



To: Board of Governors
From: Division of Research and Statistics
(Lyle E. Gramley)

SUBJECT: Annual Staff
Projection to the Joint
Economic Committee.

2/2/70
RM

Last year for the first time the Board staff provided to the Joint Economic Committee an annual projection of GNP and its components and of the financial flows consistent with it. The projection was discussed in a staff document and sent to the JEC at the time of the Chairman's testimony on the Economic Report of the President, in late February.

At a recent Board meeting, a question was raised as to whether the Board wished to continue the practice of providing such a projection to the JEC. A request was made for a memo indicating the background leading up to last year's projection and the pros and cons of providing such information to that Committee. This memo is in response to that request.

Background

On a number of occasions in recent years, the Joint Economic Committee has expressed its developing views on the question of quantitative guidelines for monetary policy. The Committee has argued repeatedly that it believes that wide swings in growth rates of monetary aggregates are inappropriate--given the lags with which monetary policy works, our forecasting ability,

LSB
LEG:chf
2/3/70

F I L E C O P Y

See Minutes
2/5/70
EG

File
EG

and our understanding of the effects of monetary policy. The Committee appears to subscribe to the judgment, often expressed by academic economists, that the observed wide swings in monetary aggregates during recent years result partly from an excessive focus by the System on interest rates and money market conditions (rather than on monetary aggregates), and partly from insufficient attention by the System to the longer-run direction and impact of its policies. These views have been espoused most strongly by Senator Proxmire and Congressman Reuss, but it seems fair to say that similar views are held (although less strongly) by many members of the JEC.

The thrust of the JEC's efforts to encourage the Federal Reserve to consider its views seriously have taken essentially two forms. First, it has repeatedly urged the Federal Reserve to avoid what it regards as disruptively large swings in the money supply. Second, it has asked for periodic reports on the Federal Reserve's intended monetary program for economic stabilization. The Committee has noted that the Administration formulates a program for fiscal policy each year that it presents to the Congress for consideration. The Committee argues that the Federal Reserve should do likewise in the arena of monetary policy, though it recognizes the need for monetary policy to adapt to unanticipated developments.

In 1968, the JEC actively considered the Reuss guidelines for monetary policy, which in effect would have had the Congress

instruct the Federal Reserve to maintain the annual growth rate of the money supply, by quarters, within the range of 2 to 6 per cent. The Board's testimony on the Reuss proposal by Governor Mitchell argued that it would be undesirable to so restrict the ability of the monetary authorities to determine the appropriate course of monetary policy. Nonetheless, in its summary report entitled "Standards for Guiding Monetary Action," the JEC recommended to the Congress that it advise the Federal Reserve System ". . . that variations in the rate of increase of the money stock (currency plus demand deposits adjusted) ought not to be too great or too sharp. In normal times . . . the desirable range of variation appears to be within the limits of 2 to 6 per cent. . . ." The JEC also requested that the Board report to it, or to some other Congressional body, when for one reason or another the actual growth of the money supply was outside those limits. The Committee also recommended that the Federal Reserve authorities should ". . . at the beginning of each year, set forth publicly as specifically as possible their notion of what kind of monetary policy the expected state of the economy calls for."

As the Board knows, we have been fulfilling the request for a report for an explanation of the behavior of the money supply, when its growth rate falls out of the 2 to 6 per cent range, by a method somewhat different than the JEC had contemplated. Specifically,

we supply a report every quarter, irrespective of the growth rate of the money supply, and our report deals with financial developments quite generally. The JEC seems to have been satisfied with these reports. Our annual projection last year was by way of compliance with the second of the JEC's request for information from us, as noted above. A letter from Senator Proxmire to the Chairman last spring indicated that the Senator was pleased that the Federal Reserve had provided that projection; he did, however, indicate that he would have preferred to have had the Board's stamp of approval on the document, rather than to have had merely a staff projection.

Given this background, the pros and cons of continuing to supply an annual projection to the JEC seem relatively clear, even though they may be difficult to evaluate. On the one hand, there is a risk of antagonizing a Congressional committee by refusing to supply them with information which they regard as appropriate on a "need to know" basis. On this score, the risk probably is considerably worse this year than last; the Committee would have a hard time understanding why materials supplied to them last year cannot again be furnished--unless we can make a strong argument to the effect that meeting their request last year was not in the national interest. On the other hand, there is the risk that a projection of this kind, because it becomes public, seriously

embarrasses the Federal Reserve for one reason or another. In this regard the most sensitive issue relates to the fact that the projection of key financial flows must inevitably include specific assumptions about the growth rates of such variables as bank reserves, bank credit, and the money supply. Thus, they implicitly assume a course of monetary policy, which--even though clearly labeled as part of a staff projection--might be misread by some as a planned course for monetary policy by the Board. Additionally, there is the risk that on some occasions, our GNP projection might differ sufficiently from that of the CEA to evoke comment from the JEC or from others, although this risk is minimized by providing only a range of annual magnitudes rather than a quarterly pattern of expected developments.

These are the same considerations that we faced last year. The staff view then was that the kind of annual projection we provided was about as risk-free a way as we could find of fulfilling what would appear to be a legitimate request of a Congressional body regarding the System's views on economic problems and stabilization policy. The experience with last year's projection has not led us to alter our views materially on this score. To be sure, the document was one among many that called for gradualism in the fight against inflation, and therefore may have contributed marginally to the maintenance of inflationary expectations. However, we find it

hard to believe that last year's staff projection had a fundamental influence on the course of economic developments in 1969. On the positive side, the projection did seem to reassure some of our more serious Congressional critics that the System did, in fact, recognize the need to consider and formulate monetary policy in full acknowledgement of our uncertainty as to the course of the economy, and of the lags in the effects of policy.

In view of these considerations, it seems to the staff that it would be advisable to submit an annual staff GNP and financial projection to the JEC again this year. We believe that failure to do so might involve stronger efforts by the JEC to require the Board itself to present some kind of preview of its prior planning for the year with respect to monetary policy.