MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Monday and Tuesday, November 19-20, 1973, beginning at 4:00 p.m. on Monday.

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

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

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

Mr. Broida, Secretary
Mr. Altmann, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Andersen, 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, Managing Director for Operations and Supervision, Board of Governors
Mr. Feldberg, Secretary, Board of Governors
Mr. Coyne, Assistant to the Board of Governors
Mr. Pierce, Associate Director, Division of Research and Statistics, Board of Governors
Messrs. Keir, Wernick, and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Pizer, Adviser, Division of International Finance, Board of Governors
Mr. Zeisel, Associate Adviser, Division of Research and Statistics, Board of Governors
Messrs. Ettin and Taylor, Assistant Advisers, Division of Research and Statistics, Board of Governors
Mrs. Junz and Messrs. Fieleke and Henry, Assistant Advisers, Division of International Finance, Board of Governors
Messrs. Kichline and Wendel, Chiefs, Capital Markets and Government Finance Sections, respectively, Division of Research and Statistics, Board of Governors
Mrs. Smelker and Mr. Peret, Senior Economists, Division of Research and Statistics, Board of Governors
Mr. Roxon, Senior Economist, Division of International Finance, Board of Governors
Messrs. Beeman, Enzler, and Wyss, Economists, Division of Research and Statistics, Board of Governors
Miss Morisse and Mr. Smith, Economists, Division of International Finance, Board of Governors

Miss Pruitt, Economist, Open Market Secretariat, Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant, Board of Governors

Mr. Plant, First Vice President, Federal Reserve Bank of Dallas
Messrs. Boehne, Parthemos, Taylor, and Doll, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Richmond, Atlanta, and Kansas City, respectively
Messrs. Davis, Hocter and Green, Vice Presidents, Federal Reserve Banks of New York, Cleveland, and Dallas, respectively
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Cooper, Assistant Vice President, Federal Reserve Bank of New York
Mr. McNees, Economist, Federal Reserve Bank of Boston

Chairman Burns noted that a problem had arisen in connection with the date on which the Committee had been planning to meet in January 1974. He asked Mr. Broida to comment.

Mr. Broida observed that the Committee of Twenty would meet in Rome on January 17 and 18, 1974, and that according to present plans the plane on which the Chairman and the Secretary of the Treasury would be traveling would leave Washington on January 15, the date listed on the Committee's 1974 schedule for its January meeting. Accordingly, it would appear desirable to modify the Committee's schedule. One possibility would be to advance the January FOMC meeting by one day, to Monday, January 14; another would be to postpone it by a week, to Tuesday, January 22. If the latter course were followed, it also would be desirable to postpone the February meeting, now listed for February 12, by a week in order to maintain a 4-week interval between the January and February meetings.

After some discussion, the Committee agreed to leave the resolution of the meeting date problem to Chairman Burns.

The Chairman then noted that this Monday afternoon session had been called to provide adequate time for consideration of the economic outlook and longer-run targets for monetary policy. Subsequently, Committee members had been advised that the staff's presentation would be compressed to permit a discussion of the possible implications of the developing fuel crisis.

While the future was always uncertain, Chairman Burns continued, the uncertainties existing at present were extraordinarily great. That had been evident at a meeting he had attended this morning on the subject of direct investment controls; there had been much speculation at that meeting about the balance of payments implications of the energy crisis, but it was clear that at this stage no statement about those implications could be made with assurance. The Committee might find itself in nearly the same situation in its deliberations today. However, the Committee's situation would not be quite the same, since there was no escape from the conclusions that the energy crisis would exert a negative influence on real economic activity and that it would release forces quickening the pace of inflation. But the likely magnitudes of such tendencies were highly uncertain and their implications for monetary policy were quite obscure to him. Accordingly, he would be listening very carefully to the comments of other Committee members on those subjects.

The Chairman then asked Mr. Partee to begin the staff presentation.

Mr. Partee made the following introductory comments:

> Our chart show presentation today describes the results of our second basic review of the economic and financial outlook for 1974, and assesses the practical policy alternatives that appear to be available to the Committee. Ordinarily, uncertainties diminish as we get closer to the period being projected. In a fundamental sense, that is the case today also. In the absence of an oil crisis, the prospects would seem to point more clearly now than last June to continued slow, but positive, real economic growth throughout the year ahead, and to persistent and strong inflationary pressures.
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> Our GNP and financial projection does not take into account the consequences of the developing energy crisis resulting from the sharp cutback in oil imports. There are great uncertainties now with respect to what these consequences are likely to be. We don't know how long the embargo will be continued, and we have very little

idea as to how the resulting shortages will be distributed by types of user--since the probable governmental response is still unclear. But the stoppage in the flow of Middle Eastern oil to U.S. markets already means a serious shortage in energy for at least a temporary period this winter, and if the embargo is continued, the consequences for the industrial sector of the economy could be highly adverse. The effects on sentiment are also likely to be very unfavorable, as is indicated by today's 29-point decline in the Dow-Jones industrial index.

A base projection of the economy that abstracts from the energy crisis is, nevertheless, useful. In making the adjustments in operating policies that may prove necessary as the crisis emerges, the Committee will need to be guided also by what it believes to be the underlying strength of the economic expansion. And it will be difficult in some cases to distinguish between market developments imposed by fuel supply constraints and those that are demand-related.

We have decided, therefore, to make an abbreviated presentation of our projection, to allow time for consideration of the energy crisis and its policy implications.

As to the monetary and fiscal policy assumptions that we have made in developing the projection, fiscal policy is now assumed to be a little more stimulative than had been anticipated earlier, reflecting mainly a moderate increase in outlays for military hardware. We still assume a 5.9 per cent increase in social security benefits effective January 1; it now appears that Congress will legislate a larger increase in benefits, but also an increase in taxes. With total expenditures for fiscal 1974 now expected to exceed $270 billion, the unified budget deficit is also likely to be a little larger than projected previously, though it is still far below the $14-1/2 billion deficit of fiscal 1973. Calculated on the basis of the full employment concept, the NIA budget would shift into moderate surplus in the year ahead, compared with approximate balance in each of the last two calendar years.

Monetary policy in the base projection is assumed to permit continuing moderate growth in the aggregates, as indexed by expansion in the narrow money stock at an annual rate of 5 per cent. We believe that this would mean continued upward pressure on the structure of interest rates, given the outlook for nominal GNP, for transactions demand for money, and for credit flows. The 3-month bill rate is projected to fluctuate around the 8-1/2 per cent level throughout most or all of the year ahead. In the absence of further changes in Regulation Q ceilings, this suggests that inflows to the savings intermediaries would continue to be moderate.

Finally, in the absence of any better information, we have assumed the continuation of a wage-price control program through most or all of 1974. This would not preclude gradual decontrol, or a change in the form of the program, sometime in the year ahead. But it does mean that we are not allowing for any explosive upward adjustment in the price structure, such as might follow an abrupt ending of controls in an environment of tight market supplies.

Mr. Gramley made the following statement on the domestic aspects of the base projection:

Revised GNP statistics released late last week indicate that real output in the private nonfarm economy rose at a 4-1/2 per cent annual rate during the third quarter. This was a shade above the second-quarter rate, but only about half as rapid as in the previous 6 months. When the economic growth slows this much, major indicators of current economic activity often point in different directions.

Thus, growth in industrial production has held up reasonably well. In the third quarter total industrial output averaged 6-1/2 per cent higher than in the second quarter, at annual rates, and the October index was up another 0.6 per cent. These are solid gains, though below the rates of increase that occurred in 1972 and early 1973. On the other hand, the index of manhours worked in manufacturing--while strengthening very recently--has been relatively flat since last spring. Reflecting the drop in home building, total new construction in constant dollars is down almost 10 per cent from earlier peak levels and a further decline is clearly in prospect--given the substantial fall in both new housing starts and residential building permits in recent months. Retail sales in constant dollars have also been quite weak. There was evidently a real increase in retail purchases in October--though we can't be sure until the CPI comes out--but the new car sales rate declined last month and dropped still further in early November.

The weakness in retail sales and in residential construction reflects demand factors and the effects of credit restraint. In the industrial sector, too, demand factors have been of substantial importance in slowing the rate of expansion.

For example, the rapid rise in output of consumer durables, a sector in which demands have weakened, ended last spring. But production of business equipment, where demands have remained strong, has continued to advance rapidly. Materials output has flattened out recently, and this probably does reflect mainly capacity restraints.

The industrial capacity problem seems to have worsened further over the summer and fall months, and would clearly limit production gains in the period ahead. But demand factors in markets for consumer durables, and the effects of credit restraint on housing, are still key factors shaping the outlook for real economic activity.

Because of weakness in these two sectors, the driving forces behind the current cyclical expansion have changed markedly. Over the year ending in the third quarter, residential construction in constant dollars was unchanged, and the real volume of consumer durables purchased rose less than in the previous year. During this period, we have benefited much more heavily from nonagricultural exports as a source of stimulus, and the contribution of rising business fixed investment was also somewhat greater than in the previous year. The volume of nonfarm exports is, of course, much smaller than the volume of business investment. The current dollar increase in nonfarm exports over the past year, however, has been close to $15 billion--well over 1 per cent of GNP, and almost 2-1/2 per cent of the value of goods output. Foreign demand for our products is a more important factor shaping business cycle developments now than at any time in postwar history.

As Mr. Bryant will be indicating shortly, our projection assumes that nonfarm exports will continue to climb during 1974--at a rate that is quite high by historical standards, though considerably below that of the past year. Our projection for business fixed investment, meanwhile, has been raised from what it was in the previous green book[1/]--partly because of the strength shown in recent private surveys of business capital spending plans, and partly because of the continued rapid increase in unfilled orders for nondefense capital goods.

The greater strength now projected for business capital spending, together with the assumed higher level of defense expenditures mentioned by Mr. Partee and a modest upturn projected for housing in late 1974, lift somewhat the expected growth of real GNP next year. Our current projection has the annual rate of real GNP growth remaining at around 2-1/2 to 3 per cent in the first half of 1974, and then drifting down to around 2 per cent in the second half. This is not a major change from the projection of a month ago, but it does imply a resolving of doubts on the higher side.

For consumer spending, however, our current projection incorporates a more pessimistic view on spending propensities. We think the dollar volume of consumer purchases could be reasonably well maintained through the first half of 1974, since projected increases in disposable income are relatively large during this period--partly because of the assumed rise in social security benefits. A large part of the increase in purchases, however, will reflect rising prices of nondurable goods, particularly gasoline. Thereafter, we are projecting a slowdown of consumer purchases, especially for durables, with auto sales tailing off to an annual rate of around 8 million units for domestic-type cars by late 1974. I should mention, however, that this projection of consumer spending in general, and auto sales in particular, may need to be revised downward by substantial amounts if the oil crisis is not resolved soon on the side of assuring consumers of the availability of reasonable amounts of gasoline at prices not too far above current levels.

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

Leaving aside the oil crisis, however, there might be some question as to whether our current projection underestimates the strength of the expansion in the industrial sector of the economy.

One category of GNP in which our projection might turn out to be low is inventory accumulation. We are still projecting a modest rise in the rate of inventory investment--to $11 billion in the first quarter of next year--and only a gentle upcreep in the inventory-sales ratio during 1974. If supply scarcities have been holding down inventory building, as seems likely, efforts to restock could begin to bear fruit once bottlenecks begin to ease, and add more than we have projected to inventory investment.

It looks to us, however, as though real GNP growth in the 2 to 3 per cent range next year would mean a continuation of rather acute scarcities of many industrial materials.

The rate of capacity use in major materials industries has risen further in recent months--to an estimated 97 per cent in October. Capacity growth in these industries seems likely to increase faster next year--especially in steel, paper, and petroleum refining--and as output slows, capacity utilization should dip a little, after reaching a peak in the first quarter of 1974. But the projected utilization rate by the fourth quarter of next year would still be high enough to limit production and inventory building.

The higher rate of real GNP growth now projected for 1974 would also strengthen the demand for labor, although we would still expect the unemployment rate to rise. A 2 to 3 per cent rate of real GNP growth over the four quarters of 1974 could be achieved with an increase in total employment of only around 1 million persons, even with a moderation in productivity growth to around 1 per cent. The labor force is projected to grow by about 1.6 million over the next four quarters, however, so that the unemployment rate would rise to around 5-1/4 per cent.

Unfortunately, this magnitude of rise in the unemployment rate cannot be expected to have much effect on wage bargaining. The rate of increase in average hourly earnings began to turn up early this year; the adjusted index for the private nonfarm economy is now about 6-1/2 per cent above a year ago, and it has been increasing in recent months at an annual rate of around 7-1/2 per cent. Even so, real spendable weekly earnings of production workers have been declining for about a year because of sharply rising prices, and workers are likely to make strenuous efforts in 1974 to obtain pay increases large enough to make up for this year's shortfall in living standards.

The implication of this, together with slowing productivity gains, is an acceleration in the rise of unit labor costs--perhaps to something like a 7 per cent rate in 1974. We are projecting a somewhat slower rise in the fixed-weight deflator for private GNP than in unit labor costs--based on the belief that demands in some markets (such as autos) will be weak, and that food prices will rise much more slowly next year than this. The rate of increase in the deflator is projected to taper off, but only to around a 5 per cent annual rate by the second half of 1974.

We recognize that even this modest improvement in price performance may not be forthcoming. As I noted earlier, supplies of industrial materials would still be tight next year if our GNP projection is realized. Furthermore, cost increases have occurred this year that have yet to be passed through to end-product prices, partly because of the controls program. Industrial materials prices, for example, have risen much more than wholesale prices of nonfood finished goods. There is an acute problem for gasoline, where skyrocketing prices at wholesale are shortly going to force up prices sharply at the retail level. The outlook for prices thus seemed gloomy even before the threat of a serious oil crisis emerged.

Mr. Bryant made the following statement regarding the outlook for the balance of trade and payments:

Our balance of payments has shown a remarkable improvement this year. The magnitude of this improvement has substantially exceeded what we expected last June. All things considered, it seems increasingly clear to us--and this is the main thought about the international situation we want to leave with you this afternoon--that fundamental adjustment in the U.S. balance of payments is well under way.

One reason for the improvement this year is the phenomenal rate at which merchandise exports have been expanding. Measured in current dollars, the rate of increase during 1973 is estimated to be roughly 45 per cent, and even in real terms the gain is about 25 per cent. As Mr. Gramley has already noted, this remarkable export expansion has been providing a considerable stimulus to the domestic economy.

The rapid growth in export demand has been generated by three events: a surge in foreign demand for our agricultural commodities, an industrial boom abroad, and the depreciation of the dollar in the foreign exchange markets. Looking ahead to next year, we foresee a reversal in the sharp run-up in value of agricultural exports, which will in turn lead to a marked slowing in the rate of increase of total exports. On the other hand, we expect that the past exchange-rate changes will continue to be a powerful stimulant to our exports throughout 1974 and into 1975.

The increase in agricultural exports we have experienced this year has been extraordinary. For calendar 1973 over 1972, we estimate that this increase will break down to a 45 per cent rise in price and a 30 per cent gain in volume. On the assumption that world harvests will be good, prices may decline in the second half of next year.

Nonagricultural exports have also been expanding rapidly. Here price increases have been much less pronounced, and volume gains have been substantial. The assumption underlying our projection is that economic activity will continue to expand in the major industrial countries in 1974, although at somewhat slower rates than the boom pace during most of 1973.

The depreciation of the dollar that has taken place in recent years has contributed materially to the growth of our nonagricultural exports. The trade-weighted depreciation of the dollar between May 1970 and October of this year amounted to more than 20 per cent in terms of 10 leading foreign currencies. Our projection is based on the working assumption that the dollar would remain near this level for at least the first half of 1974. In recent days, the dollar has risen somewhat above this level, at least partly because of the oil crisis, which the market interprets as potentially more troublesome for many other countries than for us.

The depreciation of the dollar has begun to have a dramatic effect on our imports as well as our exports. By contributing to higher dollar prices of imports, the depreciation has helped to suppress the volume of imports excluding fuels, despite the strength of domestic demand. On the other hand, the higher dollar price of these imports, part of which is due to the dollar depreciation, has been producing an increase in their value. This pattern will probably persist in 1974.

The value of our imports is increasingly influenced by the fast-changing conditions of oil supply. Imports of fuel now account for roughly 13 per cent of the total value of imports. Our fuel import projection does allow for a temporary constriction of petroleum imports near the close of this year, but it assumes a resumption of steady import growth toward the end of the first quarter of next year. This assumption may, of course, be proved quite unrealistic.

Our projection also assumes that the price of imported oil will on average be roughly 50 per cent higher in 1974 than in 1973. Recent events suggest that prices may rise instead by 90 to 100 per cent. If this larger price increase were to materialize, it would add several billion dollars to the fuel import bill for 1974. However, the net impact on our over-all balance of payments position would be substantially less, as a good part of the increased payments for oil would find its way back to this country, directly or indirectly, in the form of increased exports or private capital inflows.

The longer-run effects of a sustained cutback in oil production in the Arab countries are very difficult to foresee. It is clear, however, that output would be less restricted in this country than in Japan and Western Europe, where industrial production is much more dependent on imported oil. As a result, greater shortages would be likely to develop in Japan and Europe than in this country, so that our trade balance--exports less imports--with these countries might actually improve, even though our total exports might be depressed.

With these caveats in mind, we estimate that for 1974 as a whole, the trade surplus may be about $4 billion. But the rate of surplus would probably diminish in the latter half of 1974, as agricultural exports fall off and fuel imports continue to increase.

Because of increasing net receipts on services, we think that the surplus on goods and services combined is likely to hold up somewhat better in the latter part of 1974 than the surplus on merchandise trade. The estimate for services assumes that income received from U.S. investments abroad, including income from petroleum investments, will continue to grow rapidly. Little net change is expected in the other service components--military transactions, travel, and transportation.

For long-term private capital flows, we are seeing a net inflow on this account in 1973, for the first time since 1968. Foreign purchases of U.S. securities and foreign direct investment in this country have been particularly large so far this year.

The depreciation of the dollar has made production of internationally tradable goods in the United States more profitable compared with production abroad. And investors may now believe that the dollar is unlikely to depreciate further in foreign exchange markets. These forces will be working to strengthen the capital account in 1974. But there are also several major uncertainties affecting the outlook for capital movements next year--even without the possibility of sustained cutbacks in oil production. One uncertainty is the question of how the oil-producing countries, both Arab and non-Arab, will spend or invest the huge increases which will occur in their earnings--again, with or without the cutbacks. A substantial, but quite uncertain, share of these earnings will probably be channeled to the United States, either directly or indirectly.

Another uncertainty has to do with the removal of controls over capital outflows from this country.

The Administration has pledged to terminate the controls by the end of 1974, but no specific plans for phasing out or termination have been announced.

Because of these uncertainties, we have not shown any projections for capital flows for 1974. But unless the uncertainties are all resolved very unfavorably, we believe that net capital flows may turn out next year such as to yield a surplus in the basic balance (balance on current account and long-term capital). We estimate that this 1974 surplus could amount to as much as $4 billion. For 1973, we estimate a surplus of somewhat more than $1 billion.

To sum up, we are increasingly confident that fundamental adjustment has been showing through in the balance of payments. Nonetheless, as the worldwide advance in economic activity slackens, a good deal of further testing of the adjustment process lies ahead. Especially if cutbacks in oil production are sustained over a long period of time, effective international cooperation will be essential.

Mr. Partee made the following concluding comments:

As the presentations by Mr. Gramley and Mr. Bryant have indicated, our basic outlook for the U.S. economy is one of continued modest expansion in real output, abstracting from the possible effects of severe energy shortages. The prospects in the international area are for further growth in our nonagricultural exports, maintenance of a quite satisfactory current account surplus and--with less certainty--continuation of a relatively favorable position with respect to long-term capital flows. In the domestic area, we would expect that consumer demand--especially for durables--will continue on the weak side, and that residential construction expenditures will fall considerably further before turning up a bit in the latter part of 1974. But these sources of weakness in the economy appear counterbalanced by the outlook for further strengthening in business capital spending, an upward drift in military outlays, further improvement in non-farm exports, and persistent though still moderate inventory restocking.

The result of these and other elements entering into our projection is that real growth would moderate further in 1974 to about a 2 per cent annual rate in the latter half of the year. This would be insufficient to absorb the continuing growth in the labor force, so that the unemployment rate would be expected to move gently upward throughout the year. But this slight softening in the labor market probably would not forestall a quickening in the pace of wage increases, given the decline in real earnings which has taken place this year. Consequently, we would expect a continuing high rate of inflation, with less of the over-all price increase coming from food and internationally traded commodities and more of it from the generalized pressure of rapidly rising unit labor costs.

The projected rise in nominal GNP over the four quarters of 1974 averages 8 per cent, which is still considerably in excess of the assumed 5 per cent growth in the money supply. Therefore, we expect that interest rates generally will continue under some upward pressure. Our judgmental projection is that the bill rate will average around 8-1/2 per cent throughout the year, and that yields on new high-grade bonds are likely to be moving gradually upward to around 8-3/4 per cent for the new issue rate on the highest-grade utility bonds.

There is a real possibility that these estimates understate the pressures on financial markets that could result. Using the projected GNP and monetary numbers, our econometric model would generate significantly higher rates in both the short- and long-term areas. But the model may not allow sufficiently for the expectational effects of slow economic growth and rising unemployment.

With nominal GNP rising less rapidly in 1974 than in 1973, and with credit restraint affecting the availability of mortgage funds, growth in aggregate credit flows should slacken somewhat next year. Our flow of funds projection suggests that the total of funds raised may fall off on the order of $20 billion from the record increase of $175 billion estimated for 1973. The projected decline is more than accounted for by reduced Federal financing needs and slower growth in mortgage and consumer credit. External needs of nonfinancial businesses are likely to rise significantly further, reflecting increased capital and inventory investment in the context of a leveling in profits. Also, corporate tax payments will exceed accruals next year--in contrast to this year, when payments are running below accruing liabilities. Given the longer-term character of the bulk of corporate financing needs, we would expect a sharp rise in bond market financing, which, along with the prospect of increased municipals financing next year, will tend to put upward pressure on the long-term market rate structure.

Another indication of financial market pressures is provided by our projection of the securities acquisitions needed to be made by households in order to balance new securities supply with demand. Such purchases are likely to be about as large as this year--around $20 billion. The buildup in consumer holdings of time and savings deposits is also projected to fall off a little further next year, to a growth rate of about 8 per cent at the banks and thrift institutions combined. This should mean continuation of a relatively tight supply of mortgage funds, but not a condition of extreme scarcity. In fact, if Federal financing assistance to the mortgage market continues to be substantial, as we assume, there would likely be improved mortgage availability, and thus a turnaround in housing, as the year progresses.

All in all, I think that our base economic projection is for about as favorable an outcome as could be hoped for in the difficult circumstances we face. Real growth is low, and the unemployment rate drifts upward, but the expansion projected may be about all we can manage, given supply constraints in our basic materials-producing industries. The projected increases in unit labor costs and in the general price level are distressingly high, but a modest slowing in inflation late in 1974 may also be about as much as reasonably can be accomplished.

We did utilize our econometric model, however, to see what the results of alternative monetary policy assumptions might be. The alternatives are keyed, on the one hand, to the objective of achieving a significant reduction in inflation by 1975 and, on the other hand, to preventing the unemployment rate from rising above 5 per cent. As in the past, the incremental differences in the performance of the variables shown are based mainly on model results, adjusted to our judgmental projection for 1974.

A reduction in money growth to a 4 per cent rate could be expected to slow the rate of inflation significantly by 1975, but at the cost of a protracted decline in real output and a sharp rise in the unemployment rate. Alternatively, if money growth is raised to around a 6-1/2 per cent rate, the consequent strengthening in economic expansion would be likely to hold the unemployment rate at 5 per cent or below until very late in 1975, but at the cost of an acceleration in the pace of inflation.

The familiar problem of policy, then, appears even more acute than in the past. Given the present state of the economy, monetary policy must make its tradeoff between very unsatisfactory choices as to employment and price objectives. I believe that the only feasible course is the middle one.

As noted in the blue book,[1/] we expect that there will be a sizable upward revision in the money supply data, as nonmember bank deposit figures exceeding earlier estimates are incorporated in the annual benchmark revision. An approximation of the higher money numbers has already been taken into account in our econometric and judgmental projections of the economic outlook.

As 1974 unfolds, however, the course of monetary policy will need to take into account the fact that the output capability of our economy may be constrained far more than our projection allows for by the shortage of energy. The total supply (and use) of energy has been increasing recently at an accelerated pace, but domestic production has changed little, on balance, over the past several years. The added supply therefore has come from net imports, and almost all of this increase has been in imports of petroleum products.

The total supply of energy has barely kept pace with demand, and it is abundantly clear that a sharp

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

cutback in imports of oil will create a critical shortage if continued for any length of time. Estimates of minimum oil needs next year, given moderate growth in the economy and normal marketing procedures, are on the order of 18 million barrels per day, of which more than 7 million had been expected to come from imports. An effective embargo on both direct and indirect imports from the Arab countries is estimated to reduce total import capabilities by around 3 million barrels per day, assuming continued normal shipments from other supplying countries. With an all-out effort, perhaps as much as the equivalent of 1 million additional barrels could be provided within 6 months or so through increased domestic production and substitutions of coal for oil by the utilities. Nevertheless, that would still leave a shortfall of 2 million barrels or more--over 10 per cent of our total projected needs.

The economic effects of a shortage of this magnitude are impossible to quantify with any precision at this point in time. Much will depend on the priorities assigned in allocations of available fuel, since the impact on GNP is likely to be a good deal less from a reduction in household consumption than if industrial uses are curtailed, or if there are inadequate supplies available for transport of goods. But even if consumers take the brunt of the cutback required, there are likely to be bottlenecks and distributional problems in industry that will result in temporary layoffs and reductions in output. The imposition of a substantial cutback on consumer uses--whether by higher prices, higher taxes, or rationing--moreover, would be likely to have major consequences for the car market, for the travel business, and perhaps for home buying and related household durables. Thus the effects of the crisis are likely to be to reduce demands as well as output. Income will be destroyed, business and consumer psychology will be dampened, and the upward momentum the economy still has at this point in the cycle may well be lost. In these vital respects, the energy crisis may be different in scale, if not in kind, from the unfavorable but usually temporary effects that have come in the past from major strikes.

Under these circumstances, I would be extremely reluctant to see any sizable reduction in the monetary growth rate. The 5 per cent money growth assumed in our base projection is already very low, in that it allows for no further expansion at all in the real money stock over the next year, and it implies a substantial further rise in the income velocity of money. Appreciably slower growth for any extended period of time, with its lagged effects on the economy, could jeopardize the basis for recovery in output when the oil embargo is eased, and could help tip the economy instead into a true cyclical recession. At the same time, it should be recognized that fuel supply constraints are very likely to cut into potential real economic output, and that--despite the likelihood of a still more rapid rate of inflation--growth in nominal GNP could also fall short of the increases we have projected. Maintenance of monetary growth at close to a 5 per cent rate for M_1 could thus well imply some downward movement in interest rates as output and spending begin to slacken. Such a decline in rates, if it develops, I believe should not be resisted.

Chairman Burns invited the members to raise any questions they had regarding the staff's presentation of the economic outlook and, if they wished, to express their own views not only on the outlook but also on the energy problem and on monetary policy.

Mr. Brimmer reported that at the EPC meeting in Paris, Mr. Stein, Chairman of the Council of Economic Advisers, had observed that the adverse effects of reduced oil imports on U.S. industrial activity might be dampened by measures to concentrate supply reductions in the household sector. He then asked whether the postponement of the reduction in oil shipments to the Common Market nations other than the Netherlands--which the Mid-East exporters of oil had announced during the preceding weekend--might cause the staff to modify the observation made in the presentation that the impact of the oil cutbacks would be less severe on the United States than on Europe.

In reply, Mr. Partee commented that oil production in the Mid-East was being curtailed and shipments would fall. Because the Western European countries were so heavily dependent on imported sources of energy, they would be more affected by the prospective decline in shipments than the United States--which still produced the major share of its oil needs domestically--would be by the total embargo.

Mr. MacLaury, noting that the energy problem might accelerate the rise in prices, asked whether the staff anticipated any unusual labor strife in 1974.

In response, Mr. Wernick said the staff did not project any unusual labor problems in major industries in 1974. Most major industries had concluded new agreements this year; the steel industry would have to negotiate a new agreement in 1974, but it had new procedures that made a strike unlikely.

Mr. MacLaury then inquired whether the staff as yet had any views about the possible impact of the energy crisis on business capital spending plans.

Mr. Gramley replied that the uncertainties generated by the oil crisis could have a significant negative impact on business capital spending, but that it was impossible to evaluate the effect at present.

Mr. Mayo observed that for some time most large firms in the Seventh District had been building up fuel supplies in anticipation of a shortage, and they believed that their supplies of fuel would be adequate through the coming winter. However, many of those businessmen were concerned about the availability of fuel for those of their suppliers which had been unable to build adequate inventories and about the possible inability of many employees to travel to work. The Seventh District as a whole was probably in a better position than other parts of the country because it relied more heavily on domestic crude oil and nuclear power. However, some parts of Michigan could encounter difficulties if fuel supplies from Canada should be restricted.

Mr. Hayes remarked that his conversations with bankers and economists in the Second District had revealed a wide range of views. Some thought that the crisis was greatly exaggerated--that GNP growth would be slowed by no more than 1/2 of a percentage point--while others believed that the problem was severe--that growth would be slowed by as much as 3 percentage points. All anticipated a worsening of inflationary pressures, with estimates of 1 to 3 percentage points additional increase in the GNP deflator.

Continuing, Mr. Hayes said the major reason for the wide variance in the estimates of the impact of the crisis on the economy was a difference of opinion as to how much fuel would be diverted from the household sector. For example, one bank economist thought that an over-all deficit of 2 million barrels per day could be fully offset by a cut in gasoline consumption to 10 from 15 gallons per week per car. An economist for a large insurance company thought that such a reduction in gasoline usage was not politically feasible. One senior economic adviser of a major oil company suggested that the shortfall would come to 2 million barrels per day and would result in a reduction of 1 to 1-1/2 percentage points in the rate of expansion of GNP. Another oil company economist anticipated a shortage of 2-1/2 million barrels per day during the winter, and he thought that after allowance for a reduction in consumption in the household sector, the net shortfall for industrial uses might be less than 1 million barrels per day; he regarded that as fairly serious. In general, oil company economists viewed the situation as more serious than did most other observers.

Mr. Hayes added that he was uncertain about the potential impact on capital expenditures. The businessmen and bankers he had talked with were concerned about the impact of the fuel shortage on their own operations, but they anticipated huge investment programs in coal and other energy-producing industries.

Chairman Burns commented that it was necessary to distinguish between planned investment and the actual investment that might be realized. Widespread shortages were likely to prevent some projects from being carried out.

Mr. Eastburn, noting that the staff presentation had suggested an average of 8-1/2 per cent for the 3-month Treasury bill rate in 1974, asked whether the staff had a view concerning the Federal funds rate next year and whether it foresaw any special international flows of funds that might affect the relationship between the bill rate and the funds rate.

In response, Mr. Partee observed that the figure of 8-1/2 per cent for the bill rate, which came from the judgmental model, represented an average for the year; the rate, as had been demonstrated in recent days, could be very volatile, and large variations were to be expected. In an environment of a fairly restrictive monetary policy, an 8-1/2 per cent rate for 3-month bills implied roughly 10 per cent for the funds rate. International flows of funds were likely to exert less influence on the relationship than they had recently.

In response to a question by Mr. Eastburn concerning the relationship between interest rates and the growth rate of the money supply, Mr. Gramley said the staff had simulated the model as a means of assessing that relationship, and had found that the model produced higher bill rates than the judgmental projections in the staff presentation. In the judgmental projection, an 8-1/2 per cent bill rate was associated with a 5 per cent rate of growth in M_1. To hold the bill rate down to that figure in the simulations with the model, a higher rate of monetary growth would be required.

Mr. Morris remarked that, despite the uncertainties, it was clear that the impact of the energy crisis on the economy would be negative, at least through the first half of 1974. Concern was particularly great in New England, which depended heavily on foreign oil sources; imports accounted for 92 per cent of the area's oil supply, and 1/3 of that came from the Middle East. The region would be totally dependent on a well-run national allocation plan, and he had an uneasy feeling that national planning to deal with the energy crisis was not well organized.

Mr. Brimmer observed that the Federal Reserve itself was experiencing difficulties in assuring that sufficient fuel would be available for the airplanes that transport checks, which was further testimony on the state of the organization to deal with the crisis. With respect to the problem of appropriate policies, he noted that at the EPC meeting, the Secretariat had recommended more stimulative monetary and fiscal policies because of the effect of the energy shortage in reducing real output from the path it otherwise would have followed. Before one could assess Mr. Partee's recommendation for a 5 per cent minimum growth rate in M_1, it was necessary to distinguish between the effects on output arising from the supply side and those arising from the demand side. He asked Mr. Partee how that problem might be approached.

Mr. Partee said it was difficult to assess the relative contribution of supply and demand problems to a potential slowdown in real economic activity. One reason the staff had proceeded to present projections that did not take account of the energy crisis was because they offered a base of normal expectations against which to appraise actual developments as they emerged. For example, the projections were for a moderate decline in new car sales, even before the expected impact of the fuel shortage. Now the prospect was that the demand for big cars would be much lower, and that that would not be offset by small car sales because of the inability of auto producers to raise significantly the production of small cars in the short run. Other cutbacks in economic activity were more clearly the consequence of supply shortages resulting from unavilability of fuel or lack of transportation services.

Mr. Partee added that he would like to clarify his earlier recommendation about the growth of the money supply. He would be very uncomfortable were the expansion of M_1 to fall significantly below 5 per cent. There was real danger that the situation would deteriorate rapidly. In the circumstances, any effort to maintain interest rates might steadily diminish growth of the money supply and perhaps turn it negative, resulting in a cyclical movement in the money stock that might induce a recession in real output even should the supply situation improve. However, he would differ with the suggestion of the EPC Secretariat that monetary and fiscal policies should be directed toward offsetting the weakness in economic activity caused by shortages as well as that caused by demands.

Chairman Burns observed that a reduction in output which was initially the result of supply constraints would affect employment and incomes and thus lead to a contraction in demand.

Mr. Hayes remarked that a key issue was when the secondary effects on demand would manifest themselves. Maintenance of growth in money and credit roughly at recent rates during the initial stages of supply curtailments would run the risk of adding to inflationary pressures at the same time that the fuel shortage was pushing up prices. With price and wage controls becoming less and less effective and fiscal policy tending to become more stimulative, monetary policy was the only instrument that could possibly contain the increasing inflationary pressures. Consequently, he would shade growth in M_1 below 5 per cent over a period of several months. Given the rate of growth in money over the past year--which, in his opinion, had been execessive--some risk could be taken with a monetary growth rate below 5 per cent. In the present circumstances, it was important for the System to maintain a posture that could be recognized as steady, and for that reason, he would put emphasis on maintaining money market conditions about where they were.

Mr. Gramley observed that a great deal depended on whether the impact of the energy shortage on demands would be long delayed or would occur much more promptly, and in his opinion, it would appear very soon. For example, demand for large automobiles was declining, and production was bound to be strongly affected. Interest in suburban housing was also reported to have fallen because of potential transportation problems. Thirdly, capital spending--which might be profoundly stimulated over the longer term--probably would be curtailed in the short run by uncertainties. Consequently, a policy of maintaining interest rates would run the risk of inducing a sharp curtailment in the monetary aggregates.

Mr. Daane commented that he found it difficult to see how an easier monetary policy and lower interest rates could alleviate the suburban housing kind of problem in the short run.

In response, Mr. Gramley said his point was that in the short run weakness in demand could greatly aggravate the output curtailments arising from scarcities and induce a cumulative decline in activity. If a more expansive--or less restrictive--monetary policy could stimulate demands to a degree, such a policy was desirable; it would be very undesirable to attempt to maintain interest rates if that threatened to induce a cumulative decline in the monetary aggregates.

Mr. Hayes commented that he would be willing to modify policy when he saw the secondary demand effects developing.

Mr. Mitchell remarked that while GNP might be reduced as a result of the energy shortage, its quality might be improved by the various adaptations to the shortage.

Mr. Winn observed that demand both from abroad and from Eastern utilities for coal from the Fourth District was phenomenal, but shipments would be limited by availability of supplies--in the first instance, by shortages of qualified labor--and about 3 years would be required to open new mines. Because of the shifts from coal to oil that had occurred earlier, coal operators would be cautious, and new supplies would come at a high price. There did not seem to be a shortage of coal cars or other current limitations on transportation facilities.

Mr. Clay noted that low sulphur coal was being produced and shipped in quantity from Wyoming. There were abundant supplies of coal, and many utilities could switch from oil to coal if necessary. He also felt that it would be necessary to encourage people to change their energy consumption patterns by allowing energy prices to rise dramatically.

The Chairman then invited comments from Mr. Pizer, who was a member of an interagency committee that, among other things, had been studying fuel substitution possibilities, particularly substitution of coal for oil in electricity generation.

Mr. Pizer said a saving of 300,000 to 400,000 barrels per day could be obtained through utility conversion from oil to coal by the end of a 6-month period. That would offset about 10 per cent of the projected 3 million barrels per day shortfall. An optimistic estimate of the total offset from substitutions and savings now considered feasible would be about 1 million barrels per day by late 1974.

Continuing, Mr. Pizer observed that significant savings were possible in some areas. Gasoline consumption alone accounted for 6 million barrels per day, most of it used in automobiles. There were a number of possible changes in fuel consumption patterns which could result in a complete offset of a 2 to 3 million barrels per day shortfall. However, very little could be accomplished before mid-1974; therefore, there might be real difficulties this winter. And in order to accomplish that offset steps would have to be taken right now. Furthermore, problems would exist beyond 1974. Domestic supply projections for next year were based on imports of Arab oil amounting to about 3 million barrels per day. Even if the Arab states were to restore production to recent levels, it was not likely that they would increase production in the future at a rate sufficient to meet the growing oil import needs of the United States and other industrial countries. As had been mentioned, other countries were much more dependent on Arab oil than was the United States: Europe imported over two-thirds and Japan over two-fifths of its oil from Arab countries, whereas the United States obtained about one-sixth of its oil from that source. U.S. oil production had been declining for several years, and any increased use of petroleum in future years would require making and implementing plans now.

Mr. Balles said he had surveyed the directors of the San Francisco Reserve Bank late last week on their tentative views regarding the impact of the energy crisis. In addition, his staff had been monitoring press reports of public meetings on the subject of energy and related developments in the District. The opinions expressed by the directors covered a wide range, from the relatively optimistic view that the slowing of the economy in 1974 would be somewhat greater than had been anticipated to the pessimistic opinion that a recession was imminent and that monetary policy should be eased immediately. The one point on which they all agreed was that rationing of gasoline and other scarce commodities should be avoided. It was their general feeling that rationing would not have broad public support and, as a result, that the system would break down and black markets would develop. The directors hoped that higher prices or special taxes would be used as the allocating mechanism for gasoline and other scarce commodities.

Also, Mr. Balles continued, it was noted that the effects of the energy crisis would vary widely among industries and even among individual companies within an industry. In the petrochemical industry, for example, vertically-integrated companies would be able to maintain output, whereas companies which had to purchase their raw materials might have to cut production back severely.

Another point that emerged was that a deterioration in confidence had already set in among both consumers and businessmen, suggesting that spending plans might be revised downward.

Mr. Balles noted that shortages of petroleum products had already affected Twelfth District industries which used such products as raw materials, including chemicals, fertilizers, plastics, and synthetic fibers. Shortages of fuel and glue had resulted in soaring prices and some plant shutdowns in the plywood industry. In addition, cancellations or postponements of airline orders for jet planes were expected to have a strong negative impact on the District's aerospace industry.

With respect to the question of appropriate monetary policy, Mr. Balles said he would favor remaining in a position to move quickly toward a less restrictive policy if necessary to support an economy which was slowing because of supply constraints which were triggering a shrinkage of demand.

The Chairman observed that there was a great deal of loose thinking on the subject of reducing gasoline consumption. Apart from equity considerations, it was difficult to imagine Congress voting an increase in gasoline taxes of sufficient size to reduce consumption by 2 million barrels a day, assuming that knowledge of the price elasticity of the demand for gasoline was precise enough to determine with a reasonable degree of accuracy how large that increase should be. Nor was it likely that a gasoline tax increase could be enacted quickly. Even if Congress were prepared to raise gasoline taxes immediately by 30 or 40 cents a gallon, he would not favor such action because of the severe economic dislocations that would result.

With all of its deficiencies, the Chairman continued, rationing could be implemented reasonably promptly, especially if the Government had contingency plans drawn up. To reduce gasoline consumption by the needed amount, he thought a combination of rationing, a tax increase, and a price increase of greater magnitude than the tax increase would be necessary. He believed there should also be an excess profits tax which the petroleum companies could avoid by plowing back their excess profits into exploration and investments directed at increasing energy supplies.

Mr. Balles asked whether the inequities involved in a large gasoline tax could not be mitigated by a system of income tax credits.

The Chairman commented that tax credits were irrelevant for those whose incomes were so low that they paid no taxes and inequitable for those in the lower tax brackets whose incomes would be reduced by the gasoline tax many months before they received their income tax refunds.

Mr. MacLaury asked whether the disruptive effects of a large gasoline tax could not be moderated by spending the proceeds--perhaps to finance public transit systems, increased oil exploration, and other activities that would contribute to a solution of the energy problem.

The Chairman commented that the tax collections would begin reducing disposable income immediately, but the expenditures would occur only with a lag.

Mr. MacLaury then noted that gasoline prices were much higher in other parts of the world. Although he realized that the social and economic situations were not entirely comparable, he wondered if adjustment to higher gasoline prices in the United States might not be just a transition problem.

The Chairman replied that there might not be a major problem if gasoline prices rose from the current level to, say, one dollar or more per gallon over a period of time. However, a sudden increase of that magnitude would cause severe dislocations.

Mr. Holland noted that there was one aspect of the current situation that particularly disturbed him: uncertainty and confusion about capital payout ratios were having a depressing effect on the kinds of investments that would serve to alleviate the energy problem. For example, oil companies were delaying or halting some refinery construction projects because of uncertainty about future crude oil supplies from Arab sources. Investments in facilities utilizing new technologies--nuclear power plants, coal refining processes which would remove impurities and thus upgrade some deposits, and so forth--were being delayed because of confusion about the likely relative costs of present sources of energy over the longer run.

Mr. Sheehan agreed that uncertainty about future relative prices of competing energy sources might discourage some projects. He believed, however, that the recent worldwide increases in oil prices would stimulate certain types of investment spending. For example, it would now be profitable to produce unrecovered oil from many domestic wells by secondary and tertiary recovery methods, so that total domestic reserves were now larger. Use of oil shale would also be encouraged; that had been technologically feasible for 10 years or more, but low-cost oil had made it unprofitable.

Mr. Holland agreed, but added that large capital investments in oil shale projects, or in exploitation of high sulphur coal deposits, would not be made if the investors could not be reasonably sure that oil prices would remain high for a period long enough to recover their investment. Recent events had made price prospects even on secondary recovery processes more uncertain, and the situation was similar for other fuels. Some nuclear power plants, which could produce electricity three years from now, would be competitive with coal at $20 a ton. However, if coal prices should decline to $10 a ton, the nuclear stations would not be economical until cost-reducing improvements in nuclear power plant technology occurred, which might take another 5 years or more.

Mr. Hayes observed that the present oil crisis brought on by the Arab embargo had served to draw public attention to a long-run energy problem that had already been developing over an extended period. Even if the embargo were lifted in the near future, the nation would face an energy problem for some years to come.

Mr. Black reported that conditions in the Fifth District with respect to the energy problem were quite different from those in the Twelfth District. Firms in his District had been implementing energy conservation measures and stockpiling fuel supplies for some time. There were instances in which firms had had to cut back production because of oil shortages; he knew of a textile firm that had reduced its workweek from 6 to 5 days and of a brick factory that would have to shut down in 30 days if it could not obtain fuel oil. However, most District companies of which he was aware did not foresee serious problems for the next 6 or 8 months. Concern was being expressed about the adequacy of Government planning for the future.

Mr. Kimbrel noted that TVA was operating with a much lower-than-normal supply of coal for its generating facilities because barge transportation of coal had been affected by oil shortages.

Furthermore, a number of Sixth District industries--among them coal, steel, petroleum, and nuclear power firms--were complaining that they could not expand production capacity as rapidly as they might wish because so large a part of their capital outlays, at least in the short run, were for pollution control. Many firms were not planning to increase capacity unless legal requirements to improve air and water quality were relaxed.

In response to a question from Mr. Balles about estimates of the price elasticity of demand for gasoline, Mr. Pierce reported that various econometric studies on the subject indicated that the short-run elasticity was quite low. For periods of less than one year, a one per cent rise in price appeared to reduce gasoline demand by about one-tenth of one per cent. The longer-run elasticity was three or four times higher.

In reply to a further question by Mr. Balles, Mr. Pierce said it had been possible to calculate demand elasticity only for the relatively small changes in price that had occurred in U.S. experience. One would expect large price increases to have a substantial effect on recreational use of gasoline, but the demand for gasoline in other uses would appear to be quite inelastic. There had been cases of individual U.S. cities in which relatively large rises in gasoline prices had occurred with no decrease in gasoline demand for periods of up to 6 months.

Thereupon the meeting recessed until 9:30 a.m. the following morning, Tuesday, November 20, 1973. The attendance was the same as on Monday afternoon except that Mrs. Junz, Miss Morisse, Mrs. Smelker, and Messrs. Beeman, Enzler, Fieleke, Henry, Kichline, Peret, Roxon, Smith, Taylor, Wyss, and Zeisel were absent, and Mr. Coyne, Assistant to the Board, was present.

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

The memoranda of discussion for the meetings of the Federal Open Market Committee held on October 2, 10, and 16, 1973, were accepted.

Chairman Burns invited Messrs. Daane, Brimmer, and Bryant to report on certain foreign meetings they had recently attended. He suggested that the reports be relatively brief, in view of the length of the Committee's agenda today.

Mr. Daane made the following report on the recent Basle meetings:

> Chairman Burns and I, and Mr. Coombs, attended the November Basle meetings, held on November 11-12. The most significant part of the meetings was the agreement by the seven countries involved to terminate the March 1968 gold agreement. The basic premise of the termination was that events had overtaken that earlier agreement, which was in part predicated on the desire of central banks to protect their gold reserves and to assure continuance of U.S. convertibility. With U.S. convertibility no longer extant,

a number of those present felt the agreement had already been terminated de facto.

Chairman Burns made clear in Basle, and subsequently in his press conference here in Washington, that in joining in terminating the agreement the United States would henceforth be guided by Article 4, Section 2 of the Articles of Agreement of the IMF. That article in essence says that no member shall buy gold at a price above par value, or sell gold at a price below par value. At present prices this simply means that we will not buy gold, nor will any other country observing Article 4, Section 2, but we will be free, as will others, to sell gold. From the U.S. standpoint, then, this termination of the earlier agreement gives us greater flexibility to sell gold if, as, and when desired--which, of course, could be a step in the direction of the gradual phasing out of gold.

As for the remainder of the Basle meeting, there was the usual "tour d'horizon" at the Monday afternoon meeting with particular attention focused on exchange market developments since September. In the discussion it was generally recognized that a major factor was the dramatic improvement in the U.S. trade balance and balance of payments. One of the most interesting parts of that afternoon discussion was the report by the Japanese on their large losses of reserves (some $5 billion in 10 months) and their continuing sales of dollars in October and November with their rate allowed to ride up to 270 on November 1 and 275 on November 2.

At the final dinner meeting on Monday night, there was a diffuse and generally unproductive discussion of how the governors present evaluated Nairobi and the work of the Committee of Twenty. President Zijlstra summed it up by saying that nothing much had been expected and that non-expectation had been confirmed, that the C-20 format was much too U.N.-like to expect anything from it, and that while the Group-of-Ten concept similarly was "out," the "relevant-countries concept" linked to multi-currency interventions was "in" and provided the way for the system to evolve.

Mr. Brimmer said that in the interests of time he would limit himself today to one or two comments about the recent meeting of the Economic Policy Committee of the OECD and submit a fuller report for inclusion in the record.1/ There was some concern at the meeting about the developing oil situation, as he had mentioned yesterday. It was noted in that connection that the effects on other countries of the backflow of capital from oil-exporting countries would not be uniform; in particular, it was thought that the United States might benefit more than others from such capital flows. The outlook for inflation was considered serious, and in view of the uncertain effects of the oil situation, the EPC agreed to meet again in February to reassess the situation.

Mr. Bryant observed that the main subjects discussed at the recent meeting of Working Party 3 were the current exchange rate regime and the oil situation. While he also would submit a written report for the record,2/ he might note today that the conclusion with respect to the first subject was that there was no practical alternative but to stay with the interim regime of floating rates for the time being.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the

1/ Mr. Brimmer's report is appended to this memorandum as Attachment A.
2/ Mr. Bryant's report is appended to this memorandum as Attachment B.

System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period October 16 through November 14, 1973, and a supplemental report covering the period November 15 through 19, 1973. Copies of those reports have been placed in the files of the Committee.

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

> Since the last meeting of the Committee, the Desk has paid off the remaining $93.4 million of swap debt in German marks and Dutch guilders arising from market intervention in September and October. Since we resumed operations on July 10, Federal Reserve intervention financed by drawings on the swap lines has amounted to $512 million. All of this debt has now been repaid. Over the same period, our intervention operations were reinforced by dollar purchases by the German Federal Bank and the Netherlands Bank amounting to $583 million. In the case of the German Federal Bank, all of the dollars thus taken in have since been resold in the market. In general, operations undertaken since July 10 had proved to be self-liquidating. Since the last meeting we have also paid off another $36.3 million of Belgian franc debt, reducing our indebtedness in that currency to $263 million, as compared with a peak in August 1971 of $635 million. Our Swiss franc debt remains unchanged at $1,165 million. Meanwhile, the Treasury has requested us to defer paying off any Swiss franc debt, apparently in the thought that they may be able to negotiate some special repayment arrangement with the Swiss National Bank.
>
> On the foreign exchanges, since the last meeting the dollar has staged a spectacular recovery, rising sharply after the release in late October of the September trade figures and then scoring another major advance as the cutbacks in the Middle East oil

supplies threatened to have more serious effects on Europe and Japan than on the United States. Since then the dollar has fallen back by roughly 2 per cent from the peak levels reached on November 12, because of two ominous developments. The first was a report that the Arab countries might now proceed to use their financial weapon by shifting existing funds out of the dollar or, perhaps more likely, insisting on being paid in European and Japanese currencies for their oil exports--which would, of course, cut the world demand for dollars correspondingly. A second adverse development over the past weekend was the Arab decision to reinstate scheduled cuts in supplies going to Europe, while maintaining pressure on the United States and Japan.

Although the markets became rather disorderly during the strong upswing of the dollar, we refrained from intervening in the hope of shaking loose some of the really stubborn long positions in European currencies. I believe the very sharpness of the upswing has changed market psychology and has contributed to the subsequent steadiness of the dollar at much higher levels. Although the dollar has fallen back a bit from its peak, the markets have remained orderly and thus far there has been no need for support operations. Obviously, the situation calls for close watching; if there were a sharp break, the case for intervention might be very strong.

While the position of the dollar has continued to improve, rather acute disequilibria are developing elsewhere. Perhaps the most striking case is that of Japan, which has continued to suffer very heavy reserve losses despite--or, perhaps, aggravated by--the depreciation of the yen from 265 to the dollar to 280. Those heavy drains are an ominous development that could have substantial effects over a period of time; if they continue, the Japanese authorities clearly will be forced to take drastic action. Another situation of acute imbalance has developed in the United Kingdom, as illustrated by the October trade deficit of $750 million. In an effort to finance their large trade deficits, the British this year are borrowing $2-1/2 billion at medium term in the Euro-dollar market. Italy also continues to be in serious difficulty in its payments accounts.

Mr. Daane said it had been his impression at the Basle meeting that the British were not as worried about the outlook as Mr. Coombs' comments might seem to suggest.

In reply, Mr. Coombs remarked that the recent increase in the minimum lending rate of the Bank of England to a record 13 per cent struck him as a good indication of their degree of concern. Rising costs of imported raw materials were an important factor in the deterioration of the U.K. trade account, and he suspected that the British hoped their medium-term borrowing would enable them to get through to a time when raw materials costs dropped sharply. They had employed such borrowing for a similar purpose in the mid-1960's. If the hoped-for decline in raw materials costs did not eventuate they would be in very serious trouble.

Chairman Burns observed that he shared Mr. Daane's impression regarding the attitude of the British at Basle. At the same time, he agreed with Mr. Coombs that the increase in the lending rate of the Bank of England was a dramatic expression of concern.

Mr. Hayes asked whether the U.K. government was not heavily committed to an expansionary policy posture.

The Chairman expressed the view that, while the British had been committed to such a policy, they had begun taking restrictive measures as a matter of necessity; a 13 per cent official lending rate could not be dismissed lightly. He did not know what other measures they might be taking. Their situation was particularly difficult because British trade unions did not have the degree of discipline and of responsibility that American trade unions had.

Mr. Holland asked when the Special Manager thought it would be possible to resume market purchases of Swiss francs in order to begin gradually repaying the System's long-standing swap debt in that currency. He hoped that would be soon, not only because such debts should not be permitted to remain outstanding any longer than necessary but also because the present market situation appeared advantageous.

Mr. Daane concurred in Mr. Holland's view.

Mr. Coombs said he personally would be pleased to undertake such operations. Although it was possible that the dollar might strengthen considerably against the Swiss franc over the next month or so, perhaps rising to the neighborhood of the central rate, the System obviously could not expect to buy all of the very large volume of francs it needed at the moment that rate was reached. Accordingly, he believed it would be desirable to begin chipping away at the debt, in the expectation that the francs would be acquired at various rates over time. As he had noted, however, the Treasury had asked the Federal Reserve to defer such operations, on the grounds that they might handicap negotiations the Treasury hoped to undertake with the Swiss concerning a special arrangement for repaying the outstanding Treasury securities denominated in Swiss francs as well as the System's debt. He personally considered the chances very small that the Swiss would agree to the Treasury's proposal.

In response to a question by the Chairman, Mr. Daane said he had discussed the matter in question with the Treasury prior to the recent Basle meeting but not since.

Chairman Burns remarked that the Treasury's request that the System defer repayments on its Swiss franc debt seemed entirely reasonable so long as the Treasury planned to act promptly in opening the contemplated negotiations with the Swiss. He would be disturbed, however, if it appeared that those negotiations would not be launched until some indefinite future date. He thought it would be desirable to determine the Treasury's intentions in the matter, and he asked whether Mr. Daane would undertake to do so.

Mr. Daane said he would.

In reply to a question by Mr. MacLaury, Chairman Burns observed that the recent depreciation of the Japanese yen was not inconsistent with any international understandings. He added that in evaluating Japan's balance of payments position one should keep in mind that Japanese foreign investments through October amounted to about $8 billion and for 1973 as a whole might approach $10 billion. The Japanese authorities had close control over such foreign investments and could cut them back sharply if they so desired.

By unanimous vote, the System open market transactions in foreign currencies during the period October 16 through November 19, 1973, were approved, ratified and confirmed.

Mr. Coombs then noted that in the period from December 1 through December 28 all of the System's standby swap arrangements would reach the end of their 12-month terms. He would recommend their renewal for further periods of one year.

By unanimous vote, the Committee approved the renewal for further periods of one year of the following swap arrangements, having the indicated amounts and maturity dates:

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Term (months)	Maturity date
Austrian National Bank	250	12	December 3, 1973
National Bank of Belgium	1,000	12	December 21, 1973
Bank of Canada	2,000	12	December 28, 1973
National Bank of Denmark	250	12	December 3, 1973
Bank of England	2,000	12	December 3, 1973

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Term (months)	Maturity date
Bank of France	2,000	12	December 28, 1973
German Federal Bank	2,000	12	December 14, 1973
Bank of Italy	2,000	12	December 31, 1973
Bank of Japan	2,000	12	December 3, 1973
Bank of Mexico	180	12	December 3, 1973
Netherlands Bank	500	12	December 28, 1973
Bank of Norway	250	12	December 3, 1973
Bank of Sweden	300	12	December 3, 1973
Swiss National Bank	1,400	12	December 3, 1973
Bank for International Settlements:			
Dollars against Swiss francs	600	12	December 3, 1973
Dollars against other authorized European currencies	1,250	12	December 3, 1973

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 October 16 through November 14, 1973, and a supplemental report covering the period November 15 through 19, 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:

> Growth in the monetary aggregates resumed during the period since the Committee last met, with both M_1 and M_2 currently expected to be above the ranges of tolerance selected by the Committee at the last meeting. Consequently, the Desk is now seeking reserve conditions consistent with a Federal funds rate of 10-1/4 per cent,

about 1/4 to 3/8 of a percentage point above the rate considered desirable earlier when the aggregates looked like they were within the tolerance ranges.

The severe deterioration in the securities market in early November caused the Desk to be somewhat cautious in cutting back on reserve supply. There were three basic forces behind this deterioration: (1) market participants became less optimistic about the possibility that System operations would lead to a progressive easing in the money market; (2) demand for securities tapered off at a time when dealer inventories were swollen by Treasury sales of additional securities; and (3) the strength of the dollar in foreign exchange markets caused foreign liquidation of Treasury bills and led market participants to anticipate continued heavy sales of bills and perhaps even coupon issues by foreign central banks and also to anticipate drains on Treasury cash balances as foreign-held special certificates were cashed in. As a result, interest rates fluctuated widely over the period. After an early decline to the 7 per cent level, the 3-month bill rate rose to a high of 8.65 per cent last Wednesday, and then, as scarcities developed, fell by over 100 basis points. In yesterday's regular auction of Treasury bills, average rates of 7.70 and 7.80 per cent were established for 3- and 6-month bills, up about 1/2 of a percentage point from the rates established in the auction just preceding the last Committee meeting, but well below the intermeeting highs.

In the Government coupon market, yields rose generally although a minor rally developed in the past few days. All three issues offered in the Treasury's November refunding had fair-to-good reception in the bidding but subsequently fell to substantial discounts.

Open market operations over the period were tempered by the need to take account of the Treasury's financing, although I might add parenthetically that even keel considerations were not deemed strong enough to prevent the new issues from going to sizable discounts before payment date. Operations were also tempered by the severe upward pressure at times on bill rates, and by rather substantial misses in the reserve projections. The

Desk purchased gross about $1 billion of Treasury bills from foreign accounts, including some at times when projections indicated no need to provide reserves. Any unwanted reserve impact was avoided by other actions, however, including sales of over $300 million to other foreign accounts and the run-off of $900 million of System holdings of Treasury bills in the weekly auction.

Japan, as you know, has suffered heavy losses in the exchange market, and despite large reserves, had virtually exhausted its holdings of Treasury bills and short-term Treasury specials. We have been asked to build up the liquidity of the account by selling some of their coupon holdings. Last Thursday and Friday--with a large reserve need indicated for the statement week--the System purchased $500 million of such securities directly from the Bank of Japan. Yesterday we sold about $150 million of coupon securities for Japan with surprisingly little initial market reaction. Should we have to repeat this process frequently, however, a sizable reaction could develop. The markets remain quite sensitive as they watch developments in the monetary aggregates and the Federal funds rate, try to guess at the course of System policy, worry about foreign sales of securities, and try to assess the implication of the energy crisis for the economy and for financial markets. We shall probably have to continue to be quite flexible in our approach to markets in the period ahead.

The Treasury is, as you know, vulnerable to substantial and unpredictable cash drains if the dollar gains further strength in the exchange market. It is particularly vulnerable in the absence of legislation permitting direct lending to the Treasury by the System. The Treasury should (at least when the debt ceiling is not a constraint--as it is at the moment) run its cash balance on the high side. We have been working with the Treasury to devise means of raising money in a hurry if unexpected needs arise. I believe we have made progress on that score.

In reply to questions by Mr. Bucher, Mr. Holmes said that the Japanese monetary authorities now held about $5.5 billion of U.S. Government coupon issues and $1-1/2 billion of agency issues.

The proceeds of their recent sales of coupon issues had been reinvested in Treasury bills and specials to put them in a better position to meet day-to-day reserve drains, and the magnitude of any future coupon sales would depend on the size and duration of such drains. When the Desk made sales for foreign central banks--such as yesterday's sale of $150 million of coupon issues for the Japanese--it advised dealers that the sale was for customer account, to avoid mistaken inferences that the System was operating for its own account. The $500 million of coupon issues the Desk had acquired directly from the Japanese would be reflected in the published weekly statement, in the form of a large increase in System holdings of such issues, and he had no doubt that market participants would correctly deduce the reason for the increase.

In reply to a question by Chairman Burns, Mr. Holmes said that the System had never sold long-term issues from its portfolio.

The Chairman expressed the view that it would be desirable for the System to make such sales from time to time, if only to indicate that it was prepared to do so when circumstances warranted. He asked whether it might not be useful now to sell $50 or $100 million of the $500 million coupon issues acquired from the Japanese and replace them with shorter-term issues.

Mr. Holmes said he agreed in principle that the System should be prepared to sell coupon issues on appropriate occasions, and would keep that consideration in mind. However, he would place great importance on the timing of such sales, and on the need to condition the market for them. In his judgment, it would not be desirable for the System to sell coupon issues at this time, shortly after the market sales for the Japanese.

In reply to a question by Mr. Mitchell, Mr. Holmes said that market participants were generally aware that, when foreign central banks sold U.S. securities to finance reserve drains, the proceeds of the sales found their way back into U.S. financial markets. They also recognized, however, that the funds would be invested in a broad range of securities and that, consequently, there could be differential impacts on different interest rates.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period October 16 through November 19, 1973, were approved, ratified, and confirmed.

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

> Of the alternatives presented to the Committee,[1/] alternative B most nearly represents a posture that would

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

be consistent with a "wait and see" attitude with regard to the apparently emerging energy crisis. This alternative includes growth in the aggregates, particularly M_1, close to recent Committee desires and does not contemplate any significant change in money market conditions. Alternatives A and C contemplate an easing and tightening of monetary policy, respectively, both in terms of the monetary aggregates and interest rates.

The actual development of the energy crisis as to timing and intensity is uncertain and the monetary relationships we have posited could easily be thrown off. The eventuality most likely to throw off the specified relationships would be the actual emergence of a substantially weaker economy than projected. This could so reduce the transactions demand for money that interest rates would have to decline substantially if M_1 growth were to be maintained on its desired longer-run trend. The odds on such a very marked weakening in transactions demand emerging during the next 4 weeks do not appear very high, but it cannot be discounted entirely.

If the impacts of a fuel shortage on economic activity do not become manifest for a while yet, it is probable that over the next few weeks monetary policy will not have to confront in a major way the problem of to what extent it should attempt to maintain the growth in money in the face of a significant supply-induced slowing of economic activity and in money demands. Indeed, if the staff's projection of a 10 per cent (annual rate) rise in nominal GNP for the fourth quarter is anywhere near the mark, a rather sizable transactions demand for cash is in fact indicated over the next few weeks. And it would not be surprising if there were some further rise in short-term rates from this alone, assuming growth in nonborrowed reserves is kept to the dimensions implicit in alternative B and in the absence of energy crisis expectational effects.

Still, expectations may be quite volatile between now and the next Committee meeting--affecting not only domestic market participants but international flows of funds. With regard to domestic markets, for example, fears of recession and anticipations of reduced credit demands in the near future could lead to a drop in short-term rates and also to some degree in long rates. There

> could also be some increased demand for cash (as well as for short-term interest-earning assets) related to the energy crisis. The specifications of alternative B do allow for this to some extent since the November-December range of tolerance for M_1 growth is, at 4-1/2-6-1/2 per cent, asymmetrical on the high side around the 5 per cent long-run path. But the Committee may wish to consider widening ranges for the aggregates a little on both the low and high sides to allow for uncertainties affecting public cash management practices in a period of volatile expectations.
>
> A fairly stable Federal funds rate would act as a moderating influence on the magnitude of over-all interest rate fluctuations. It would also enable the System to be accommodative to short-run swings in money demand. Thus, if the Committee wished to consider a stance over the next few weeks that represented an effort to hold financial markets on a steady course while the dimensions of, and public policy in relation to, the energy crisis were being sorted out, it could do so by holding the Federal funds rate fairly steady.
>
> The Committee may wish to consider a strategy that also in some degree guards against an earlier-than-anticipated weakening in economic activity that could be generated by the oil situation. In that context, if the aggregates do fall below their ranges of tolerance, permitting the funds rate to drop some would be a useful hedge, setting in motion forces that would eventually work to sustain monetary growth in a weakening economic situation.

In reply to a question from Mr. Bucher, Mr. Axilrod said the staff expected the volume of large-denomination CD's outstanding to stop declining in late November and to rise during December.

Mr. MacLaury noted that recent monthly levels of M_1 and extensions into the future reflecting the 5 per cent growth path called for under alternative B were shown in a blue book chart in two different lines, of which the lower was based on the currently published figures and the higher reflected the preliminary results of a benchmark adjustment now being made. According to the text, the adjustment was likely to result in an upward revision of the M_1 growth rate for the year ending in September from 5.3 to 6-1/2 or 7 per cent. He asked what the staff thought the upward revision in M_1 implied for desirable growth rates in the future. In particular, should the target rate now be reduced to compensate for the overshoot disclosed by the revision? Or was such compensation not necessary on the grounds that the higher path had been built into the staff's GNP projection?

Mr. Axilrod replied that in his view the latter was the correct implication. Allowance had indeed been made for the upward revision in M_1 in developing the GNP projection; the 5 per cent growth path assumed in the projection was that portrayed by the higher of the two lines shown in the blue book chart. The currently published series was also shown in the chart--and used as basis for the specifications of the several alternatives--only because revised monthly seasonal adjustment factors had not yet been developed. Accordingly, if the Committee considered the course of GNP reflected in the projection to be a reasonable outcome, it need not compensate for the excess of recent M_1 growth over earlier target rates. He might note that the 5 per cent path of alternative B was a shade below the longer-run target path of 5-1/4 per cent that the Committee had had in view since last March.

Chairman Burns asked how certain the staff was that the revised series would be more accurate than that currently published.

In reply, Mr. Axilrod observed that the principal revision consisted of benchmark adjustments to June and December call report data for nonmember banks tabulated by the FDIC. Although those data were single-date figures and typically reflected some window-dressing, it was his impression from examining the historical record that they provided the basis for reasonably reliable adjustments.

In response to questions by Messrs. Mitchell and Brimmer, Mr. Axilrod noted that in the previous annual benchmark adjustment it had been found that nonmember bank deposits had grown substantially more than had been allowed for in the month-to-month estimates. Accordingly, the staff had raised somewhat the ratios employed for subsequent monthly estimates for nonmember banks. The latest benchmark figures indicated that the ratios had not been increased enough, and they were now being raised considerably further. It was quite possible, of course, that the next benchmark adjustment would reveal that that procedure had produced an overstatement of the nonmember figures.

Mr. Hayes said he had some difficulty in understanding Mr. Axilrod's conclusion that there were no implications for desirable future growth rates in M_1 in the discovery that recent growth rates had been considerably higher than the Committee had believed.

Chairman Burns remarked that he had had the same thought in mind in asking about the relative accuracy of the revised and unrevised series. If the revised series were more accurate, he did not see how the Committee could ignore the fact that monetary growth had overshot the mark.

Mr. Partee commented that the benchmark adjustment being made to single-date FDIC figures for nonmember banks was consistent with long-standing practice; while those figures were far from ideal they were the only ones available for the purpose. Allowance for the upward revision in the money supply numbers had led to the projection of a higher level of GNP in 1974--absent the fuel crisis--than indicated a month ago or in the chart presentation of last June. He might add that before the higher money supply numbers were incorporated, the model had implied that the relationships between monetary growth and interest rates (given GNP) were being distorted to an exceptional degree. Since that was no longer the case, he felt much more comfortable with the current projection. It was also worth noting that a 5 per cent growth rate in the nominal money supply in 1974 would undoubtedly mean that the money stock would be declining in real terms.

After some further discussion, Chairman Burns observed that he had felt uneasy about the revision since he had learned of it recently. The staff was now putting together for his review the worksheets it had employed, a description of the rationale of its procedures, and information on any alternative procedures it had considered and rejected. From his own prior experience, he was aware that there usually were various approaches to problems of this kind and that the results could be heavily dependent on the particular approach chosen.

Mr. MacLaury then noted that the staff's projections of the relationship between RPD's and the monetary aggregates recently had been wide of the mark primarily because of difficulties in foreseeing changes in large-denomination CD's. Against the background of that experience, he would be interested in the staff's assessment of the usefulness of RPD's as an operating handle.

In reply, Mr. Axilrod observed that the Desk obviously could not determine the distribution of the reserves it supplied among the various categories of member bank deposits against which reserves were required. Accordingly, he was inclined to interpret the selection of RPD's--reserves available to support private nonbank deposits--as a handle symbolizing the Committee's intent to have the Desk accommodate the short-run fluctuations in reserves needed to support Government deposits, the main category omitted from RPD's. If the Committee decided that the Desk should also accommodate fluctuations in CD's, it presumably would narrow the definition of the reserve handle correspondingly. There was no doubt that such a procedure would substantially reduce the problems of projecting the relations between the handle and the monetary aggregates. For example, staff estimates prepared at the time of the October meeting suggested that the October-November ranges for M_1 and M_2 specified by the Committee would be consistent with growth in RPD's less reserves required to support CD's at a rate of about 7.5 per cent over that 2-month period. The latest estimate of the growth rate for that reserve measure was 5.3 per cent. While the estimate was not perfect, the error in it was considerably smaller than that in the corresponding estimate for RPD's.

Mr. Daane asked whether the Manager had any additional observations on the value of RPD's as a handle.

Mr. Holmes replied that RPD's had certain advantages and the Desk had learned to work with them without encountering major problems. It had been his impression, however, that the Committee recently had been primarily concerned with growth rates in the monetary aggregates; indeed, in the policy discussion at the last few meetings there had been hardly any mention of RPD's. Under those circumstances, RPD's could be viewed as something of a fifth wheel. He personally was disturbed by situations in which the outcome for the monetary aggregates was reasonably close to the Committee's desires but that for RPD's--the handle--was far outside the range that had been specified.

Mr. Mitchell expressed the view that the Committee could achieve its objectives more effectively if the System discarded lagged reserve accounting and if the staff regularly prepared analyses of the differences between expected and actual changes in reserves required for the various categories of deposits. Such analyses were important because of the problem that frequently arose of inconsistency among the Committee's specifications for the various aggregates, including RPD's, M_1, and M_2.

Chairman Burns observed that, as Mr. Holmes had indicated, Committee members had paid relatively little attention to RPD's in the policy discussion at recent meetings, focusing instead on the monetary aggregates--primarily M_1, but also M_2. The specifications approved by the Committee at each meeting did include a range for RPD's, which reflected an estimate for CD's. In the recent inter-meeting periods, however, the staff--taking account of the Committee's emphasis on the monetary aggregates--had made successive adjustments in the specified RPD range to allow for the rather wide deviations that emerged between the original expectations for CD's and the actual values. He gathered that Mr. Mitchell would like to have that process spelled out somewhat more precisely in the staff reports.

Mr. Mitchell said he would put his suggestion differently. In preparing its projections of the relationships between the monetary aggregates and RPD's, the staff necessarily made separate estimates of the prospective changes in reserves that would be required to support each category of deposits. The various specifications adopted by the Committee--for RPD's, M_1, and M_2--proved to be internally consistent when those estimates were reasonably accurate, and internally inconsistent when the estimates were inaccurate. In his judgment, much of the Committee's difficulties could be attributed to the fact that the staff did not provide it with a full accounting of the differences between actual and expected changes in each of the various categories of reserves.

Chairman Burns expressed the view that it would be a simple matter to provide such information, either in the Manager's report or in the blue book.

Mr. Axilrod said that, if the Committee so desired, the section of each blue book concerned with recent developments could be expanded to include a reconciliation of the expectations at the time of the previous meeting with respect to the various categories of reserve use with the actual use by category.

Mr. Mitchell commented that such a table would serve the purpose he had in mind.

Chairman Burns observed that an analysis of that kind would be useful not only in providing information on a current basis but also in contributing to a longer-run record of experience that could be reviewed in connection with appraisals of the Committee's operating procedures. He suggested that the Committee ask Messrs. Axilrod and Holmes to decide whether the analyses should be included in the Manager's reports or the blue book.

Mr. Holmes remarked that while the arithmetic of such a reconciliation would pose no problems, it might often be quite difficult to explain why particular differences emerged between expected and actual changes in individual categories of reserve use. The staff would, however, do its best in that connection.

Mr. Brimmer commented that such retrospective analyses would no doubt be interesting and helpful to the Committee, and on balance their benefits probably would outweigh their costs in terms of staff resources devoted to their preparation. In his judgment, however, the more interesting question was how the

Manager would be expected to react to divergences that developed among the various specifications as he attempted to carry out the Committee's instructions; an account of historical experience would be of little value to him in obtaining the guidance he needed for current operations. Perhaps the Subcommittee on the Directive, of which Mr. Holland was Chairman, planned to address itself to that question.

Mr. Holland remarked that the Subcommittee did indeed plan to deal with that question in one section of its report.

Mr. Black observed that he would find helpful some additional information in current blue books about the assumptions underlying the relationships that were incorporated in the alternative sets of specifications. For example, it would be useful to know why RPD's were expected to behave in some particular fashion if M_1 and M_2 grew at some designated rates.

Mr. Hayes said he might offer at this point some comments he had originally planned to make later in the meeting, in connection with the contemplated discussion of policy records. While the Committee might well find it useful at meetings to consider studies of past changes in RPD's, M_1, and M_2, including analyses of the kind suggested by Mr. Mitchell, he thought it was now going into far too much detail in assessing likely future changes in such aggregates in the periods between meetings. In his judgment, those measures were not useful as handles for operations over short periods because their random short-run fluctuations were bound to be misleading. Accordingly, he would restate a view he had expressed often before: that at each meeting the Committee should consider the general economic situation, in terms of growth in real GNP, price developments, and so forth; the growth rates in the aggregates over periods sufficiently long to have real significance for the economy; and the present state of money market conditions. In light of such considerations, the members should then reach a conclusion formulated in terms of what, in his view, was now the Committee's primary operating handle--namely, the Federal funds rate. Such conclusions might take the form of decisions to ease or tighten a little. In his view, the Committee could not reasonably expect to do more than that when it discussed policy for intervals as short as 4 or 5 weeks.

Chairman Burns observed that there were differences of view regarding appropriate handles among the members of the Committee; Mr. Hayes' comment was welcome, but it had to be weighed against other opinions. Mr. MacLaury's question about the usefulness of RPD's as a handle was a reasonable one in view of the recent large discrepancies between its actual growth rate and the growth rate that had been specified. There were earlier periods, however, in which the actual growth rate for RPD's had been relatively close to the specification but that for M_1 or M_2 had not. On the whole, he thought that the RPD handle had been used with a reasonable degree of skill, and that the recent adjustments in RPD's had been carried out quite intelligently. Such comments reflected a tentative appraisal, and perhaps the Committee would ultimately decide to drop RPD's as a handle. He hoped, however, that it would not change its operating procedures hastily, but rather would approach the question cautiously and deliberately.

Mr. Daane remarked that the matters now under discussion were highly relevant to the question regarding policy records which the Committee planned to discuss later today. He hoped the members would keep in mind the differences between specifications and results, and the problems of internal inconsistency among the various specifications, when it considered the question of publishing its specifications in quantitative form in the policy records.

Chairman Burns then observed that, in view of the turn the Committee's discussion had taken, it might be desirable to proceed with the discussion of policy records at this time on the understanding that if no clear decision was reached by, say, noon, the discussion would terminate and the remaining hour would be devoted to current monetary policy.

There was general agreement with the Chairman's suggestion.

Chairman Burns then noted that the Subcommittee on Policy Records, consisting of Messrs. Brimmer, Daane (Chairman), Mayo, and Morris, had submitted a useful report[1/] in which a range of ideas was presented. While the Subcommittee was not unanimous, there were some questions on which unanimity could be bought only at too high a price. It was helpful for the Subcommittee to spell out their differences of opinion, particularly since opinion was divided within the full Committee also.

The Chairman observed that he also had submitted a brief memorandum to the Committee on the subject of policy records,[2/] in the hope of sharpening the Committee's deliberations. In the memorandum he had suggested that, at least in the immediate future, the Committee not include in the policy records quantitative information on its 6-month targets for the monetary aggregates, but rely instead on adjectival statements. He had reached that conclusion for three reasons, which were spelled out in the memorandum.[3/] With respect to the 2-month ranges for RPD's, M_1,

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1/ This report, dated October 11, 1973, was distributed to the Committee on October 12. A copy has been placed in the Committee's files.

2/ A copy of this memorandum, which was dated November 15, 1973, has been placed in the Committee's files.

3/ The reasons cited in the memorandum were as follows:

"1. When the record for a meeting is published 3 months later, a substantial part of the time period covered by the 6-month targets adopted at that meeting will still lie ahead. (continued) and M_2 and the inter-meeting range of tolerance for the Federal funds rate, he had suggested that the Committee consider the alternatives of publishing or not publishing this set of specifications in quantitative form. Before discussing the short-run targets, the Committee might consider the desirability of reporting the 6-month targets in quantitative form in the policy records.

Mr. Morris remarked that there was great force to the argument that the 6-month targets were susceptible to misinterpretation unless a serious effort was made to counter that risk. On the other hand, he thought the 2-month ranges would often be incomprehensible to the public unless they were presented within the context of the longer-run objectives. He had in mind situations in which the Committee concluded, say, that M_1 should grow at a 5 per cent annual rate over the coming 6 months but felt that, for various reasons, a much lower growth rate in the 2 months immediately ahead would be consistent with the longer-run goal.

(continued) Despite any cautions to the effect that the longer-run targets are subject to review and revision at each subsequent meeting, the probability is that their publication will have a significant effect on market interest rates as participants contrast the stated targets with the growth rates recorded thus far in the period and draw inferences about the likely thrust of open market operations for the remainder of the period.

"2. The risk of misinterpretation of changes in the Committee's longer-run targets is great. Some of the problems involved are illustrated in the attached note, prepared by the staff, concerning the decisions taken at selected meetings in 1973.

"3. Regular publication of the longer-run targets for the monetary aggregates would lead many observers to conclude that the Committee had moved further in the direction of a monetarist approach than it in fact has."

Chairman Burns said he thought misinterpretations could be minimized in such cases by indicating in the record that the short-run target rate cited was well below the Committee's objective for the longer-run, without reporting a precise figure for the latter.

Mr. Morris then expressed the view that publication of all of the short-run specifications would be a big step forward. If it was possible to obtain a consensus in favor of such a procedure he would concur in it.

The Chairman remarked that, as he had indicated in his memorandum, improvement in the policy records was needed. In view of the nature of the activity being reported, however, perfection should be viewed as a distant goal, to be approached gradually. While he opposed publication of the 6-month targets now, he might well change his mind at some point in the future. Not all conceivable improvements in reporting procedures had to be made at this time. Some improvements should be made, however, since dissatisfaction with the present procedures obviously was widespread within the Committee.

Mr. Daane said he would like to stress the Chairman's last point; certainly everyone present recognized the deficiencies of the RPD range--the only specification now shown in quantitative terms--as a means of conveying the sense of the Committee's policy decision. However, he did not believe that publication of all of the short-run specifications would be an improvement. In his view, all three of the arguments the Chairman had advanced against publishing the longer-run targets would apply with equal or greater force to publishing the short-run targets. Specifically, such publication would tend to stimulate market efforts to guess the current stance of open market policy; it would lead to misinterpretations about longer-run policy objectives if quantitative information on the latter was not also published; and it would foster the belief that the Committee had gone further toward a monetarist approach than it had.

With respect to possible misinterpretations, Mr. Daane noted that that subject had been explored in connection with 6-month targets in a staff note attached to the Chairman's memorandum. He was somewhat surprised that a similar analysis for the short-run targets had not also been presented. In any case, he invited the members' attention to a table comparing the ranges of tolerance specified by the Committee at successive meetings in 1973 for RPD's, M_1, M_2, and the Federal funds rate with the actual results for those variables.[1/] Considering the frequency and size of "misses" revealed

1/ A copy of the table referred to is appended to this memorandum as Attachment D.

by the table, he thought that publication of the short-run targets would expose the Federal Reserve to severe criticism.

Mr. Mayo said he would focus at this point on the question of publishing figures on the longer-run targets. He was the author of the proposal in the Subcommittee's report that the quantitative information be provided in the policy records on the longer-run targets and not on the short-run specifications. He was impressed, however, by the observations in the note attached to the Chairman's memorandum regarding the problems of potential misinterpretation of figures on the 6-month targets. The note stressed the distinction between the Committee's target "path"--which had been 5-1/4 per cent for growth in M_1 since March--and the target rates for 6-month periods--which had been set at levels ranging down from 5-1/4 to 3-3/4 per cent and then back up to 5 per cent at successive meetings over that period. After reflection, he had concluded that the most appropriate method of describing the long-term objectives of policy would be to publish quantitative information on the target path rather than on the 6-month targets. Such a procedure would be consistent with a comment the Chairman had made publicly on a number of occasions, to the effect that monetary policy should be assessed in terms of performance and economic results over a considerable period and not in terms of statistics for a week, a month, or perhaps even a quarter.

Mr. Daane remarked that, if the Committee decided to publish some quantitative information on targets, he would find the course Mr. Mayo had suggested much more acceptable than other alternatives.

Mr. Brimmer noted that the full title of the policy record was "Record of Policy Actions." It seemed to him that such a record should include information about the guidance given to the Manager for his operations over the policy period--the period in which he was expected to implement the instructions. It was for the Committee to decide how it formulated such instructions--whether in terms of the Federal funds rate, M_1, or other variables--but, insofar as it could, it should tell the public what it had instructed the Manager to do. By the same standard, the Committee would not be obliged to publish quantitative information on its longer-run targets. He had been deeply impressed by the arguments in the Chairman's memorandum against publishing the 6-month targets--particularly the point that such a procedure might be destabilizing because only half of the 6-month period covered would have passed by the time of publication. Accordingly, he would favor not publishing the quantitative 6-month targets in the policy record.

Mr. Daane observed that Mr. Brimmer's comments about guidance to the Manager served to point up a key difference of view on the matter. In a memorandum dated May 31, 1973, Mr. Hackley, then General Counsel of the Committee, expressed the opinion that publication of the specifications was not required by law if they were regarded by the Committee simply as guidelines or understandings with respect to interpretation and implementation of the directive. Mr. Hackley indicated that the specifications would have to be shown in the policy record only if the Committee regarded them as constituting policy actions.

Mr. Brimmer said he had tried to stress his view that the specifications given to the Manager were policy actions.

Mr. Francis expressed a similar view.

Mr. Mitchell remarked that, if the policy records were going to contain any quantitative information on the Committee's targets, he believed it should consist of the longer-run objectives for the aggregates. If any disclosure was essential, it was disclosure of the basic course of policy described by those objectives. The short-run targets given to the Manager might differ from the longer-run targets because of operational difficulties or because of the Committee's desire to reinforce its determination to achieve certain long-run objectives. But such communications, to his mind, were internal matters that did not properly belong in the public domain. He would not be concerned about the risks of publishing the longer-run targets since there would be no implication that the Committee had held to the same targets at following meetings.

Mr. Holland expressed the view that the Committee owed it to itself, to its critics, and to the public generally to communicate as fully as feasible what it was trying to do. There were good reasons, in terms of possible market effects, for not disclosing that information immediately, but such risks did not justify withholding the information indefinitely. There was no need for the Committee to feel apologetic about the techniques it had evolved in its continuing effort to improve the means for communicating its wishes to the Manager. Those techniques were imperfect, as had been acknowledged in discussion earlier today, but they still constituted a sophisticated means for communicating with the Manager which, on balance, reflected to the credit rather than the discredit of the Committee. Certainly, the results frequently differed from the targets; the public would have to undergo a learning process in understanding why that was the case, just as the Committee itself had done. He had come increasingly to believe that it was a sophistry to assert that the decision to adopt certain targets for operations did not constitute a policy action.

Mr. Holland then said he would like to suggest an approach which, he thought, would achieve the advantages of two different procedures that had been suggested today. What he had in mind was publishing the short-run specifications in quantitative form in the policy records released 90 days after each meeting, and providing information about the longer-run target paths the Committee had been following during a calendar year in a preamble to the part of the Board's Annual Report that contained the policy records for the full year. Depending on circumstances, the information on longer-run paths might be presented in quantitative terms in some cases and in qualitative terms in others.

Mr. Eastburn noted that the Chairman had suggested in his memorandum that any statements in the policy records regarding longer-run targets should be formulated in qualitative terms. He asked whether the Chairman could illustrate how that might be done.

Chairman Burns observed that a device which might often be useful was one that he had mentioned earlier as a possible means of minimizing misinterpretations of figures cited on the short-run targets--namely, indicating whether the short-run figures were above or below the longer-run targets. In general, however, he thought experimentation would be needed and that appropriate methods would evolve as experience was gained.

Mr. Eastburn remarked that it would seem reasonable for the record for a meeting to indicate whether the Committee had raised or lowered its longer-run targets or left them unchanged.

Mr. Hayes commented that the device of describing longer-run objectives in qualitative terms might also be used for the short-run targets. The record for a meeting might indicate, for example, that the longer-run target growth rate agreed upon for M_1 was slightly higher than the previous target rate but was still moderate, and that in the short-run the Committee was seeking a considerably lower growth rate for some special reasons that would be described. If any quantitative information were to be published, however, like Mr. Mitchell, he would prefer to have it relate to the longer-run rather than the short-run targets.

Mr. Balles remarked that, like others, he had found persuasive the Chairman's point about the disadvantages of publishing the 6-month targets with a 3-month lag. At the same time, he wanted to firmly associate himself with the views expressed by Mr. Holland. That led him to wonder whether it might be feasible to publish the 6-month targets with a 6-month lag.

Mr. Daane noted that in the Subcommittee report he had suggested a compromise procedure of publishing a descriptive review of Committee policy annually, with as much illustrative quantification as desired. That proposal could be modified to call for experimental publication once a year with the possibility in mind of shifting later to a semi-annual publication.

The Chairman observed that at one point he had planned to suggest an annual publication showing all of the numerical specifications adopted by the Committee at successive meetings during the year. He had abandoned that thought, however, after reviewing a tabular presentation of the specifications adopted at the meetings thus far in 1973. It was evident that such a presentation, particularly of the successive 6-month targets for M_1, would not convey the Committee's objectives at all adequately. As Mr. Mayo had noted earlier, the Committee had held to a 5-1/4 per cent M_1 growth path at the meetings from March 1973 on, but it had repeatedly modified its 6-month objectives for M_1--in response first to the overshoots of the second quarter and then to the shortfalls of the third quarter. A listing of those 6-month targets would suggest changes in policy that were in fact illusory.

Mr. Hayes agreed that a tabular presentation of Committee targets, with little or no explanation and analysis, would be misleading. It should be possible, however, to describe the Committee's objectives and the results achieved during a calendar year in essay form, explaining why specific targets had been changed in certain ways and what factors accounted for the misses. Such essays would be interesting and informative.

Mr. Brimmer remarked that there was another possible procedure for providing retrospective information on the Committee's longer-run targets which was roughly analogous to that now used for providing periodic information on foreign currency operations. Twice each year the Special Manager published reports on foreign operations up to the date of the report without commenting on possible subsequent developments. On the domestic side, reports might be published--perhaps four times a year--which included information on the Committee's longer-run targets for the 6 months ending with the date of the report.

Mr. Broida commented that that procedure might involve certain difficulties. During any 6-month period the Committee would normally consider its longer-run targets on six separate occasions. If the suggested procedure were followed, observers would tend to compare the 6-month targets adopted at the beginning of the period with the results over the period. Such comparisons would be inappropriate, however, if the targets had been changed during the period.

Mr. Daane referred to the table he had mentioned earlier, in which successive short-run targets were compared with actual outcomes, and asked what conclusions the Chairman had drawn about the desirability of publishing those targets.

Chairman Burns replied that the table Mr. Daane had mentioned made it quite clear that the System's ability to achieve its short-run targets was quite limited. In his view, nothing would be lost by disclosing that fact and a great deal could be gained. The disclosure might, of course, result in some misinterpretation and some superficial criticism, but it could also lead informed observers to make constructive suggestions for improving the System's procedures. Moreover, there was now a widespread impression that the Committee was aiming at the wrong targets. Such criticism would be more intelligently directed if observers were aware of the actual targets and of the extent to which the results reflected misses.

The Chairman noted that the Committee was now being subjected to other kinds of criticism: that it was issuing virtually meaningless directives to the Desk, that it was engaged in an exercise in obfuscation, and that it was following muddleheaded procedures. The response could be made that the Committee did adopt specific targets, but that it could not reveal them for a time because of possible market effects. While that was a valid response, it did not justify withholding information on the targets after the risk of market effects had passed.

Mr. Daane said he wanted the Committee to be forthcoming in explaining to the public what it was attempting to accomplish and why, but he still did not believe that publication of the short-run targets would lead to constructive criticism. As was clear from some of the discussion earlier today, the Committee was not satisfied with its current procedures; until it was, he would not want to plunge ahead to publication of the targets.

Chairman Burns remarked that in his view the problem of procedures was not one that would be solved in a few months. He expected the Committee to travel a zig-zag course along the road to satisfactory procedures, moving forward gradually and uncertainly as it learned from experience. With respect to the immediate question of the policy records, one possibility would be to ask the staff to draft alternative versions of the records for the next several meetings, incorporating different kinds of information on targets, to help the Committee members reach a judgment in the matter.

Mr. Mayo observed that he was deeply concerned about one aspect of the subject under discussion today--the Committee's willingness to subject itself to careful scrutiny with regard to its short-run targets. According to Mr. Daane's table contrasting those targets with results, the growth rate for M_1 fell outside the target range in 9 of the 11 periods shown. The results for M_2 were better, but for RPD's--to the extent that variable could be considered a target in the same sense as M_1 and M_2--they were even worse--10 of 11. He would have no objection to publishing those target ranges, with an appropriate lag, if he anticipated that resulting criticisms would be developed on rational lines. What concerned him, however, was the possibility that the record of misses would be interpreted too narrowly and used in new attacks on the System by hostile critics in the Congress. That record could be described by those critics as providing evidence that monetary policy and the Federal Reserve as an institution were inept; that the Federal Reserve staff was incompetent; and that the Federal Open Market Committee should be modified or abolished. Such critics would argue that the System's own reports reflected poor performance, and consequently, that a GAO audit was indeed needed to investigate monetary policy.

In his judgment, Mr. Mayo continued, the specifications provided to the Manager were appropriately considered as guidelines rather than as policy actions, and therefore were not required to be published. The quantitative targets were important, but their real essence lay in the attached shades of meaning--which, he believed, it would be close to impossible to capture in a brief written description. Publication of the short-run target ranges not only would invite attacks on the System of the kind he had described; it would mistakenly suggest to many observers that monetary policy in 1973 had been a failure. Judged properly in terms of the longer-run effort to promote economic stability, monetary policy, he believed, had been successful this year within the range in which it could operate.

It was for those reasons, Mr. Mayo concluded, that he favored limiting any quantitative information published on targets to the long-term paths for the monetary aggregates.

Mr. MacLaury said it was important to make a sharp distinction between the kind of information on Committee objectives published in the policy records with a 3-month lag and the kind of information that could be included in a separate publication describing the Committee's procedures. He would be opposed for the time being to providing more quantitative information about targets in the policy records. He believed, however, that the public was entitled to more information on the Committee's procedures--the type of information it would get, for example, if the blue books and green books for a calendar year were published with a one-year lag. While he was not suggesting that course, he would suggest a one-time publication describing procedures. That publication could indicate that the Committee had three different levels of targets for the aggregates--the long-term paths, the 6-month targets, and the 2-month operating ranges--and it could clarify other aspects of the instructions to the Manager.

Mr. Francis remarked that he would favor publishing information about current Committee objectives for the aggregates, on all three of the levels Mr. MacLaury had mentioned, in the policy records issued after each meeting with an appropriate lag. The paths reflected what the Committee hoped to accomplish over the longer run; the 6-month targets were part of the strategy of working toward the longer-run objectives; and the 2-month operating ranges reflected the effort to keep moving in the desired direction. In his view, the public was entitled to information on all three.

Chairman Burns said he regretted the need to break off the discussion of policy records at this point, but the time remaining today had to be devoted to current monetary policy. The members obviously had thought deeply about the policy record problem and some had strong feelings on the subject. While today's discussion had been highly useful, it was clear that the

Committee was not yet ready to reach a decision. A substantial period of time should be set aside for pursuing the matter; perhaps a special session might be held on the Monday afternoon preceding the meeting scheduled for Tuesday, December 18. Either he or the Secretary would be in touch with the members about that possibility. In the interim, he hoped the members would continue to ponder the matter. Personally, his views had been influenced by today's discussion--particularly the comments of Mr. Mayo--but he could not yet say whether or not he would reach a different conclusion. Mr. Mayo's comments certainly deserved full and earnest consideration on everyone's part.

Chairman Burns then observed that he would offer a word or two by way of introduction to the discussion of monetary policy. In the nearly four years he had served on the Committee, the economic outlook had never been more cloudy in his own mind than it was today. He felt much less confident about the direction of monetary policy than he had in the past. He had found yesterday's meeting reassuring in one respect, however, in that he detected a willingness on the part of Committee members to change the course of monetary policy, and to do so quickly, if the economic situation began to clarify in a manner that seemed to call for a shift. It had been his observation in the past that the Committee had tended to delay unduly before deciding on a change in monetary policy.

Chairman Burns said he had reached the tentative conclusion, which was subject to change during the course of today's discussion, that monetary policy should not be tightened or eased at this time. He did not believe a good case could be made in favor of a firmer policy. Given the prevailing concerns about the energy situation and the related performance of the stock market, it would be unwise, in his view, to pursue a policy that would result in weak bond markets and perhaps lead to financial difficulties. A better case could be made for an easing of policy, but he thought such a move at this point would be premature. The implications that recent events would have for demand were not yet clear; indeed, the impact of those events would be on the supply side in the first instance. Moreover, any easing of policy at this time could prove mischievous, because it might well be interpreted as suggesting that monetary policy could make a significant contribution toward resolving current economic problems and thus lead to confusion and misdirected effort in the private economy and perhaps in the Government as well. In his view, monetary policy might be able to play a marginally constructive role, such as in helping to prevent a deteriorating situation from worsening, but it could not offer a solution to the problems that the nation was on the threshold of experiencing.

Accordingly, the Chairman continued, he thought policy should be kept substantially unchanged at present. He also believed, however, that the Committee should be prepared to hold one or more telephone meetings in coming weeks, and perhaps even a meeting in Washington, if developments required a review of policy before the meeting scheduled for December 18.

Mr. Brimmer indicated that on the basis of the discussion at yesterday's session he had come to the same policy conclusion as Chairman Burns. It seemed to him that the specifications shown in the blue book under alternative B, without modification, would be consistent with such a policy position.

Several Committee members indicated that they agreed with Mr. Brimmer.

Mr. Morris said he wanted to introduce a dissenting view. He had not found yesterday's staff presentation particularly relevant to the current policy decision because it had abstracted from the energy crisis. As a result, the staff had revised its 1974 GNP projection upward at a time when, in his judgment, the projection should have been revised downward.

Chairman Burns observed that, as he understood it, the staff had approached the problem in two stages. In the first stage they had carried through the revision of the GNP projection as an analytical exercise, ignoring the energy crisis. Next, they had qualified the results with comments about the impact of the crisis which they felt they could not accurately quantify at this time.

Mr. Morris then said that, in his judgment, the economic outlook had deteriorated seriously since the last meeting. Five weeks ago he would have assessed the probability of a recession in 1974 as relatively low despite the obvious indications of a slow-down in the rate of economic growth. He was now convinced that the probability of a recession, as defined by the National Bureau of Economic Research, was at least 50 per cent. He agreed that the dimensions of the energy crisis could not be quantified, but the direction of its influence was clear. Accordingly, he believed it was important for the record of today's meeting to indicate that the Committee had recognized the marked change that had occurred in the economic outlook over the past few weeks. That was the reason he would find it necessary to dissent from a _status quo_ directive such as alternative B which did not recognize the change in the underlying economic situation. He strongly favored alternative A.

Mr. Morris said he was not suggesting that adoption of alternative A, which would be a modest move in the direction of an easier policy, would necessarily avert a recession. He did suggest that by taking that step the Committee could moderate the softening tendencies in the economy. On the basis of the experience in the 1969-71 period, he was not persuaded that a recession constituted good therapy in terms of substantially improving the prospects for price stability. Moreover, a recession was clearly undesirable in a period marked by a multitude of economic problems and a pervasive lack of confidence in Government.

Mr. Morris indicated that in addition to an easier open market policy, he would urge that some more overt easing action be taken by the System. If the Board continued to feel that a modest, symbolic reduction in the discount rate was not desirable, he would suggest the elimination of the marginal reserve requirements that had been imposed on large-denomination CD's. With business loans at banks declining and with banks allowing their CD's to run off, the conditions that had led to the imposition of the added required reserves no longer existed. A reduction in margin requirements also would be desirable in present circumstances, but he would not favor lowering those requirements until the stock market had stabilized for at least one week.

Mr. Mitchell observed that Mr. Morris seemed to be overlooking the possibility that solutions to the energy problem would be found which were directed at maintaining production and avoiding a recession. He (Mr. Mitchell) could visualize one type of program that called for no monetary action and another type that clearly called for an easier System policy. He did not want to change policy today because he preferred to wait and see what sort of program was developed.

Mr. Morris said he did not think a wait-and-see approach to the energy crisis was appropriate. He thought enough was known already to indicate the existence of a serious problem; even if the Arab oil embargo were to be lifted today, the country would still experience a substantial oil shortage in the first quarter. He wanted to underscore his judgment that on the basis of the information available now the probability of a significant recession next year was high.

Chairman Burns asked what damage might be done, in Mr. Morris' view, if the Committee decided to maintain its present policy posture today but was prepared to meet during the interval before the next scheduled meeting if the negative signs visible now persisted or became stronger--a development he would not rate as having a low probability. Specifically, he wondered if Mr. Morris thought any significant damage would be done by delaying action for one to four weeks.

Mr. Morris replied that the issue was debatable, but in his view a delay of one month could have an important effect on the performance of the economy by next spring. He thought it was highly desirable for the Committee to move promptly toward creating the financial conditions which, among other things, would provide a stimulus to housing. He would be prepared to move back to a less expansionary policy in four weeks if developments by that time suggested that the probability of a recession in 1974 had become quite low.

Mr. Mitchell expressed the view that the housing market was being affected less by financing considerations than by a decline in the demand for new houses related to concerns about the availability of gasoline for automobile transportation.

Mr. Morris said it was his impression that home mortgage financing was still difficult to obtain.

Chairman Burns indicated his agreement with Mr. Mitchell's view that the housing market seemed to be affected more at this time by demand factors than by the availability of financing.

For example, sales of mobile homes had dropped sharply despite a good availability of financing at relatively stable interest rates. Housing demand, like that for other consumer durables, was being adversely influenced by a feeling among consumers that inflation was eroding their buying power. High interest rates and a restricted availability of financing were negative influences in the housing market, but he did not think housing construction would be stimulated significantly under current circumstances by the policy course being advocated by Mr. Morris. As he had said earlier, his inclination was to wait for some clarification in the economic situation before easing monetary policy. He could be wrong, but he did not think any damage would be done by delaying a decision.

Mr. Morris observed that since his policy prescription involved only a modest move, he thought that no damage would be done if that move had to be reversed in four weeks.

Chairman Burns agreed that that was probably the case. However, if M_1 began to weaken, as Mr. Morris' prognosis suggested was likely, the Manager would already be instructed under alternative B to begin easing money market conditions. Moreover, if events so dictated, the Committee could hold a special meeting within the four-week interval to consider additional easing. He would add with regard to Mr. Morris' suggestion for using other policy instruments that the Board already had certain possible actions under consideration.

Mr. Morris then said he might add another, noneconomic, reason for changing policy today. If a recession did develop by next spring, he would want the record to show that the Committee had recognized the problems generated by the energy crisis and had moved promptly toward ease.

The Chairman noted, with respect to Mr. Morris' final observation, that the Committee clearly would not want to suggest that it had tightened policy today. He was concerned that the adoption of the alternative B range for the Federal funds rate--9-1/2 to 10-1/2 per cent--might convey such an impression, since the range adopted at the preceding meeting had been a quarter-point lower. The Committee had been specifying successively lower ranges for the funds rate at recent meetings; it had set a range of 10 to 11 per cent in August, 9-3/4 to 10-3/4 in September, and 9-1/4 to 10-1/4 in October. If it favored an unchanged stance today it might be best to retain the October range.

Mr. Hayes remarked that an unchanged stance might be defined in terms of the present level of the funds rate rather than the range adopted at the preceding meeting. In that connection, he noted that the funds rate currently was about 10-1/4 per cent, the upper limit of the range the Chairman had proposed.

Mr. Daane observed that Mr. Morris, in explaining his policy views, had referred to the prospect noted in yesterday's staff presentation of additional economic weakness as a result of the energy situation. He wondered, however, whether Mr. Morris was giving sufficient weight to another prospect noted by the staff--that the effect of the energy problem on costs was likely to lead to a quickening pace of inflation. In his own view, both problems would be impervious to monetary policy in the very short run.

Mr. Morris commented that he had not ignored that consideration. It was his belief that the recession he foresaw would not have any substantial impact on the rate of inflation because of the nature of the inflationary process under way.

Mr. Black said he favored alternative B for much the same reasons the Chairman had advanced. That alternative could be considered to involve some easing, in the sense that it called for a higher rate of growth in M_1 than recorded recently.

Mr. Francis observed that in view of the uncertainties in the present economic situation he thought policy should be kept close to its present path. He favored the specifications of alternative B as outlined in the blue book, including the 9-1/2 to 10-1/2 per cent range for the Federal funds rate. He would not want to lower that range by a quarter-point, as the Chairman had suggested, since the funds rate was now in the neighborhood of 10-1/4 per cent.

Mr. Kimbrel said he also favored the specifications of B as outlined in the blue book. In his judgment, the upward revision of the money supply figures offered grounds for not lowering the 9-1/2 to 10-1/2 per cent range of alternative B. He thought the Committee should be prepared to move quickly in changing the stance of policy if unfolding circumstances differed from those anticipated at this time.

Messrs. Daane and Mitchell noted that they also favored the B specifications.

Mr. MacLaury said he wanted to associate himself with Mr. Morris' assessment of the economic outlook. However, he did not agree with the latter's policy prescription, because he thought monetary policy could not do much at this point in improving that outlook except through the route of psychology. The record should show that the Committee was aware that policy could have an impact on psychology. He favored alternative B, except that he would specify a 9 to 10-1/4 per cent range for the funds rate.

Mr. Mayo expressed a preference for alternative B but with a 9 to 10-1/4 per cent range for the funds rate.

Mr. Eastburn said he had some sympathy for Mr. Morris' position and originally had been inclined toward alternative A. Now, however, he favored alternative B, for two reasons. First, as important as the energy problem was, its implications were so uncertain at this point that they should not be taken into account in deciding on policy. Secondly, the upward revision now being made in the money supply statistics suggested that B was the better choice. However, he liked the idea of being flexible with respect to moderate declines in the funds rate. He thought the System should not go out of its way to resist such declines if they were brought about by market forces.

Mr. Sheehan remarked that he was deeply troubled by the current economic situation, and he had a great deal of sympathy for Mr. Morris' position. Although the Chairman had stressed supply effects in discussing the energy crisis, he (Mr. Sheehan) was just as concerned about the indications he saw of weakening demands. The drop in automobile sales was particularly disturbing because developments in the auto industry ramified so widely through the economy, affecting metals, textiles, glass, machine tools, and so on. The weakness in auto sales had developed before the public had become sharply aware of the energy problem and it would now be dramatically compounded by that problem. In his judgment, the economy would face serious disruptions this winter even if the Arab countries decided immediately to resume oil exports to the United States, and the disruptions would be even more severe if they did not. He was not sure that monetary policy could do very much about the current weakening in demand, and he would probably not dissent from the consensus that seemed to be emerging for alternative B. However, because he shared Mr. Morris' view about the likelihood of a recession, he could easily vote for alternative A. He would not consider the adoption of that alternative to be a major shift of policy. Over the past 3 months the funds rate had edged down from nearly 11 to about 10 per cent, and in the last few days it had moved back up to a little over 10 per cent. A decline now of another half or full percentage point would not strike him as a major move.

Chairman Burns observed that before the energy crisis developed he had begun to think that the pattern of the 1955-57 period would probably be repeated. In early 1956, because activity in both the automobile and home building industries was declining, economists were generally predicting that a recession was inevitable. A recession did come, but not until 18 months or so after those predictions were made. There was now a great deal of strength in other parts of the economy. However, the energy crisis had changed the present picture--it had definitely tipped the scales in the direction of a recession. At the same time, it had definitely tipped the scales in the direction of faster inflation. His present thinking was that a large change in policy might be indicated, but at this point it would be premature.

Mr. Hayes said that, in light of the various opinions he had heard about the implications of the energy crisis--many of which, admittedly, were preliminary--he was not willing at this point to join Mr. Morris in his conclusions about the prospects for the economy. He favored alternative B today.

Mr. Hayes added that in the interest of time he would summarize the further remarks he had planned to make and submit the full statement for inclusion in the record. He then summarized the following statement:

> I think it quite likely that we may soon be worrying about excessive money growth in the face of a growing shortage of real output. But I would admit that visibility for the moment is very low. In any case, earlier fears of inadequate money and credit no longer appear warranted in view of the recent pick-up in money expansion rates and the substantial upward revision of money statistics.
>
> For the nearer term, I would be inclined to deemphasize the aggregates as criteria for policy and to place greater stress on money market conditions

and expectations. And if we do shift our emphasis in this way, I also feel strongly that the best course of action for the time being is to maintain a steady policy stance, symbolized by a Federal funds rate centering around the present figure of about 10 to 10-1/4 per cent, and ranging perhaps from 9-1/2 to 10-1/2 per cent. I would prefer the language of alternative B and if the Committee does wish to set short-range targets for the aggregates, I would like to reduce somewhat the lower ends of the ranges shown for alternative B. While this prescription seems to me decidedly the best at this time, it is obviously more important than ever for the System to retain a high degree of flexibility, so that it can respond quickly if visibility improves and changes are called for. I would not want to guess at this time, however, whether the flexibility will be needed in the direction of less or more restraint.

In line with my reasoning on general policy, I believe this is not the time to change the discount rate--and our directors have been of this opinion for the past month or more.

Mr. Bucher said he shared the frustrations that others felt about the thickness of the clouds enfolding the future. With each passing month he appreciated more how inexact a science was monetary policy and how much reliance the policymaker had to place on his own judgments about circumstances and situations. He had a great deal of sympathy for Mr. Morris' comments; they were not inconsistent with the impressions and attitudes he had been formulating from his own observations. At the same time, he shared the Chairman's view about the problems of acting when so little was known about what lay around the corner.

Mr. Bucher remarked that one factor which he considered of great importance--the present state of public psychology--seemed to him to argue for moving somewhat further in the direction of ease. There had been a remarkably rapid shift in attitudes among all sectors of the public. It was not very long ago that Committee members had been commenting, with some surprise, on the continuing euphoria about the future among businessmen, but that optimism had suddenly disappeared. The declines that were occurring in the stock market were a good reflection of present attitudes. He might also note that, while the magnitude of the effects of the energy crisis could not be known at this point, it was clear that they would be in a negative direction. The recent upturn in the monetary aggregates was an encouraging development which made the decision on policy today more difficult. He understood, however, that part of the rise could reflect a short-term aberration related to movements in foreign official deposits.

At the outset of this meeting, Mr. Bucher continued, he had been strongly inclined toward alternative A. Now, however, he would favor a position intermediate to A and B. He certainly would want to reduce somewhat the funds rate constraint, particularly the lower limit, from that shown under alternative B. The range of 9 to 10-1/4 per cent suggested by Mr. MacLaury appeared reasonable to him.

Mr. Holland said he favored alternative B, although he would accept a widening of the range for the Federal funds rate if desired by a majority. If the Committee adopted a wait-and-see posture at this point because of uncertainties relating to the energy situation, he thought the record should clearly indicate that the Chairman would consider calling a special meeting as soon as that situation was clarified.

Chairman Burns observed that there might well be a need for a special meeting for other reasons also, and Mr. Holland agreed.

Mr. Balles said he shared Mr. Morris' concern about the outlook for the economy. On the other hand, he saw the virtues of waiting to see more clearly the nature of the program adopted by the Administration to deal with the energy problem before making a substantial change in policy. Accordingly, he favored alternative B, with the proviso that the range for the funds rate would be modified to 9 to 10-1/4 per cent.

Mr. Balles added that he hoped the System as a whole could take some probing action toward ease that had high visibility. While a change in open market policy might not become known to the public for some time, a reduction in the discount rate would have an immediate impact. He personally would favor reducing the discount rate in the near future to convey the message that the System was easing up on the credit brakes in view of the problems created by the energy crisis.

Mr. Sheehan commented that the use of open market operations to reduce the Federal funds rate to, say, 9-1/2 per cent would quickly convey the same kind of signal.

Mr. Winn remarked that inflationary psychology was by no means dead at this point. Signs were already emerging that consumers were reacting to reports of shortages by sharply increasing their purchases of some types of goods, and there undoubtedly would be large price increases in the energy area. In light of the possibility of spectacular increases in prices, he was concerned about the risk of overstating the case for moving toward ease. Given all of the likely distortions, and in view of the existing uncertainties, he would favor alternative B.

Mr. Plant said he agreed it would be desirable to keep policy steady, at least in the immediate future, in light of the prevailing uncertainties. Alternative B would seem appropriate today. He saw no objection to a modification in the range for the funds rate along the lines suggested by Mr. MacLaury or Mr. Mayo.

Mr. Clay observed that shortages were evident wherever one turned. War in the Middle East had aggravated the energy shortage and had caused people to recognize a crisis that had been in clear view for a long time. He believed that an immediate, sharp, and dramatic rise in the cost of energy would assist in both conserving and allocating the available supplies. It should also stimulate increased supplies, by leading to the opening of capped oil wells among other things. A slower rise in the price of energy would be less helpful.

It now appeared, Mr. Clay continued, that the monetary aggregates had been overshooting the targets. In his judgment, the money stock was larger than desirable, and that fact had to be at least one of the factors contributing to the continuing inflation. He could not understand how a faster increase in the money stock could relieve the existing shortages; instead, it would only increase the inflation problem. Under those circumstances, he would favor allowing M_1 to grow at a targeted rate of no more than 5 per cent over the fourth quarter of 1973 and the first half of 1974 combined.

Accordingly, Mr. Clay concluded, he favored alternative B. In view of the uncertainties, including those concerning the nature of the program to deal with the energy problem, he would not want to adopt specifications very different from those shown under alternative B in the blue book.

Chairman Burns noted that there was a consensus in favor of alternative B except perhaps with respect to the specification for the Federal funds rate. He suggested that the Committee consider that matter further.

The members discussed various possibilities for the funds rate specification, including retention of the 9-1/4 to 10-1/4 per cent range that had been specified at the previous meeting. Several members indicated that they would prefer to set the upper limit at 10-1/2 per cent, since the funds rate was currently in the neighborhood of 10-1/4 per cent and some flexibility on the upside was desirable.

Messrs. Mayo and MacLaury proposed also that the lower limit be reduced by a quarter-point, to 9 per cent. Otherwise, the midpoint of the new range would be slightly above that of the previous one, from which it might be incorrectly inferred that the Committee had sought to edge toward firmer money market conditions.

Mr. Mitchell remarked that a broadening of the range would appear particularly desirable under present circumstances.

Various members indicated that, while a 9 to 10-1/2 per cent range was not their first choice, it would be acceptable to them.

Mr. Holmes asked for clarification of one aspect of the Committee's intentions. Assuming that a 9 to 10-1/2 per cent range were specified for the funds rate and that the monetary aggregates appeared to be growing at rates at the midpoints of the ranges specified for them, would the Committee want the Desk to supply reserves at a pace consistent with a reduction in the funds rate to 9-3/4 per cent, the midpoint of its range?

Mr. Mitchell observed that he personally would not be disturbed if the monetary aggregates displayed some vigor at this point, following their recent doldrums. Accordingly, he would be pleased to see the funds rate decline to, say, 9-1/2 or 9-3/4 per cent.

In response to a question by Mr. Daane, Mr. Mitchell said he was not proposing that the Desk actively move toward a lower funds rate if the aggregates were strong.

Messrs. Daane, Hayes, and Francis indicated that they would prefer to have the funds rate remain at about its present level if the aggregate growth rates were at the midpoints of their ranges.

Chairman Burns agreed. He added that such a course would appear consistent with the sentiment of the majority for holding steady at this point, at least for a while.

The Chairman then proposed that the Committee vote on a directive consisting of the staff's draft of the general paragraphs and alternative B for the operational paragraph. It would be understood that that directive would be interpreted in accordance with the following specifications. The longer-run targets would be those shown in the blue book under alternative B--namely, growth rates for the fourth and first quarters combined for M_1, M_2, and the bank credit proxy of 5, 7-1/2, and 4 per cent, respectively. The associated ranges for growth rates in the November-December period would be -1 to -3 per cent for RPD's, 4-1/2 to 6-1/2 per cent for M_1, and 6-1/2 to 8-1/2 per cent for M_2. The range for the weekly average Federal funds rate in the inter-meeting period would be 9 to 10-1/2 per cent.

Mr. Morris said he planned to dissent from the proposed directive because he believed that a wait-and-see posture at this point was a mistake.

> With Mr. Morris 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 economic activity in the fourth quarter is likely to remain at about the moderate rate of the third quarter, but curtailment of oil supplies from abroad has generated considerable uncertainty about subsequent prospects. In October total nonfarm employment expanded substantially further, and the unemployment rate dropped from 4.8 to 4.5 per cent. The advance in wage rates has remained relatively rapid, and unit labor costs have been increasing at a fast pace. Wholesale prices of industrial commodities rose sharply in October, reflecting in part large increases for petroleum products; although farm and food prices declined considerably further, they remained well above the pre-freeze level of early June. In foreign exchange markets, the dollar appreciated against major foreign currencies following announcement in late October of a large surplus in the U.S. merchandise trade balance, and the dollar strengthened markedly further in early November as expectations grew that the developing oil crisis would create particularly severe problems for Western Europe and Japan. In the third quarter and in October, the balance of payments on an official settlements basis was in substantial surplus.

The narrowly defined money stock, which had declined in August and September, rose moderately in October. The more broadly defined money stock expanded sharply as a result of large net inflows at banks of consumer-type time deposits. Net deposit inflows at nonbank thrift institutions improved somewhat further. Bank credit expansion remained moderate in October, reflecting in part a lack of growth in business loans as borrowers shifted to the commercial paper market. The outstanding volume of large-denomination CD's, which had begun to decline in late September, fell substantially further. Short-term market interest rates, while fluctuating widely, rose on balance from mid-October to mid-November. Rates on most types of long-term market securities also advanced somewhat.

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 equilibrium in the country's balance of payments.

To implement this policy, while taking account of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead.

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

It was agreed that the next meeting of the Committee would be held on Tuesday, December 18, 1973, at 9:30 a.m. It was understood also that the Chairman might call for a special session on the afternoon of Monday, December 17, for the purpose of continuing the discussion of policy records.

Thereupon the meeting adjourned.

Arthur L. Broida

Secretary

ATTACHMENT A

November 20, 1973

TO: Federal Open Market Committee

FROM: Andrew F. Brimmer

SUBJECT: Report on Meeting of Economic Policy Committee of OECD, November 15-16.

Summary

The discussions at the EPC meeting of November 15-16 confirmed the results of the Short-term Forecasters meeting that preceded it: concern about inflation remains the major policy problem in almost every country. And, concerns that restrictive actions taken by individual countries might cumulate to a situation of "overkill" were thought to be unfounded. As regards the oil problem, most countries seemed to feel that this would add to inflation rather than be deflationary. The thought was that supply would be affected more than incomes and, therefore, more than demand. This led to the conclusion that restrictive demand management policies would need to be pursued, and perhaps be tightened, over the next few quarters.

As regards the balance of payments situation, it was noted that much bigger changes than had been anticipated had occurred during 1973. Part of this resulted from temporary factors, such as the confluence of the cycle and the acceleration of commodity prices, including those for agricultural products. All these changes had helped to push the U.S. and the Japanese payments balances in the right direction. However, some other countries, such as Italy and the United Kingdom, had moved in a direction conflicting with adjustment aims.

The oil problem was thought not to add to the OECD area's balance of payments problems in unmanageable proportions. The Secretariat estimated that about one-third of oil price increases would be paid for by the OECD area in increased exports of goods and services. The remaining two-thirds would be financed by a backflow of capital from the oil exporting countries. The changed situation of the OECD area vis-à-vis the oil producers gives rise to a need to reevaluate the current balance aims of the OECD countries. It was thought that attempts to keep traditional current balance aims would lead to adjustment problems. And this was an area where concerted action would make some sense. There seemed to be no sense at all in having the currency of all OECD countries together depreciating vis-à-vis the oil producers. However, it might well be that individual countries' currencies would be put under downward pressure. This might be especially true for Japan, if Japanese output were to be affected appreciably by energy shortages. This would be particularly so because there is little reason to expect backflows of capital from oil producers to Japan.

Thus, on the whole, the Committee did not seem to feel that the oil situation added an unmanageable dimension to current policy problems, neither in the domestic area nor on the external side. However, it was felt that a rather closer monitoring of the factual developments would be needed than in the past. The Committee agreed to meet again on February 13, 1974 in order to reassess the situation and to reexamine policy options aiming at reducing the rate of price inflation while maintaining adequate rates of economic growth.

Discussions on the Scope for Concerted Action

The Committee again took up the possibilities for acting jointly to control inflationary pressures. As at past meetings, the members agreed in general that countries' aims were to achieve reasonable price stability. But members were not convinced that achievement of this common objective could gain from concerted action. The Secretariat put out a statement of a number of so-called "sub-objectives" on which they thought Committee members might be able to agree. In brief these were:

1. Countries agree to a need to avoid collective mistakes in demand management such as occurred in the recent upswing.

2. Countries agree that each in its own way should seek to avoid having temporary rises in prices reflected in wage increases that are likely to be irreversible.

3. Countries are conscious of the fact that exchange rate changes may have an important impact on the fight against inflation. The Secretariat then argued that countries should take care for this reason to avoid large fluctuations of exchange rates that are not justified by fundamental disequilibria and went on to expand this argument. The United States, as well as Japan and some others, objected against the elaboration of this point beyond the first

sentence quoted above. The reasoning was mainly that these problems were currently being discussed in another forum and that the EPC was not the appropriate body to preempt these discussions at this stage.

4. Countries agree that every opportunity should be taken to reduce price pressures by the liberalization of international trade.

5. Countries agree that primary commodity prices play an important role in the assessment of inflation and that greater weight than in the past might be given to the need to insure reasonably stable prices of raw materials. However, this should not be taken as an endorsement of international commodity agreements of price fixing arrangements. The last sentence was added by the U.S. delegation.

With regard to oil policy, the Secretariat proposed the following areas of agreement:

1. Most countries are likely to experience adverse effects from the present situation, although these might be spread unevenly among countries.

2. Countries generally agree that they should not shield their consumers of oil from the effects of rising foreign oil prices.

3. There was general agreement that the main brunt of supply shortages should, as far as possible, be concentrated on the less essential types of consumption, that is generally on household consumption.

4. The Committee realized that the changed oil situation might wipe out to a large extent the traditional surplus on current

external account that the OECD area has run. For the area as a whole this might be no problem. But for individual countries it would be desirable to arrive at some generally accepted view as to their appropriate current account aims in these altered circumstances.

Scope for Individual Action

Under this heading the Secretariat summarized the general feeling that demand management has to remain restrictive in the next few months, and that, perhaps, policies might not even be sufficiently restrictive at this time. Rising unemployment in some countries was taken more as indicating the need for selective manpower policies rather than as a need for changed demand management policies.

Disagreement concerning the utility of prices and wages policies continued to persist among member countries. Some countries, which have found such policies useful, felt that they have been a valuable supplementary instrument in periods of reasonably easy labor market conditions and have helped under those circumstances to prevent wages ratcheting up in the face of temporary price increases.

ATTACHMENT B

November 20, 1973

To: Federal Open Market Committee Subject: Report on recent WP-3 Meeting

From: Ralph C. Bryant

I would like to report very briefly on one aspect of the discussions at the recent Working Party 3 meeting in Paris (October 29-30) that may be of particular interest to the Committee.

The Working Party had a wide-ranging discussion of recent experience with floating exchange rates. Appraisals of this experience varied, of course, from country to country, but the majority view was that -- given all the circumstances -- it had been reasonably satisfactory. The most critical view of recent experience was voiced by the French representative, who emphasized that he could not accept the desirability of floating for the longer run even though in the shorter run it had been a regrettable necessity. The German delegates expressed the view that greater rate flexibility had given Germany somewhat greater autonomy to use monetary policy for domestic objectives than it otherwise would have had. Several delegations called attention to the facts that there had recently been heavy reliance on capital controls and that a number of important exchange-rate relationships (most notably, within the EEC snake) had <u>not</u> been floating; hence, it was argued, it would be inappropriate to draw definitive conclusions about floating exchange rates from the recent experience.

Without exception, each national delegation to the meeting took the pragmatic view that there was no better alternative for the immediate future than to continue with the current exchange-rate arrangements.

ATTACHMENT C

November 19, 1973

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on November 19-20, 1973

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that growth in economic activity in the fourth quarter is likely to remain at about the moderate rate of the third quarter, but curtailment of oil supplies from abroad has generated considerable uncertainty about subsequent prospects. In October total nonfarm employment expanded substantially further, and the unemployment rate dropped from 4.8 to 4.5 per cent. The advance in wage rates has remained relatively rapid, and unit labor costs have been increasing at a fast pace. Wholesale prices of industrial commodities rose sharply in October, reflecting in part large increases for petroleum products; although farm and food prices declined considerably further, they remained well above the pre-freeze level of early June. In foreign exchange markets, the dollar appreciated against major foreign currencies following announcement in late October of a large surplus in the U.S. merchandise trade balance, and the dollar strengthened markedly further in early November as expectations grew that the developing oil crisis would create particularly severe problems for Western Europe and Japan. In the third quarter and in October, the balance of payments on an official settlements basis was in substantial surplus.

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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 equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPH

Alternative A

To implement this policy, while taking account of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with faster growth in monetary aggregates over the months ahead than has occurred over the past 6 months.

Alternative B

To implement this policy, while taking account of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead.

Alternative C

To implement this policy, while taking account of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with slower growth in monetary aggregates over the months ahead than has occurred over the past 6 months.

ATTACHMENT D

FOMC RANGES OF TOLERANCE COMPARED WITH ACTUAL RESULTS

DATE OF FOMC MEETING	TARGET PERIOD	RPD's		M1		M2		Federal Funds Rate	
		TARGET	ACTUAL	TARGET	ACTUAL	TARGET	ACTUAL	TARGET	ACTUAL[1/]
1972 - Dec. 19	Dec. - Jan.	4 to 11	14.3	3 to 9	6.4	4 to 10	9.4	5-1/8 to 5-7/8	5.34 to 5.86
1973 - Jan. 16	Jan. - Feb.	4.5 to 10.5	9.0	3 to 7.5	2.8	4 to 9	6.2	5-3/4 to 6-3/8	6.03 to 6.58
Feb. 13	Feb. - Mar.	-2.5 to 2.5	4.3	3 to 8	2.8	2 to 7	5.3	6 to 7[3/]	6.75 to 7.13
Mar. 20	Mar. - Apr.	12 to 16	11.6	4 to 7	3.5	5 to 8	6.5	6-3/4 to 7-1/2[2/]	6.84 to 7.23
Apr. 17	Apr. - May	10 to 12	9.6	4 to 6	9.1	4.5 to 6.5	9.0	6-7/8 to 7-1/2	7.14 to 7.81
May 15	May - June	9 to 11	13.1	4 to 6	11.6	5.5 to 7.5	10.2	7-1/4 to 8-1/2[3/]	7.95 to 8.55
June 19	June - July	8 to 11.5	17.7	4 to 8	8.8	5 to 8	7.8	7-3/4 to 9-3/4[3/]	8.59 to 10.22
July 17	July - Aug.	11.5 to 13.5	13.6	3.75 to 5.75	1.6	4.5 to 6.5	5.7	9 to 11[3/]	10.39 to 10.58
Aug. 21	Aug. - Sept.	11 to 13	10.9	1 to 4	-1.6	6.75 to 9.75	5.0	10 to 11	10.74 to 10.80
Sept. 18	Sept. - Oct.	15 to 18	6.6	0 to 4	1.1	5 to 8	7.4	9-3/4 to 10-3/4[2/]	9.87 to 10.84
Oct. 16	Oct. - Nov.	2 to 5	-4.2[e]	1 to 4	6.2[e]	5 to 8	10.6[e]	9-1/4 to 10-1/4	9.7 to 10.0[e]

e - Estimated on the basis of data available on November 16, 1973

1/ Statement week averages between FOMC meetings.

2/ As originally set by the FOMC. The range was later reduced somewhat before the next FOMC meeting.

3/ The target range as widened by the FOMC between meetings.

ATTACHMENT E

November 20, 1973

Points for FOMC guidance to Manager in implementation of directive		Specifications (As agreed, 11/20/73)
A. Longer-run targets (SAAR): (fourth and first quarters combined)	M_1	5%
	M_2	7-1/2%
	Proxy	4%
B. Short-run operating constraints:		
1. Range of tolerance for RPD growth rate (November-December average):		-1 to -3%
2. Ranges of tolerance for monetary aggregates (November-December average):	M_1	4-1/2 to 6-1/2%
	M_2	6-1/2 to 8-1/2%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		9 to 10-1/2%
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.

C. If it appears that the Committee's various operating constraints are proving to be significantly inconsistent in the period between meetings, the Manager is promptly to notify the Chairman, who will then promptly decide whether the situation calls for special Committee action to give supplementary instructions.