

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

June 7, 1978

CONFIDENTIAL (FR) CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida (1)

Attached is a memorandum from the staff dated today and entitled "Proposed modification of directive language."

This memorandum will be considered by the Committee at its forthcoming meeting.

Attachment

CLASS II - FOMC

June 7, 1978

TO: Federal Open Market Committee SUBJECT: Proposed modification

FROM: Staff of directive language

In a memorandum to the FOMC dated May 11, 1978, Chairman Miller noted that the 2-month ranges for the aggregates cited in the Committee's domestic policy directive were frequently misinterpreted as FOMC targets rather than as guides to operations. He observed that this misinterpretation was probably due, at least in part, to the language used in the directive, and he suggested a modification of the language intended to reduce the problem (shown here in attachment B). Although the Committee did agree in May to amend one phrase in the directive with this end in view, 1/2 it decided to defer consideration of a more general modification along the lines suggested by the Chairman until the June meeting.

Attachment A shows a new version of the proposal, with changes intended to take account of the Committee's deliberations at the May meeting and a few suggestions received subsequently. The new proposal differs from that included in Chairman Miller's May 11 memorandum in the following respects:

1. It incorporates (in lines 20-24) certain changes that had been suggested by Governor Partee and commended to the Committee's attention at the May meeting by the Chairman.

^{1/} The statement that the Committee "expects" the growth rates to be within the ranges specified was replaced by a description of the latter as "ranges of tolerance."

- 2. It allows (in lines 25-30) for alternative formulations ("monetary aggregates" and "money market"), in view of the issue raised by President Black.
- 3. The phrase, "including the conditions in foreign exchange markets" has been deleted (from line 15) in light of the Committee's decision to delete the corresponding phrase from the directive adopted in May.
- 4. In lines 12-13, the earlier language ("In the short run, the Committee seeks to foster money market conditions...") has been replaced by the following: "In the short run, the Committee seeks to achieve bank reserve and money market conditions...." The word "achieve" is suggested instead of "foster" to avoid repetition of the latter rather unusual word, which is employed in line 2. The addition of a reference to "bank reserve" conditions is suggested in light of the facts that the Federal funds rate is of significance mainly as an indicator of the pressure on bank reserves and that the Manager affects the funds rate through operations to absorb or supply reserves.
- 5. In lines 14-15, the phrase "...while taking account of more general financial market conditions" has been replaced by "...while giving due regard to developing conditions in financial markets more generally."

 This change is suggested in the interest of clarity.
- 6. In lines 2-3, it is proposed to use the phrase "...to foster monetary and financial conditions..." rather than "...to foster bank reserve and other financial conditions..." for the purpose of describing the Committee's general policy stance. The former appears to be clearer and incidentally avoids repetition (with line 12) of the term "bank reserve."

Attachment A

Current proposal

June 7, 1978

Suggested substitute for final four paragraphs of domestic policy directive

1 In light of the foregoing developments, it is the policy of 2 the Federal Open Market Committee to foster monetary and financial conditions that will resist inflationary pressures while encouraging 3 4 continued moderate economic expansion and contributing to a sustainable 5 pattern of international transactions. At its meeting on April 18, 6 1978, the Committee agreed that these objectives would be furthered by 7 growth of M-1, M-2, and M-3 from the first quarter of 1978 to the 8 first quarter of 1979 at rates within ranges of 4 to 6\frac{1}{2} per cent, 6\frac{1}{2} to 9 9 per cent, and $7\frac{1}{2}$ to 10 per cent, respectively. The associated 'range 10 for bank credit is $7\frac{1}{2}$ to $10\frac{1}{2}$ per cent. These ranges are subject to 11 reconsideration at any time as conditions warrant. 12 In the short run, the Committee seeks to achieve bank reserve 13 and money market conditions that are consistent with the longer-run 14 ranges for monetary aggregates cited above, while giving due regard 15 to developing conditions in financial markets more generally. During 16 the period until the next regular meeting, System open market operations shall be directed initially at keeping the weekly average Federal funds 17 rate at about the current level. $\frac{1}{2}$ Subsequently, operations shall 18 be directed at maintaining the weekly Federal funds rate within the 19 range of ____ to ___ per cent. In deciding on his specific objective 20 for the Federal funds rate the Manager shall be guided mainly by the 21 relationship between the latest estimates of annual rates of growth 22

Or, at attaining a weekly average Federal funds rate slightly (or somewhat) above (or below) the current level.

23 in the June-July period of M-1 and M-2 and the following ranges of tolerance: ____ to ____ per cent for M-1 and ____ to ____ per 24 cent for M-2. If, giving approximately equal weight to M-1 and M-2, 25 their rates of growth appear to be 26 Monetary aggregates emphasis 27 significantly above or below the midpoints Money market emphasis 28 close to or beyond the upper or lower limits 29 of the indicated ranges, the objective for the funds rate shall be raised or lowered in an orderly fashion within its range. 30 If the rates of growth in the aggregates appear to be above 31 32 the upper limit or below the lower limit of the indicated ranges at a 33 time when the objective for the funds rate has already been moved 34 to the corresponding limit of its range, the Manager is promptly to notify the Chairman who will then decide whether the situation calls 35

for supplementary instructions from the Committee.

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Chairman Miller's Proposal of May 11, 1978

Attachment B

Suggested substitute for final four paragraphs of domestic policy directive

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will resist inflationary pressures while encouraging continued moderate economic expansion and contributing to a sustainable pattern of international transactions. At its meeting on April 18, 1978, the Committee agreed that these objectives would be furthered by growth of M-1, M-2, and M-3 from the first quarter of 1978 to the first quarter of 1979 at rates within ranges of 4 to 6-1/2 per cent, 6-1/2 to 9 per cent, and 7-1/2 to 10 per cent, respectively. The associated range for bank credit is 7-1/2 to 10-1/2 per cent. These ranges are subject to reconsideration at any time as conditions warrant.

In the short run, the Committee seeks to foster money market conditions that are consistent with the longer-run ranges for monetary aggregates cited above, while taking account of more general financial market conditions, including the conditions in foreign exchange markets. During the period until the next regular meeting, System open market operations shall be directed initially at keeping the weekly average Federal funds rate at about the current level. Subsequently, operations shall be directed at maintaining the weekly Federal funds rate within the range of ______ per cent. The specific level of the

^{1/} Or, at attaining a weekly average Federal funds rate slightly (or somewhat) above (or below) the current level.

Federal funds rate sought shall be influenced by the relationship between
the latest estimates of annual rates of growth in the May-June period
of M-1 and M-2 and the following ranges: to per cent for
M-1 and to per cent for M-2. For this purpose, M-1 and M-2
shall be given approximately equal weight.

If the rates of growth in the aggregates appear to be above the upper limit or below the lower limit of the indicated ranges at a time when the objective for the funds rate has already been moved to the corresponding limit of its range, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.