

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, February 14, 1972, at 2:30 p.m.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Clay
Mr. Daane
Mr. Kimbrel
Mr. Maisel
Mr. Mayo
Mr. Mitchell
Mr. Morris
Mr. Robertson
Mr. Sheehan

Messrs. Coldwell, Swan, and Winn,
Alternate Members of the Federal Open
Market Committee

Messrs. Heflin, Francis, and MacLaury,
Presidents of the Federal Reserve Banks
of Richmond, St. Louis, and Minneapolis,
respectively

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Bernard and Molony, Assistant
Secretaries
Mr. Hackley, General Counsel
Mr. Partee, Economist
Messrs. Axilrod, Eisenmenger, Garvy, Gramley,
Hersey, Scheld, Solomon, Taylor, and Tow,
Associate Economists
Mr. Holmes, Manager, System Open Market
Account

Mr. Melnicoff, Deputy Executive Director,
Board of Governors
Mr. Cardon, Assistant to the Board of
Governors
Mr. Altmann, Assistant Secretary, Office
of the Secretary, Board of Governors
Mr. Bryant, Director, Division of International
Finance, Board of Governors
Mr. Chase, Associate Director, Division of
Research and Statistics, Board of Governors
Messrs. Keir, Pierce, Wernick, and Williams,
Advisers, Division of Research and
Statistics, Board of Governors
Mr. Wendel, Chief, Government Finance Section,
Division of Research and Statistics,
Board of Governors
Miss Eaton, Open Market Secretariat Assistant,
Office of the Secretary, Board of Governors
Mrs. Rehanek, Secretary, Office of the
Secretary, Board of Governors

Messrs. Parthemos, Andersen, and Craven,
Senior Vice Presidents, Federal Reserve
Banks of Richmond, St. Louis, and San
Francisco, respectively

Messrs. Boehne, Hocter, and Green, Vice
Presidents, Federal Reserve Banks of
Philadelphia, Cleveland, and Dallas,
respectively

Mr. Kareken, Economic Adviser, Federal
Reserve Bank of Minneapolis

Mr. Meek, Assistant Vice President, Federal
Reserve Bank of New York

Chairman Burns observed that the purpose of today's meeting
was to discuss the latest report of the committee on the directive.^{1/}

^{1/} This document, entitled "Third Report of the Committee on
the Directive," was distributed to the Open Market Committee on
January 19, 1972. Also distributed on that date was a memorandum
from the System Account Manager entitled "Reserve targets." Copies
of both documents have been placed in the Committee's files.

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Of the three members of the directive committee--Messrs. Maisel, Morris, and Swan--two would be leaving the Federal Reserve System soon; Mr. Maisel was approaching the end of his service as a member of the Board of Governors and the FOMC, and Mr. Swan planned to retire as President of the San Francisco Reserve Bank later in the year. He (Chairman Burns) thought it was fitting at this time for the Open Market Committee to spend the greater part of an afternoon considering a subject on which they had worked so intensively for so long a period. Before turning to the main business of the meeting, however, he might take a few minutes to comment on some of the subjects that had been discussed in the hearings of the Joint Economic Committee on February 9, at which he had testified.

The Chairman then summarized the discussion on two subjects at the JEC hearings--profits of Government securities dealers and proposals for General Accounting Office audits of the Federal Reserve. After some discussion of these matters, the Chairman invited Mr. Maisel to comment on the directive committee's latest report.

Mr. Maisel remarked that while the directive committee had not repeated in its third report the analysis of its two previous reports, it still considered that analysis valid. As the members would recall, the earlier reports had noted that the Open Market Committee must make three different kinds of decisions. These relate to the desired course of economic activity; the levels of

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intermediate monetary variables that appeared appropriate given the goals for economic activity; and the instructions to the Manager regarding the day-to-day operations needed to achieve the Committee's objectives for monetary variables. In its first report, submitted in March 1970, the directive committee had considered how the second type of decision, relating to intermediate monetary variables, might best be formulated. It had concluded that there would be many advantages to expressing the targets of monetary policy in terms of total reserves over a period of three or four months.

The latest report, Mr. Maisel continued, was concerned primarily with how the third kind of decision--relating to instructions for day-to-day operations--should be formulated. The report stressed, however, that the choice of a variable for expressing operating instructions could be made independently of the choice of intermediate monetary variables. In particular, the operating variable recommended--nonborrowed reserves--could be used whether the intermediate variable of concern was interest rates, M_1 , M_2 , bank credit, or some other.

In the judgment of the directive committee, Mr. Maisel observed, there were four major deficiencies in the procedures under which the Federal Open Market Committee now developed its policy directives. First, the FOMC did not have a clear enough picture of the relationship between changes in operating variables--

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whether money market conditions or reserves--and changes in the intermediate monetary variables. Secondly, there was insufficient understanding of the relationship between changes in the intermediate variables and changes in the economy, including questions of both timing and magnitude. Third, there tended to be insufficient discussion of developments with respect to the demand for money, although that subject had been considered at length on some occasions--such as last spring and summer when international events were influencing money demands. Finally, the time period on which the Committee focused in its policy deliberations was often too short. When the Committee set its targets for intermediate variables for only a month or two ahead, it was dealing with a period in which current operations could not have much effect; and it was not taking into account the longer-run implications of its decisions.

In addition to the problems of arriving at a proper directive, Mr. Maisel remarked, there also were some operating problems under current procedures. It was the Open Market Committee's practice to try to achieve its objectives for the intermediate monetary variables by calling for gradual changes in the Federal funds rate from meeting to meeting. But that particular control mechanism was a poor one; like a badly designed thermostat, it tended to result in repeated undershooting or overshooting. Moreover, because market participants were aware that the System

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operated by changing the funds rate gradually, day-to-day changes in that rate affected expectations in ways which often were counter-productive from the System's point of view.

As noted in the report, Mr. Maisel continued, the directive committee recommended that the FOMC formulate its instructions to the Manager in terms of nonborrowed reserves, corrected for changes in reserves required for Government and interbank deposits. The Desk would be instructed to achieve smoother increases or decreases in such reserves, subject to the proviso that between meetings of the Open Market Committee the Federal funds rate should not be allowed to move more than 100 basis points above or below the level expected to be consistent with the objective for reserves. In the judgment of the directive committee, adoption of such a procedure would make it easier for the Open Market Committee to debate policy and communicate with the Manager. And, since the Federal Reserve was established to control bank reserves, it would make it easier for the System to explain and justify its actions. Finally, it should improve the Committee's ability to control whatever intermediate monetary variables it wanted to control.

Mr. Maisel said he might conclude by quoting an opinion of the staff committee that had been cited in the directive committee's original report: ". . .primary focus on money market conditions, construed as net borrowed reserves, borrowings and the Federal funds rate, can and often has led to inappropriate

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policy. We also believe that financial markets are sufficiently resilient to offer scope for wider week-to-week fluctuations, and intermediate-term changes, in money market conditions than have generally been permitted in the past." The directive committee had agreed with that view two years ago and it continued to do so.

Chairman Burns then asked Messrs. Swan and Morris whether they had any supplementary comments at this time.

Mr. Swan said he would simply underscore Mr. Maisel's observation that use of reserve targets was likely to result in clearer instructions to the Manager, greater public understanding of the System's operations, and better control of the intermediate variables. With respect to the last point, if the relationships among money market conditions, reserves, monetary aggregates, and so forth were fully understood it would not matter which variable was used for formulating operating instructions. Since that was not the case, the choice did matter; and he thought the possibility of error--as well as the possibility of misunderstanding--would be reduced if a reserve target were employed.

Mr. Morris noted that the directive committee had recommended that fluctuations in the Federal funds rate between FOMC meetings be limited to a 200 basis point range. It might be desirable, however, to limit fluctuations to a narrower range during the transition period in which both the market and the FOMC were learning how to operate under the new system, and then to widen the range as experience was gained.

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Chairman Burns remarked that it would be helpful to have the views of staff members at this point. He suggested that Mr. Axilrod comment first, and then Messrs. Holmes and Partee.

Mr. Axilrod said that in his view the directive committee had rightly stressed the various kinds of uncertainty that confronted the Open Market Committee in the process of deciding on monetary policy and on the means of effectuating it. The staff members responsible for providing the Committee with supporting analysis were well aware of the limitations of knowledge about the relationships involved, and they shared the view of the directive committee that the problems arising from those uncertainties would not disappear if the Committee shifted to a reserve target. However, they also agreed that policy could be implemented more effectively--in the sense that the Committee's ability to achieve its objectives for the intermediate variables would be improved somewhat--if more emphasis were placed on reserve targets. Against the background of the projection errors of the past month and the past year, he was not prepared to guarantee that the results would be significantly better; there were imprecisions in existing knowledge about the relationships involving reserves as well as other variables, and there would be misses under the new system as well as under the old. Nevertheless, he believed that reserves could--and should--be given more weight in the Committee's operating

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procedures. Such a course could be justified on the simple ground that the way to speed up or slow down the growth of deposits was to speed up or slow down the rate at which reserves were supplied.

Mr. Axilrod remarked that a proviso limiting the range of fluctuations in the Federal funds rate appeared desirable, partly for the sake of minimizing the undesired consequences of unexpected short-run changes in the mix of deposits or in the levels of excess reserves and borrowings, and partly because at times the Committee had objectives for interest rates as well as for monetary aggregates. It was essential, however, that the acceptable range for the Federal funds rate be wider than in the past if the Committee wanted to have greater emphasis placed on reserves; otherwise, it would be changing the form, but not the substance, of its instructions. While he did not have any specific range to recommend, he noted that the FOMC recently had been employing ranges of about plus or minus one-half of a percentage point and that an extension to plus or minus a full percentage point would seem reasonable.

In his judgment, Mr. Axilrod continued, nonborrowed reserves had certain advantages over total reserves for target purposes. First, short-run changes in the level of borrowings could serve as a buffer for accommodating temporary ebbs and flows of reserve demand and, in the process, limit fluctuations in the Federal

funds rate. Secondly, nonborrowed reserves could be controlled more closely than total reserves from day to day, particularly under lagged reserve accounting.

As a final point, Mr. Axilrod said, he would note that occasions could arise on which the FOMC would want to give more than customary emphasis to interest rates and less to reserves. On such occasions he would suggest that the Committee simply modify the form of its instructions to stress its rate objectives. Under normal circumstances, however, he thought the most efficient procedure would be to work with reserves as the operating variable and allow for the possibility of wider fluctuations in the funds rate than were typical now. It was possible that market forces would tend to dampen those fluctuations over time, as participants adjusted to the new procedures.

Mr. Holmes remarked he was not sure how much he could say about reserve targets that would be useful before the Committee had had a full discussion of the subject. That was because a great deal depended on what sort of target was wanted and how rigid it would be, the time span over which it was to be achieved, and what interest rate constraints were to be imposed. He assumed it was clear from his memorandum that the Desk was less than wildly enthusiastic about shifting to a reserve target-- particularly to a rigid one under which heavy reliance would have to be placed on staff projections and assumptions about inter-relationships among reserves, money and credit aggregates, and

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interest rates on the one hand, and about interrelationships between financial indicators and the real economy on the other. He would agree that the staff had done much useful research in that area, but he thought the current state of the art made it risky to seek precision where no precision existed. He would also agree, of course, that there was room for further experimentation with procedures involving greater emphasis on reserves if the Committee so desired.

Mr. Holmes noted that the Desk had not encountered any problems in operating under the reserve target adopted at the January 11 FOMC meeting. However, a large element of luck was involved in that outcome. The staff assumptions about relationships between reserves and money market conditions, which were aided by the fact that January was nearly half over at the time of the meeting, had turned out close to the mark. And with lagged reserve accounting, the pattern of required reserves had been pretty well set at the time of the meeting.

In the event, Mr. Holmes continued, with M_1 sluggish, the Desk had permitted the January growth rate in seasonally adjusted total reserves to run above the 20 to 25 per cent target range, at 28 per cent--or so it thought. He supposed it was just as well that the Desk had followed that course since otherwise, when the new seasonal adjustment factors introduced after the end of the month were applied, the growth rate shown for total reserves would

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have been below 20 per cent. In that connection, he thought the revision of the 1971 monthly growth rates for total and nonborrowed reserves, which ranged up to 10 percentage points for individual months, had quite disturbing implications for the implementation of a reserve target. His memorandum to the Committee noted the risk that faulty projections or faulty seasonals might lead the Desk to push money market conditions around needlessly, and the recent revisions in seasonal factors underscored that concern.

Mr. Holmes then said he would mention--without going into detail--several specific aspects of the directive committee report that he thought needed clarification. The first concerned the meaning of a "steady" supply of reserves to the market. He assumed the growth rate was not to be stabilized month by month; to appreciate the problems involved in such a course, one needed only to consider the actual pattern in the first two months of this year, when the sharp increase of January was being followed by a decline in February. The second point needing clarification concerned the longer time span proposed for viewing the monetary variables, which would seem to involve greater reliance on projections than many Committee members had seemed willing to accept heretofore. The third related to the list of monetary and/or credit variables the Committee wanted to rely upon. If his understanding was correct, the directive committee would give weight to M_1 , M_2 , and the large-denomination CD component of the credit proxy. However, the reserve

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target would be adjusted in the interval between Committee meetings to take account of unprojected changes in Government and interbank deposits. Thus, if M_1 were falling short of projections but time and savings deposits (including large CD's) were expanding rapidly enough to offset the reserve impact of the M_1 shortfall, the reserve target could be met. Put differently, on the basis of present reserve requirements, a \$1 shortfall in M_1 could be made up by approximately a \$5 overshoot in passbook savings deposits or a \$3 overshoot in other time and savings deposits including large CD's. That, indeed, was a way to apply weights to a basket of aggregates, but one might ask whether the weights were the right ones.

A fourth aspect of the report that needed clarification, Mr. Holmes continued, related to the agreement that use of a reserve target was apt to increase the range of fluctuations in the Federal funds rate and in other interest rates. The thorny question was how much variation should be tolerated. The directive committee suggested a range of 200 basis points between meetings. Suppose, however, that nonborrowed reserves appeared to be on target; would the Open Market Committee expect the Federal funds rates to bounce around within such a range without intervention by the Desk? Or should the Desk try to maintain a relatively stable funds rate so long as that did not involve any significant deviation from reserve goals? The question was an important one from the point of view

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of operations since, as noted in his memorandum, operations directed at limiting fluctuations in the Federal funds rate offered some protection against faulty reserve projections.

Finally, Mr. Holmes observed, there was the question of the impact that increased interest rate variability--and that variability had been considerable in recent years--would have on market expectations and psychology. While the view of the directive committee--that the market would adjust speedily to the new system--might be correct, he believed some further experimentation was needed. Certainly, the January experience was no test. In general, he suspected that close attention would have to be paid to the impact of reserve targeting on psychology.

Mr. Maisel said he would like to comment on two of the points Mr. Holmes had raised. One, concerning the weights to be given to M_1 , M_2 , and so forth, really involved the question of intermediate targets, which--as he had indicated earlier--could be considered independently of the question of operating variables. Only if the Committee decided to set goals for variables such as M_1 for each inter-meeting period would there be a need for concern about the weights for those aggregates; otherwise, the Desk could operate on the basis of reserves per se. Secondly, in his comments on the Federal funds rate Mr. Holmes had referred to other interest rates as well. In his (Mr. Maisel's) view, market interest rates generally were affected by the supply of and demand for credit,

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and they might or might not be importantly influenced by changes in the Federal funds rate. But the question of the relationship between the funds rate and other interest rates was an important one that should be considered by the Committee.

Mr. Partee commented that he had been listening to and participating in debates on this subject for a long time. As Mr. Brimmer had indicated in the paper he gave at the recent New Orleans meeting of the American Economic Association, the Open Market Committee had been discussing the matter at least since 1964, when the first directive committee under the chairmanship of Mr. Mitchell had submitted the report that ultimately led to the development of the current blue book. One reason for the durability of the issue, he believed, was that it could be interpreted as involving a basic matter of principle--namely, whether the proper function of the central bank was to influence credit markets and interest rates or to determine the growth rates of the monetary aggregates. However, as posed by the directive committee, the present question should be regarded as one not of principle but simply of operating strategy. Specifically, the issue being discussed today concerned the relative amount of emphasis that should be placed on reserves and on money market conditions from day to day in trying to achieve the Committee's objectives. He would view a decision to adopt the reserve-oriented strategy as another step in the direction in which monetary policy had been evolving in recent years.

Mr. Partee remarked that a directive specifying both a reserves target and a Federal funds rate constraint could be used to place varying degrees of emphasis on the two variables by changing the terms of the constraint. If the acceptable range for the funds rate was quite narrow, the result would be essentially a money market target; if the range was quite broad, it would be essentially a reserves target. He agreed with Mr. Axilrod that the acceptable range for the funds rate should be significantly wider than it had been in the past. However, he also thought it would be feasible to experiment with the new system by making the range only moderately wide at the outset and gradually increasing its width as experience was gained, in line with Mr. Morris' suggestion today.

Mr. Partee said he was persuaded that nonborrowed reserves were better than total reserves for target purposes. Both because of lagged reserve accounting and the lagged impact of changes in interest rates, he thought it could be quite difficult for the Manager to hit a total reserves target. He agreed with Mr. Holmes that the success on that score in January was due partly to luck and partly to the fact that practically all of the deposits affecting reserves for the month were already in place when the target was set on January 11. If the Committee adopted a reserve target it would be crucial, in his judgment, to provide for adjustments for unexpected changes in Government and interbank deposits.

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Such changes often were sharp, and if no adjustments were made the reserves available for private deposits would be affected in undesired ways. At times the Committee might also want to provide for adjustments to the reserve targets depending on developments with respect to specific monetary aggregates. For example, if reserve growth was on target but time deposits were expanding rapidly and the narrow money supply not at all, the Committee might want to have the rate of increase in reserves stepped up in order to encourage some expansion in M_1 .

In sum, Mr. Partee said, he thought the point had arrived at which the Open Market Committee might want to experiment with the proposed approach to operations. He anticipated that the staff would encounter difficulty with some technical problems, including those relating to seasonal adjustment and to changes in deposit mix. In his judgment, however, the proposed strategy--properly constrained and qualified--was worthy of consideration by the Committee.

Chairman Burns then called for general discussion. In view of the importance of the subject, he hoped all members of the Committee, as well as the Reserve Bank Presidents not currently serving, would participate. And to provide focus to the discussion, it would be desirable to agree in advance on the specific issue to be considered. One possibility was the following: Should the Committee in the future place main emphasis in its

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directive on targets formulated in terms of reserves, money market conditions, or monetary aggregates such as M_1 or M_2 ? He asked whether Mr. Maisel agreed with that statement of the issue.

Mr. Maisel said that while the issue might be put that way, he would prefer to state it differently. If the Committee defined its targets from meeting to meeting in terms of M_1 or M_2 , the Manager would presumably continue to operate from day to day with an eye on money market conditions or reserves, changing his objectives for such variables in light of current developments in the monetary aggregates. The Committee might decide to follow that course at some point. However, what the directive committee was now recommending was that the Committee set targets in terms of reserves per se. While the reserve targets selected would presumably be arrived at in light of the Committee's objectives for intermediate monetary variables, the staff would not have the problem of making continual adjustments in the targets between meetings on the basis of actual changes in M_1 or M_2 .

Mr. Axilrod noted that in his comments he had not been addressing the question of whether reserves were better than M_1 or M_2 for target purposes. Rather, he had assumed that the Committee would be formulating its objectives in terms of such aggregates as M_1 , M_2 , or bank credit, and he had considered whether the Committee was more likely to attain those objectives if the Desk placed main emphasis on reserves or on money market conditions in its day-to-day operations.

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Mr. Mitchell said he thought the question Mr. Axilrod had addressed was the appropriate one for the Committee to consider. He would suggest, however, that the day-to-day operating variable be referred to as the "handle" rather than the "target," since the latter could also mean "objective."

Mr. Mitchell then noted that he had found the directive committee's report to be delightful; he particularly appreciated their contribution of the term "murky wallow" to describe the situation resulting from operations under the current type of directive. In his judgment, the Open Market Committee had consistently failed to face up to the issue of what the economy needed in terms of the level and trend of liquidity or in terms of the level and trend of bank credit. Once that decision was made, he thought the Desk should be told how to move in the desired direction in terms of total reserves. He agreed with Mr. Morris, however, that the shift to the new approach should be made gradually, in view of the problems of transition that were likely to be encountered. In general, he was sympathetic to the recommendations of the directive committee, although he favored moving a little more cautiously than their report suggested.

In a concluding observation, Mr. Mitchell referred to the earlier comments about the relative merits of nonborrowed and total reserves for target purposes, and expressed the view that the

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System's ability to influence the volume of borrowed reserves was limited partly because of its failure to keep the discount rate in line with market rates. If those rates were kept in line the Committee would have better control over total reserves.

Chairman Burns then proposed that the question to be discussed be put in terms of which "handle" the Committee wanted to emphasize--reserves or money market conditions--in seeking to realize its objectives for the intermediate monetary variables, and beyond that, its more fundamental objectives for real economic activity and prices. He called for a go-around on that question, beginning with Mr. Hayes.

Mr. Hayes said that while he did not think emphasis on money market conditions was necessarily an easy path, or that it represented a perfect system, he did consider it preferable to using reserves as the handle. His chief reaction to the latest report of the committee on the directive was that it did not make a convincing case for the reserve approach. That approach seemed to offer some superficial appeal as a more assured means of reaching such intermediate objectives as particular growth rates in the money and credit aggregates. However, he regarded it as something of a siren song that could divert the Committee's attention and energies from the goals that really mattered.

Throughout the report, Mr. Hayes continued, there were expressions of hope and belief that emphasis on reserves would lead to substantially better results, but nowhere in the report--nor in the discussion thus far today--was clear-cut evidence offered in support of that position. To be sure, it was desirable for the Open Market Committee to set its targets in terms of quantities over which it could exercise some measure of control, and it was, of course, true that the Federal Reserve System dealt in reserves. But such observations struck him as superficial; he would rather exercise modest influence on quantities the Committee felt were genuinely significant in the economy than completely control quantities that might well be less significant. What quantities had real economic significance? It seemed to him that they were the money supply, the total availability of credit, and the levels and movements of interest rates. They were not total reserves; they were not nonborrowed reserves. To his knowledge it had been nowhere demonstrated that total or nonborrowed reserves had any strong, direct effects on the ultimate goals for the economy.

One of the main problems in dealing with reserves, Mr. Hayes said, was the variability of the multiplier. The Committee had very

little knowledge of how a given amount of reserves provided at a particular time would be distributed among time deposits, private demand deposits, and deposits of other types. Of course, if adjustments were made for unexpected changes in Government and interbank deposits, the problems they posed would be eliminated.

Mr. Hayes observed that the directive committee had conceded in its report that there was a great lack of knowledge about the linkages between operating handles and intermediate variables, and between the latter and the economy. It proposed that the Open Market Committee attempt precision in an area where it knew very little about cause and effect. He thought the Committee, if anything, had tried to be too specific in delineating its operating instructions to the Manager, and as he understood the proposal it would go even further in a direction he regarded as undesirable. He would much rather see the Committee devote its attention at each meeting to determining the general characteristics of the financial climate it wanted to bring about to achieve broad economic objectives. In that process it should give emphasis to a variety of factors including growth rates in various aggregates as well as interest rates and other credit market conditions. That in turn would set a broad framework to provide guidance to the Manager in his day-to-day conduct of operations. Given the vagaries of projections, and the after-the-fact revisions, it seemed to him a misguided effort for the members of the Committee to attempt to provide detailed

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guidance four or five weeks in advance for the specific reserve operations that might best serve the underlying objectives. Incidentally, the extent of changes in the 1971 monthly reserve figures brought about by the application of new seasonal adjustment factors dramatically emphasized the point that troubled him; the Committee had suddenly learned that the monthly growth rates it had had in view were off the mark by as much as 10 percentage points.

In his judgment, Mr. Hayes said, the dissatisfaction some of the members had felt with the current system of setting out Committee objectives and operating instructions was due, in good part, to the fact that the response of various quantities the Committee had wanted to influence had been slower than it would have liked. An awareness of the lags at work should help to foster patience. Beyond that, when the Committee desired to get a more significant response from money and credit aggregates, it might be appropriate on occasion to encourage somewhat greater moves in money and credit market conditions--but always with an awareness that there were tradeoffs between developments in aggregates and in the credit markets. The Committee could not avoid facing those tradeoffs by embracing a reserve target approach that could have major impact on both the aggregates and the credit markets and yet not necessarily produce the aggregate mix desired. And to accept whatever interest rates developed as a result of the

mechanical pursuit of a reserve target would be to create wide oscillations that could only do damage to market psychology.

Mr. Hayes said that even if he had high hopes regarding the value of a reserve target approach--and he admitted to considerable skepticism on that point--he thought it would be most unwise to adopt such an approach without a good deal more experimental study and simulation of possible results than had been presented to the Committee thus far. That type of study could be carried out either with respect to past periods, as was done to some extent in an appendix to the directive committee's report, or with respect to the current period as it unfolded.

Mr. Hayes observed that the Committee's real concern, of course, involved the delicate and difficult problem of achieving satisfactory economic growth and reducing unemployment while at the same time putting an end to inflation and restoring equilibrium to the balance of payments. The Committee should not let frustration about the difficulty of achieving those multiple objectives be translated into hasty action on the form of the directive. And he thought the Committee should remain humble about its ability--and the staff's ability--to specify in any precise way the changes in monetary and credit aggregates or in interest rates that would accomplish the Committee's objectives.

In a concluding observation, Mr. Hayes referred to the directive committee's suggestion that the staff should provide

analyses of potential changes in the demand for money. He would be delighted if that could be done. He might note, however, that thus far it had not proved possible to analyze effectively past changes in the demand for money, let alone those that might be expected in the coming months.

Chairman Burns said it might facilitate further discussion if the Committee were to adopt a specific terminology. He proposed that the term "fundamental objectives" be used to refer to such matters as real economic activity, the level of prices, and the balance of payments. The term "monetary objectives" might be used in reference to the growth rates of M_1 , M_2 , and the bank credit proxy, and to the level of interest rates. Finally, the word "handles" might be used to refer to the operating guides that might be employed in working toward the monetary objectives which were deemed best calculated to serve the fundamental objectives. There were two major handles--involving primary emphasis on reserves and on money market conditions--and the Committee was seeking to arrive at a judgment about their respective merits. He hoped the members would employ that terminology, in the interest of efficient communication; and that they would direct their comments primarily to the subject of handles.

Mr. Francis said he strongly supported the general thrust of the report of the committee on the directive. In his judgment, lengthening the period for which the FOMC set goals for the monetary

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variables and making the operating instructions to the Desk more explicit were both steps toward better monetary management. What was needed was a means for influencing the monetary aggregates in a manner that would facilitate attainment of the fundamental objectives, and it seemed to him that the most effective means was to influence the level of bank reserves. The directive committee's recommendation to use nonborrowed reserves as an operating target was an excellent beginning in moving to such an approach.

Mr. Francis referred to Mr. Hayes' comments regarding the need for further experimental study before a reserve target was adopted. He observed that the St. Louis Bank had done a great deal of work in that area; in particular, it had made many simulation analyses involving various reserve aggregates. On the basis of those studies he was convinced that the FOMC would be much more likely to achieve its fundamental objectives if it used reserve targets and paid considerably less attention to money market conditions and interest rates. He strongly urged that the FOMC begin by establishing a target in terms of the rate of growth in nonborrowed reserves, while permitting the Federal funds rate to fluctuate within a very wide band. He thought that band could be set initially at 2 percentage points without creating any problems. Then, from meeting to meeting, the Committee could determine, in light of developments in the intermediate aggregates, whether any change was needed in the target growth rate

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for reserves in order to achieve whatever fundamental objectives it had decided upon.

Mr. Kimbrel said he would like to ask a question before commenting on the directive committee's proposals. He was inclined to agree with the observation that financial markets were sufficiently resilient to absorb wider changes in money market conditions. He wondered, however, whether the Treasury's financing costs would tend to be higher under such circumstances.

Chairman Burns said he doubted that that question could be answered confidently at this point.

Mr. Axilrod agreed that the matter was uncertain. He suspected, however, that after some transition period the new procedure in itself would not affect interest rates on Treasury bills or coupon issues to any great extent. However, it might well be that during the transition period the Treasury would have to offer significantly better terms than otherwise in its financings, as a result of increased uncertainty in the market about the future course of rates. But he should note in that connection that the Committee had not yet focused on the question of the extent to which it should observe even keel constraints under the new procedure.

Mr. Kimbrel then remarked that more than a decade ago--long before his day at the Atlanta Reserve Bank--Malcolm Bryan, then President of the Bank, had been advocating a procedure much like that now

being recommended. Personally, he thought the proposal offered some hope of smoothing out the roller-coaster behavior of the aggregates under present procedures. In his judgment it would be worthwhile to undertake a trial of directives in which primary emphasis was placed on nonborrowed reserves, subject to a constraint on the Federal funds rate. He believed that it would be desirable to phase in the new procedure over a reasonable period of time rather than to make an abrupt shift.

Mr. Boehne observed that the Philadelphia Reserve Bank was in general agreement with the directive committee's report. The Bank favored expanding staff reports to the FOMC in the manner suggested and lengthening the horizon for setting targets. As to the "handle" to be employed, the Bank found nonborrowed reserves to be acceptable. It was not unmindful of the need to give some consideration to money market conditions, but it believed that the proposed 200 basis point spread would be a good place to start. While the case for the reserve approach was not overwhelmingly convincing, there did appear to be enough in its favor to justify a trial by the Committee.

Mr. Winn remarked that when one considered the history of monetary developments over the centuries he was likely to be struck by the frequency of efforts to find a simplistic approach to the subject, all of which had failed. He suspected that any simple approach the Committee might adopt now would have to be abandoned

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shortly, in view of the highly diverse--and often incompatible-- nature of the Committee's fundamental objectives for production, prices, the balance of payments, and so forth. Secondly, while the use of a reserve target might sharpen the Committee's focus in some respects, a given growth rate in reserves could be associated with very different rates of growth in such intermediate variables as M_1 and M_2 , on which the public tended to focus. He wondered whether the Committee would be able to hold to its reserve target when such variables were behaving in ways that appeared to be inconsistent with the needs of the times. While he saw no harm in experimenting, he thought the effort to use reserves would be hampered by such problems.

Mr. Sheehan said he had nothing substantive to contribute to the discussion, but he did wonder whether the present was a good time for the Committee to experiment. On the other hand, there might never be a good time to experiment.

The Chairman observed that the term "experiment" was being used in two different senses in the discussion today. Some speakers were thinking of experiments in the statistical laboratory, involving simulation analyses with historical data. Others were thinking of experiments in actual operations, which would involve moving in the direction recommended by the directive committee but at the outset not going all the way. To illustrate the second kind of experiment, he might note that the directive committee had recommended using a

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reserve target but attaching a constraint limiting fluctuations in the Federal funds rate to a range of 200 basis points. Instead of adopting their recommendation in full, the Open Market Committee might experiment with the approach by setting a somewhat narrower range for the funds rate initially and observing the results. If that experiment were successful the Committee might then decide to move to the full 200 basis points range recommended in the report.

Mr. Brimmer remarked that the question of handles to which the Chairman had restricted today's discussion was only the tip of the iceberg; below the water line were the broader issues of the Committee's intermediate and fundamental objectives. While he could not say now what conclusions he might reach on the broader issues, he hoped the Committee would have an opportunity to debate them at some point.

In response to a question by Chairman Burns, Mr. Brimmer said he had not meant to suggest that the Committee should be debating the broader issues today. Since the directive committee report under discussion was concerned mainly with handles, he thought it was appropriate for the Committee to consider only that subject now.

Mr. Brimmer went on to say that he did not favor adopting the recommendations of the directive committee at this point. He would first want to have the answers to the difficult questions the Manager had raised about the proposal, and he suspected that

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providing them would require a good deal of work. He was also concerned about the question of the relationship between open market operations under the proposed procedure and the operations of the Treasury, involving not only the issue of even keel during financings but also the management of the Treasury account at the Federal Reserve. In the latter connection he might note that it would be technically possible for the Treasury to offset the reserve effects of System operations by varying the size of its balance at the Reserve Banks.

Mr. Maisel said he had only one observation to add to his earlier comments. He thought the strongest argument for adopting a reserve handle was offered by the results of the Committee's efforts over the past year to use money market conditions for the purpose. It seemed to him that the difficulties experienced during the last four or five months, and also last spring, in reaching conclusions on operating instructions and in achieving objectives for the monetary variables represented clear proof that money market conditions were a poor handle. That was primarily because not enough was known about the relationships between such conditions and the monetary variables. It was difficult for him to believe that the Committee could not improve on its 1971 performance by shifting to a reserve handle.

Mr. Daane said he was sure he voiced the sentiments of all those present in expressing his gratitude to Messrs. Maisel, Morris,

and Swan for the hard thinking and analysis embodied in their report. Personally, however, he was not prepared to adopt a single variable as the handle for operations, any more than he would be prepared to chose a single variable to express the Committee's intermediate monetary objectives or its fundamental objectives.

In his view, Mr. Daane observed, there had been too great a tendency throughout his years with the Federal Reserve to equate a given operational handle with a given intermediate monetary objective and with a given fundamental objective. The result had been a confusion of means with ends. One problem with the course recommended by the directive committee was that it would distract the FOMC from looking through to the real world of employment, prices, and so forth; it would encourage a preoccupation with handles, to the detriment of the Committee's fundamental objectives. The same result could be expected if the Committee became preoccupied with some single intermediate monetary objective. He, for one, was not convinced that the Committee knew enough about the relationships--the linkages--between either of the two types of operating handles under discussion and the variables expressing its intermediate monetary objectives or its fundamental objectives to warrant such a course.

In his judgment, Mr. Daane continued, the Committee should be striving for a more broadly based and less mechanical approach to policy formation, with less rather than more emphasis on

projections and on precise quantification of instructions. There had been a number of references today to the desirability of undertaking an experiment, but if one looked back over the Committee's history he would find that experimentation with guides for operations was nothing new. In 1951 the Committee had used interest rates as the handle or guide to operations. During most of 1952 and 1953 it had used the volume of member bank borrowings for that purpose. In 1954 it had shifted gears again and begun to rely increasingly on free reserves. By 1960, when he had taken leave from the System for a post with the Treasury, the Committee had become completely unenamored with free reserves, partly because projections of reserves had proved so highly unreliable. The same sort of deficiency affected projections of nonborrowed reserves, according to an analysis made at the Richmond Bank when he was a staff member there. Moreover, in the 1950's there had been wide differences between the reserve projections made at the Board and the New York Bank. Perhaps all the differences in those projections had disappeared over the ensuing ten years, but he doubted it.

A second reason for the disenchantment with a free reserve target, Mr. Daane remarked, was the instability of the relationship between that variable and market interest rates. It was found through experience that a given level of free reserves could have widely different and unpredictable implications for interest rates, depending on the distribution of reserves and

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on the situation with respect to market expectations. The same basic deficiency affected aggregate reserve targets; because of variations in reserve distribution and in expectations, the results might be incompatible with the desired levels and directions of change in interest rates.

Personally, Mr. Daane observed, he was highly skeptical about the conclusion of the directive committee that undesired effects on expectations could be avoided by getting the market to accept a wider range of variations in the Federal funds rate. He would like to see the market--and the public generally--accept wider variations in the funds rate and also in the growth rate of the money supply. But even if they came to do so, expectations would still be influenced by the System's operations. Thus, if the Committee were employing a reserve handle, attitudes in the market would then be influenced by both actual and prospective developments with respect to reserves.

In sum, Mr. Daane said, while he was grateful to the members of the directive committee for their report he considered their conclusions to be Utopian. In his judgment, they expected too much of the Open Market Committee with respect to the degree of precision with which it could formulate its instructions with predictable results. They also expected too much of the staff in terms of projections and linkages, and, incidentally but not unimportantly, too much of the Manager.

Mr. Mitchell commented that he strongly endorsed Mr. Brimmer's view that the Committee needed to supplement today's discussion of handles with a discussion of its monetary objectives. He had already expressed his views on the subject of handles, and at this point would mention only one further advantage in using reserves for the purpose. If the Federal Reserve were asked what it had done for the economy in, say, the last quarter, he thought it would be much better to be able to reply that it had supplied some particular amount of reserves than to say that it had eased or tightened money market conditions.

Mr. Heflin remarked that, as Mr. Daane's comments suggested, the Richmond Bank had a long history of support for the view that money market conditions were the appropriate handle for open market operations. However, he was inclined to think that the Committee had paid too much attention to the Federal funds rate in recent months. In particular, he believed that its failure to keep M_1 on the desired course was due to an unwillingness to accept the variations in the funds rate that would have been needed for that purpose.

No matter what handle the Committee used, Mr. Heflin continued, it would be faced with tradeoffs between interest rates and rates of growth in the monetary aggregates. Apart from the questions the Manager had raised today, he would be concerned about the implications a reserve target would have for fluctuations in

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interest rates, including bank loan rates. The Committee could not be indifferent to the consequences of its policy actions for interest rates generally.

Nevertheless, Mr. Heflin observed, he thought it would be desirable to move in the direction of greater emphasis on a reserve handle. Like Mr. Morris, however, he would not want to set the range for fluctuations in the Federal funds rate at 200 basis points immediately; it would be better to make a smaller beginning. Personally, he saw no special merit in money market conditions as a handle. As long as he had been associated with the Federal Reserve he had been hearing on the one hand that the Committee should pay more attention to money market conditions, and on the other that it should pay more attention to reserves; while he did not know where the truth lay, he assumed it was somewhere in between.

Mr. Heflin then noted that the Manager's memorandum described a possible procedure for experimenting with reserve targets which was designed to avoid some of the drawbacks Mr. Holmes saw in alternative approaches. He (Mr. Heflin) would favor using Mr. Holmes' approach, because it would mean less volatility in money market conditions and also because it would involve less reliance on projections.

Mr. Clay said he did not think that acceptance of the directive committee's report would solve the Open Market Committee's problems. It would not increase the Committee's ability to look over a longer horizon, nor would it keep market participants from

attempting to anticipate the course of policy. Moreover, the Committee was not likely to sit by and let interest rates climb or fall too much or let the money supply grow too fast or too slowly while it pursued some particular target for reserves.

The Committee's real problem, Mr. Clay continued, was that it was not confident that any particular combination of the tools at its disposal would accomplish its objectives. Accordingly, it tended to vary its approach from time to time. He personally was not prepared to agree to the exclusive use of reserve targets at this point.

Mr. Clay noted that for a number of months the Committee had been referring in its directive to both bank reserves and money market conditions. In fact, however, more attention had been paid to money market conditions than to reserves. He would favor continuing to use the same kind of directive language, but on the understanding that more emphasis would be placed on reserves. Perhaps the experience gained by that means would increase the Committee's confidence in the reserve approach to the point at which it would be willing to hold steadily to a particular course over a period of time and really do the kind of job that was needed.

Mr. Mayo said that one conclusion he had drawn from the report of the directive committee was that more staff work was required on the linkages between reserves and M_1 , M_2 , and the bank credit proxy, and between such variables and interest rates. The

purpose of the research would not be to facilitate a mechanical approach to policy-making, but rather to improve the Committee's ability in general to interpret developments and to formulate policy. A second commendable aspect of the report was that it put in proper perspective the desirability of formulating policy objectives for a period of three or four months ahead. Despite the frailties of staff projections, it seemed better to aim for objectives over such periods rather than over periods so short that the objectives were either unattainable or attainable only at great risk.

While he did not think an extremely strong case had been made for a reserve target, Mr. Mayo continued, he was willing to give that approach a trial. As to the width of the constraint on the Federal funds rate, he would not want to move immediately to a range of 200 basis points. He noted, however, that in deciding on specifications at recent meetings the Committee had tended to adopt wider ranges than proposed in the blue book. More importantly, the Committee had tended over time to gradually widen the acceptable range for the funds rate, and he thought it should continue to do so.

In general, Mr. Mayo said, he would not want the Committee to adopt a simplistic approach to what in fact was a highly complex problem. In increasing its emphasis on reserves it should reach judgments about appropriate growth rates only after full consideration of all factors bearing on policy.

Mr. MacLaury said that he, too, wanted to thank the directive committee for its report and particularly for the emphasis it had placed on the importance of formulating objectives for periods of several months. That, he thought, was a major contribution.

If he understood the report correctly, Mr. MacLaury continued, the case for shifting to a reserve target was based mainly on three considerations. The first was an allegation that the demand for money was a less predictable variable than the supply of money. The second seemed to be a feeling that, given the context in which the Committee operated, the members were not psychologically prepared to call for changes in interest rates of the size required to achieve the desired growth rates in the monetary aggregates, but that they would permit such changes to occur if they could be described simply as the by-product of the Committee's pursuit of a reserve target. While he resisted the implications of that kind of argument, he did not deny that there might be something to it. The third was the argument that since the Committee was not satisfied with the results achieved with a money market conditions handle it should try a different handle. But dissatisfaction with one technique, in itself, did not constitute a positive case for some other technique. Assuming that the Committee wanted to emphasize the monetary aggregates as the intermediate variable, he wondered whether the relationship

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between those aggregates and reserves was in fact more reliable than that between the aggregates and money market conditions. To his mind, that had not been clearly demonstrated.

He also had other reservations about the proposal to use reserves as a handle, Mr. MacLaury said. For one thing, he had a good deal of sympathy for the points Mr. Holmes had made in his memorandum regarding the problems that could arise under such an approach. For another, while he thought the distinction the Chairman had drawn between handles and intermediate monetary objectives was a useful one, he did not think the two were wholly separable; and he was concerned about the fact that adopting a reserve handle would almost by definition mean giving even more weight to the monetary aggregates as an intermediate objective than was done now. In light of recent experience he would be less happy about locking policy more tightly to the aggregates than he might have been, say, a year ago.

If the Committee nevertheless wished to give increased weight to the monetary aggregates, Mr. MacLaury observed, the question arose as to whether it could not do so under its present procedures--simply by agreeing to place more stress on proviso clauses relating to the aggregates and to accept the wider range of fluctuations in the Federal funds rate that would ensue. By that means the Committee could achieve the results it sought without

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binding policy tightly to the aggregates. The argument Mr. Mitchell had just advanced for a reserve handle--that its use would permit the Federal Reserve to describe its contributions in particular terms--struck him as an unworthy reason for choosing the reserve handle approach. No doubt the System exposed itself to criticism from some quarters when it accepted some responsibility for influencing interest rates, but it should be prepared to stand up to such criticism.

In sum, Mr. MacLaury remarked, he thought the Committee would be misleading itself if it concluded that it would achieve better results by shifting to a reserve handle. Admittedly, the dual emphasis in past directives on reserves and money market conditions might sometimes have posed the problem of inconsistent instructions to the Manager. However, the Committee would be doing itself a disservice if it tried to avoid such problems by employing a reserve handle exclusively.

Finally, Mr. MacLaury said, he was disturbed by the suggestion that the constraint on the funds rate should be formulated in terms of a range on either side of some central value. One could argue in favor of moving the funds rate rapidly in a particular direction if the objective was to produce a quick response in the monetary aggregates. However, he could see no advantages--and important disadvantages--in permitting the rate to fluctuate widely in both directions.

Mr. Swan said he had only two points to add to his earlier observations. First, he thought many of the criticisms that had been made of a reserve handle would apply to any handle. Secondly, while he agreed with the view that the Committee should debate the question of its intermediate monetary objectives as well as that of handles, he felt that under current procedures there was a tendency to confuse the two. In his judgment adoption of a reserve handle would make it a little easier for the Committee to deliberate on its monetary goals.

Mr. Coldwell said he thought the Committee had done itself a disservice over the past year in concentrating less on questions of policy than on questions of implementation, in effect trying to take over part of the Manager's job at the cost of giving insufficient attention to the major decisions it had to make. He hoped the Committee would spend more time discussing its goals and less in attempting to specify statistical targets.

The practice of focusing on targets, Mr. Coldwell continued, had led the Committee to rely on projections and forecasts that had proved to be very faulty. In his view, what the directive committee was proposing was, primarily, to substitute one projection for another, and he did not think the new one would work any better than the old one. The report also seemed to ignore some of the practicalities of the situation. He doubted that the Committee would be willing to disregard the consequences of its operations

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for interest rates, particularly when large changes in rates were likely. He might note in that connection that the Federal Reserve had sought for a time to keep the discount rate in line with money market rates, but it soon encountered circumstances under which it was unwilling to continue that policy. He had no greater hopes for the Committee's ability to hold to reserve targets.

In his judgment, Mr. Coldwell observed, the Committee should formulate its objectives for the monetary aggregates for periods of six to nine months. With respect to day-to-day operations, it should give its instructions in terms of a measure that was definite and certain, usable by the Desk, and readily quantifiable. That seemed to him to be a good description of money market conditions.

Mr. Morris said he had been rather distressed to hear Mr. Daane describe the directive committee's recommendations as Utopian. The directive committee had emphasized in its report that it did not regard reserve targets as a panacea. It did believe, however, that if the FOMC shifted to a reserve target it would be less likely to make mistakes. That was mainly because an incorrect course would have immediate, highly visible consequences in the financial markets and therefore could be quickly corrected. In contrast, he could recall more than one occasion when, under a money market conditions strategy, the FOMC had been very slow to react to signals that it was supplying

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reserves much more rapidly or slowly than economic conditions warranted. Perhaps the best example was in the second half of 1968 when, in an effort to resist rising interest rates, the System had supplied more reserves than any member would have thought desirable at that time. If the Committee continued to employ a money market strategy it was highly likely to repeat that mistake in 1972, since interest rates probably would come under upward pressure as the economy expanded. By focusing on money market conditions the Committee would again tend to resist the rise, supplying excessive reserves in the process and not recognizing that fact until well after the damage had been done.

Mr. Morris said he would like to make one other point that perhaps had not been spelled out sufficiently in the directive committee's report. He believed that, while the Manager should be expected to achieve the reserve target given him within a reasonable tolerance, he should not be expected to rigidly follow some specified weekly path without regard to the consequences for short-term interest rates. Rather, he should be expected to achieve the reserve objective in a way that would minimize the effects on interest rates. He had great confidence in the ability of the Manager and the staff at the Desk to carry out such an instruction. No doubt the Desk would have to go through a learning process; that was one reason for his (Mr. Morris') suggestion that the band for the Federal funds rate be narrower than 200 basis

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points at the outset. Under such a procedure he thought some of the fears others had expressed about the possible consequences of a reserve handle for interest rates would not be warranted.

Mr. Robertson expressed the view that the Committee would have made the mistake of 1968 no matter what handle it had been using, and that it undoubtedly would make other mistakes in the future whatever decision it reached today. The purpose of the present exercise, as he understood it, was for the Committee to find some better way of reaching its goals. While the nineteen Board members and Reserve Bank Presidents sitting around the table might express nineteen different views on the subject, all would no doubt agree that there was at least some validity to the case for using each of the kinds of targets that had been mentioned--reserves, money market conditions, and monetary aggregates. It seemed to him, therefore, that the real question concerned the weight that should be given to each. His own feeling, reflecting his experience during 20 years of service on the Committee, was that reserves should be given the largest weight--about 50 per cent. It might well be that nonborrowed reserves represented a better handle than total reserves; he did not attach much importance to the choice. Secondly, he thought conditions in money markets should be as orderly as possible--certainly, no one wanted disorderly markets--and he would give money market conditions a weight of 30 per cent. Third, he

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would assign the remaining 20 per cent of the weight to the whole basket of monetary aggregates, taken together.

At the same time as the Desk was operating under such a weighting scheme, Mr. Robertson continued, he would want it to keep an eye on the effects its operations were having on market psychology and expectations. If the market was reacting in undesirable ways because it was misreading the Committee's intentions, a review of operations would be in order.

Under such an approach, Mr. Robertson observed, the Committee would be giving main weight to reserves, in effect continuing on the course on which it had launched at its January 11 meeting. At the same time, it would not be ignoring either of the types of measures it had previously employed for target purposes--money market conditions or monetary aggregates.

Chairman Burns noted that a number of speakers had expressed fairly strong views on the subject of handles--some favoring emphasis on reserves and others favoring emphasis on money market conditions. It was clear, however, that whether one considered all nineteen participants in the go-around or Committee members alone, a majority favored placing greater, although by no means exclusive, emphasis on reserves.

In light of that sentiment, the Chairman continued, he would outline a specific proposal which the Committee might find workable. As the members knew, the second paragraph of the

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directives adopted at the two preceding meetings had followed a pattern originally suggested by Mr. Daane, under which the Committee had called for achievement of bank reserve and money market conditions geared to its monetary objectives. He believed that a majority of the Committee would agree that a directive of that general nature--without special emphasis on either reserves or money market conditions--could prove serviceable for at least a number of months.

As to the interpretation of such language, Chairman Burns observed, he would suggest first that the Manager be instructed to achieve growth in reserves not at some specific rate--as recommended by the directive committee--but rather at a rate within a certain range, which could be fairly broad. Secondly, there should be some constraint on the range of fluctuation in the Federal funds rate. He thought a majority of the members would favor a narrower band than the 200 basis points that had been recommended. The desirable range might be described as wide enough to allow significant changes in the supply of reserves but not so wide as to lead to disturbance in markets.

As a number of speakers had emphasized, the Chairman continued, it was important to maintain orderly market conditions. Accordingly, as the third point he would suggest that in aiming for reserve growth within the desired range, the Manager would be expected to move the Federal funds rate in an orderly way

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within specified limits. In other words, the funds rate would not be allowed to bounce around unchecked between its upper and lower limits.

Fourth, the Chairman said, a number of speakers had observed that it was important not to lose sight of whatever monetary objectives the Committee had adopted for the purpose of serving its fundamental objectives for the economy. The Manager would have in view projections representing the staff's best judgment of the growth rates in M_1 , M_2 , and the bank credit proxy that were likely to be associated with the Committee's reserve target and Federal funds constraints. If the Manager found that the monetary aggregates were deviating from expectations to a significant degree, he would make some allowance for that fact in his operations. Finally, if the Manager found that he could not achieve the Committee's various objectives within the stated constraints, he would promptly notify the Chairman, who would then decide whether the situation was sufficiently serious to call for special Committee action to give new or supplementary instructions.

In his judgment, the Chairman observed, the procedure he had outlined was an intermediate one which fell far short of that recommended by the directive committee but went much further in the direction of a reserve handle than some members would prefer. He asked whether the members believed they could live with that procedure for at least a few months.

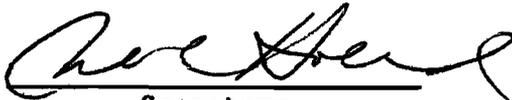
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No members responded in the negative.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, February 15, 1972, at 9:30 a.m.

Thereupon the meeting adjourned.


Secretary