| Proxy | 9-3/4% |
- B. Short-run operating constraints:
1. Range of tolerance for RPD growth rate (Aug.-Sept. average): 11 to 13%
 2. Ranges of tolerance for monetary aggregates (Aug.-Sept. average):
M₁ 1 to 4%
M₂ 6-3/4 to 9-
 3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings): 10 to 11%
 4. Federal funds rate to be moved in an orderly way within range of toleration
 5. Other considerations: account to be taken of international and domestic financial market developments and of forthcoming Treasury financing.
- C. If it appears that the Committee's various operating constraints are proving to be significantly inconsistent in the period between meeting the Manager is promptly to notify the Chairman, who will then promptly decide whether the situation calls for special Committee action to give supplementary instructions.