

MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held on Tuesday, October 2, 1973, at 11:00 a.m. at the call of Mr. Mitchell, acting as Chairman in the absence of Chairman Burns and Vice Chairman Hayes. The latter, who had returned to the country in the afternoon of October 1, served as Acting Chairman during the meeting. This was a telephone conference meeting, and each individual was in Washington, D. C., except as otherwise indicated in parentheses in the following list of those participating

PARTICIPATING: Mr. Hayes, Acting Chairman (New York)
Mr. Balles (San Francis
Mr. Brimmer
Mr. Bucher
Mr. Daane
Mr. Francis (St. Louis)
Mr. Holland
Mr. Mayo (Chicago)
Mr. Mitchell
Mr. Morris (Boston)
Mr. Sheehan

Mr. Broida, Secretary
Messrs. Altmann and Bernard,
Assistant Secretaries
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance
Messrs. Andersen (St. Louis), Scheld
(Chicago), and Sims (San Francisco)
Associate Economists
Mr. Holmes, Manager, System Open
Market Account (New York)
Mr. Coombs, Special Manager, System
Open Market Account (New York)
Mr. Sternlight, Deputy Manager,
System Open Market Account
(New York)

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Mr. Melnicoff, Deputy Executive Director,
Board of Governors
Mr. Feldberg, Secretary to the Board
of Governors
Mr. Coyne, Assistant to the Board
of Governors
Messrs. Keir and Pierce, Advisers,
Division of Research and Statistics,
Board of Governors
Mr. Gemmill; Adviser, Division of
International Finance, Board of
Governors
Mr. Struble, Senior Economist, Division
of Research and Statistics, Board
of Governors
Miss Pruitt, Economist, Office of the
Secretary, Board of Governors
Mrs. Ferrell, Open Market Secretariat
Assistant, Office of the Secretary,
Board of Governors

Mr. Baughman, First Vice President,
Federal Reserve Bank of Chicago (Chicago)
Mr. Anderson, Assistant Vice President,
Federal Reserve Bank of Boston (Boston)

Vice Chairman Hayes noted that this meeting had been called for the purpose of considering supplementary instructions to the System Account Manager in light of certain significant inconsistencies that had developed among various elements of the instructions the Committee had agreed upon at its meeting on September 18.

Secretary's Note: On Monday, October 1, 1973, the Secretary had transmitted the following message to members of the Committee (to President-members by telegram):

"As you know, the Committee agreed at September 18 meeting that, to facilitate attainment of specifications for aggregates decided upon, the Desk (beginning in the following week) should initially aim at reserve conditions consistent with a Federal funds rate of about 10-1/2 per cent. However, in view of sharp market rally that began shortly after Committee meeting, and against background of instruction in policy directive to take account of domestic financial market developments, Desk did not wish to be over-aggressive in pursuit of this objective and average Federal funds rate has remained around 10-3/4 to 10-7/8 per cent.

"Since the Committee meeting short-term market interest rates (other than funds rate) have dropped about 1 to 1-3/4 percentage points and long-term market rates have continued to decline. At the same time, the monetary aggregates have weakened and all of the key aggregates are now projected to be below the September-October ranges of tolerance adopted by the Committee.

"System Account Manager has notified Acting Chairman Mitchell that significant inconsistencies have developed among various elements of Committee's instructions, and the Acting Chairman has called a telephone conference meeting of the Committee for 11:00 a.m. EDT, October 2, 1973, to consider supplementary instructions.

"Among the possible alternatives are the following:

"1. So long as market conditions do not become disorderly and aggregates remain at or below lower ends of ranges adopted, to provide reserves at a rate considered likely to be consistent with a progressive reduction of the funds rate within the 9-3/4 to 10-3/4 per cent range adopted on September 18.

"2. To undertake reserve supplying operations consistent with an average Federal funds rate of about 10-1/2 per cent until instructed otherwise, unless such action threatens to reinvigorate the recent sharp market rally.

"3. To undertake no reserve supplying actions that would tend to confirm inferences by market participants that the sharply lower levels of short- and long-term rates are an objective of policy, even if one consequence is a Federal funds rate averaging at or slightly above the 10-3/4 per cent level. If this third alternative is chosen, upper end of funds rate range of tolerance might be raised to 11 per cent."

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Vice Chairman Hayes suggested that the meeting begin with a report from the Manager on System operations and market developments since the September 18 meeting of the Committee.

Mr. Holmes presented the following statement:

Over the period since the Committee last met, short-term interest rates have plummeted--the 3-month bill rate by over 175 basis points--as the sensitive financial markets became convinced that the System had relaxed its policy of restraint a bit and that the peak of interest rates in all maturity areas had been passed. At the same time, growth rates in the monetary aggregates and RPD's appear to be below the lower end of the ranges of tolerance specified by the Committee at the meeting.

Following the meeting, in accordance with the Committee's basic policy decision, the Desk planned to become somewhat less restrictive in the supply of reserves, anticipating that the Federal funds rate would edge off to about 10-1/2 per cent last week. As you know, the funds rate has continued, on average, to run above the desired level, despite a rather substantial supply of reserves to the banking system. Apart from the usual technical reasons that sometimes make it difficult to control the Federal funds rate precisely--i.e., commercial bank problems in managing their reserve accounts, a \$600 million shortfall in float over the past weekend, and a \$1.3 billion shortfall from reserve projections yesterday--banks appear to be placing greater emphasis on Federal funds purchases rather than on alternative sources of funds. Once the decline in short rates got under way, banks became reluctant to commit themselves to relatively high rates on even 90-day CD's and this tended to increase rate pressure on the overnight Federal funds market.

The extremely sensitive state of market expectations is illustrated, I believe, by the sharp decline in other market rates despite the fact that the weekly average Federal funds rate hit a record high last week, primarily reflecting an extremely tight funds market last Wednesday. As usual, the market may have overreacted, and it would not be surprising to see some short rates back up slightly even if we get the Federal funds rate down to the

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10-1/2 per cent level. Pushing persistently down towards the lower end of the 9-3/4 to 10-3/4 per cent range of tolerance would, I believe, set off another wave of market speculation and a renewed decline in the general level of interest rates.

This morning we have had a fair backup in short-term rates, with the 3-month Treasury bill quoted at 7.40 per cent, compared with the 7.15 per cent established in yesterday's auction. Yesterday we supplied the market with \$1.5 billion in reserves only to see \$1.3 billion of that amount offset by a shortfall from yesterday's reserve projections. Today the Federal funds rate opened at 10-3/4 per cent--higher than we have been seeking--but it has been tending to ease off slightly. We had been prepared to make 2-day RP's, but have not taken any action as yet since there is the possibility that the rate may come down on its own. We are buying about \$50 million of Treasury bills directly from foreign accounts.

Mr. Daane noted that the second of the three alternatives described in the Secretary's wire called for reserve-supplying operations consistent with a 10-1/2 per cent funds rate unless such operations threatened to reinvigorate the recent sharp market rally. He asked how the Manager appraised the chances of achieving a 10-1/2 per cent funds rate without reinvigorating the rally.

Mr. Holmes expressed the view that the chances were good. There had been some backup in short-term rates this morning, and he suspected that market rates would be generally stable at about their prevailing levels if the reduction in the funds rate could be carried out smoothly, without overshooting, to a level below 10-1/2 per cent.

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Mr. Mayo commented that, in view of the discussion at the September Committee meeting, he had expected the Desk to undertake some probing action, at least by not resisting any tendencies for the Federal funds rate to decline to 10-1/2 per cent. He asked whether the difficulty arose because the rate had not shown any tendency to fall.

Mr. Holmes replied that the Desk had not awaited such tendencies; it had tried to encourage the desired decline, but without success. Yesterday, for example, the System had supplied \$1.5 billion in reserves in an effort to move the funds rate down from its prevailing level of 10-7/8 per cent, but the System's action had been almost fully offset by a shortfall in float and an unexpectedly high level of the Treasury balance.

Mr. Mitchell noted that the apparent preference of banks for raising funds in the Federal funds market rather than through sales of CD's seemed to be a major contributor to upward pressure on the funds rate. He asked how long such a preference might be expected to continue.

Mr. Holmes said he thought it would be a short-run phenomenon, lasting perhaps another week or so.

Mr. Francis commented that the recent increase in marginal reserve requirements on large-denomination CD's probably had also tended to encourage banks to substitute Federal funds for CD's.

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In reply to a question from Mr. Morris, Mr. Holmes said he believed the market had already discounted a decline in the funds rate to 10-1/2 per cent. As he had indicated earlier, he suspected that such a funds rate would prove consistent with a level of bill rates above their recent lows.

Mr. Balles asked Mr. Holmes to elaborate on his view that a decline in the funds rate to 9-3/4 per cent--that is, to the lower end of the range specified by the Committee at its last meeting--would set off a new wave of speculation and a renewed general decline in interest rates.

Mr. Holmes noted that the sharp downward adjustment in short-term rates since the last Committee meeting had occurred without any accompanying reduction in the Federal funds rate, so market participants were still uncertain about the degree of easing in System policy. In his judgment, a pronounced decline in the Federal funds rate now would be interpreted by the market as a strong indication that monetary restraint was being relaxed. That would affect market rates generally, and it might result in a greater reduction in long-term rates than had occurred during the recent rally.

Vice Chairman Hayes then asked Mr. Axilrod to comment on the implications of recent interest rate developments for the behavior of the monetary aggregates.

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Mr. Axilrod observed that the recent sharp drop in short-term interest rates could be described as a market easing, even though the Federal funds rate had remained at record levels. Since analysis suggested that the growth rate of money responded to changes in short-term rates in general and not just to changes in the Federal funds rate, the question naturally arose as to whether the decline which had occurred in short-term rates should not lead the staff to raise its projections of the monetary aggregates. By way of background, he might note that, as indicated in the blue book prepared for the September meeting, a funds rate of about 10-3/4 per cent was likely to be consistent with growth in M_1 at an annual rate of about 3 per cent in the 6-month period covering the fourth quarter of 1973 and the first quarter of 1974. In September the Committee adopted a target of 4-1/2 per cent for the growth rate in M_1 over that period, recognizing that such growth was likely to be consistent with a decline in interest rates.

It was the consensus of the staff, Mr. Axilrod continued, that if the funds rate remained around 10-3/4 per cent over the next few months short-term market rates would rebound, and apparently that adjustment had begun today. However, the staff would not expect rates to snap back all the way to their previous

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peaks; and even if they did, there would have been an interim period of easing. According to the various econometric models and judgmental analyses, the effect of the interim easing on growth in the monetary aggregates would be relatively minor, adding perhaps one-half of a percentage point to the annual growth rate over the 6-month period. Thus, taking into account both the drop in short-term market rates that had occurred and the expectation of some back-up, the staff would expect a continuation of current money market conditions to be associated with a longer-run growth rate of M_1 on the order of 3-1/2 per cent, which would still be well below the Committee's 4-1/2 per cent target. No significant effect would be expected on the growth rates of the aggregates in the near term--that is, on the rates over the September-October period.

Vice Chairman Hayes asked Mr. Partee to comment on the relation to the economic outlook of the recent decline in interest rates.

Mr. Partee said it occurred to an economist when he observed a large and unexpected drop in interest rates--particularly when accompanied by low growth in the aggregates--that that might be indicating something about the state of the economy. After reviewing the evidence, however, he saw nothing that would suggest a major change in the staff outlook as previously

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presented to the Committee. Plant and equipment expenditures and net exports should be strong for quite some time to come; housing and consumer spending--especially for durables--were expected to be soft; and inventory investment should strengthen, at least for a time, as stocks were rebuilt. Thus, it seemed quite likely to him that interest rates would back up later in the fall, and that the aggregates would begin to grow more vigorously again in keeping with the nominal GNP.

At the same time, Mr. Partee continued, it was important to recognize that real growth in the economy had slowed and that the outlook was for continued slow growth. Recognition of that fact had undoubtedly spurred the recent market rally, and at this time a somewhat easier monetary stance than was appropriate during the spring and summer might be called for. Given the clear prospect that excessive economic expansion was now in the past, it was difficult to defend a policy which continued to impose maximum restraint on both interest rates and monetary aggregates.

Therefore, Mr. Partee said, it would seem appropriate to him to back off a bit from the System's extremely tight monetary posture, as the Committee had decided at the last meeting. He would recommend a move to reduce the funds rate to the 10-1/2 per cent area, but he would avoid going appreciably below that level until it was possible to review the economic situation in

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depth and reassess the outlook for the aggregates. In light of the speculative attitude about the future course of System policy and interest rates which had underlain the recent rally in the securities markets, it would be preferable to avoid the appearance of any marked easing in policy. He would recommend a stance consistent with alternative 2 at this juncture.

Mr. Hayes asked whether the evident slowdown in real economic growth was not primarily due to capacity constraints and shortages rather than to a slackening in demand.

In response, Mr. Partee observed that the picture was mixed. Supply constraints were very real in many basic industries and some fabricating industries, but at the same time there were some indications of slackening demand. Construction was slowing, manufacturing employment had shown very little growth in recent months, and average weekly hours had declined somewhat. While it was obvious that growth in real GNP could not have continued at anything like the 8 per cent rate of the first quarter, he did not see any indication of supply pressures developing that would suppress real growth markedly below the 4 per cent rate or so that the economy had recently been experiencing. All available evidence tended to support the view that the slowing reflected mainly a moderation of demands.

Mr. Hayes expressed concern about the outlook for prices and asked Mr. Partee if he also considered that outlook highly unfavorable.

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Mr. Partee responded affirmatively. While food prices might come down somewhat or stabilize following their extraordinary increase, he thought that the pace of advance in wage rates would increase in late 1973 and in 1974, and that productivity growth would be small. As a consequence, he expected considerable increases in unit labor costs.

Mr. Morris remarked that he found it hard to reconcile Mr. Partee's view that the Committee had made the right decision at its last meeting with his opinion that a decline of more than one-quarter of a point in the funds rate could undo the monetary restraint already put in train.

In response, Mr. Partee said he had not meant to imply that he concurred in all aspects of the Committee's decision at its last meeting--at which he had not been present--but only that he agreed that the economy was now at the point where there could be a little easing. The precise dimension of that easing would have to be determined in forthcoming meetings of the Committee. He was not greatly concerned about temporarily low growth rates for the monetary aggregates because they were the natural consequence of actions the Committee had taken. If very low growth rates persisted, however, it would be necessary to become increasingly active to bring about reasonable growth again. Growth rates in the aggregates were highly variable from month to month, and he would not be surprised if the kind of spurt in M_1 that had often occurred in the past were to develop some time this fall.

Mr. Daane remarked that it would be useful to have the views of the Special Manager on the international implications of recent and prospective interest rate developments in the United States.

In response, Mr. Coombs said the recent decline of domestic short-term rates had received a great deal of attention abroad, and foreign observers apparently had concluded that the System had either taken the first step toward monetary ease or was on the verge of doing so. Understandably, exchange market participants were worried about the possibility of a pronounced change in stance which would cause interest rate differentials to widen and could seriously dampen what they hoped was a developing recovery of the dollar. In his judgment, there might already have been marginal effects of that kind.

Mr. Brimmer asked what the effect would be on the Federal funds rate and on short-term rates generally if the Manager were instructed to resist any tendency for the funds rate to rise but otherwise to remain passive rather than to probe actively in an effort to move the rate down into the neighborhood of 10-1/2 per cent over the next week or two.

In reply, Mr. Holmes said the reserve outlook suggested that the funds rate would be under upward pressure, particularly over the next week. Accordingly, given such an instruction the Desk probably would be working to keep the rate at the current 10-3/4 or 10-7/8 per cent level. Maintaining the funds rate

at that level probably would reinforce the tendency for other short-term rates to back up a bit, but not necessarily to their previous peaks.

Mr. Brimmer then asked about the probability of an overshoot below the 10-1/2 per cent if the Desk moved actively to reduce the funds rate to that level in the immediate future.

Mr. Holmes estimated that the chances of overshooting were 50-50. If current reserve projections proved correct, the Desk would be supplying reserves next week, and he suspected that the 10-1/2 per cent level could be reached without too much difficulty. He added that recent reserve-supplying operations had been large but not overly aggressive.

Mr. Balles asked about the latest projections of M_1 for October and November.

In reply Mr. Axilrod said that, on the basis of firm figures through September 19 and partial figures through September 26, it appeared that M_1 would decline at a 2.7 per cent annual rate in September. M_1 was now expected to rise in October at a rate of about 1-1/2 per cent. Those figures would imply a decline at an annual rate of slightly more than 1/2 per cent for the 2-month period, below the 0 to 4 per cent range of tolerance the Committee had specified for that period. The staff expected M_1 to increase modestly in both November and

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December and to grow over the fourth quarter as a whole at an annual rate of about 2-1/2 per cent, or perhaps a shade higher. These projections were based on an assumption that the Federal funds rate would remain at about its current level.

In reply to a question by Mr. Balles, Mr. Axilrod said that third-quarter growth in M_1 was now estimated at a 0.3 per cent annual rate, measured from the June to the September level, and at a 5 per cent rate, measured from the average level of the second quarter to that of the third quarter.

Vice Chairman Hayes noted that while he had been abroad during the past few weeks he had had conversations with bankers, businessmen, and newspapermen, both American and foreign, which tended to confirm the view Mr. Coombs had expressed earlier. In particular, the recent drop in short-term rates--and to some extent in long-term rates--seemed to dominate their thinking about U.S. monetary policy. Generally speaking, they believed that the System had embarked or was about to embark on a major change in policy. He questioned whether it was desirable for that impression to prevail at a time when inflation still appeared to be the most critical economic problem, and he would be reluctant to act in such a way as to confirm that view.

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The Vice Chairman then called for comments on the appropriate course for policy at this point, beginning with Mr. Mitchell.

Mr. Mitchell noted that the existence of inconsistencies in the Committee's instructions had been apparent for several days. He had considered the desirability of having a meeting of the Committee in Washington, but after discussing the matter with other Board members he had concluded that it would be best to deal with the immediate problem by this telephone conference. A decision could be made later, in light of the developments over the next several days, as to whether the Committee should hold another special meeting next week or wait until the regularly scheduled meeting on October 16.

Mr. Mitchell added that late yesterday, at about the time the message calling this meeting was dispatched, he talked by telephone with Chairman Burns, who was in South Africa. Messrs. Partee and Axilrod, who also participated in the conversation, provided summary reports on the economic and financial situation and he (Mr. Mitchell) read the text of the message being sent to the Committee. After a rather extended discussion, Chairman Burns expressed the opinion that the second of the three alternatives described in the message offered the most satisfactory solution to the problem at the moment and would not prejudice decisions to be taken by the Committee in the future.

Mr. Mitchell remarked that he also favored alternative 2. He expected that there would be a diversity of views today, and he thought it might be well for the members to allow for the possibility that another meeting would be held next week.

Mr. Morris said he preferred alternative 1 which, in his view, was consistent with the instructions the Committee had agreed upon at its September 18 meeting. He thought that current market expectations were based on a belief, reinforced by statements of the Chairman and other System officials, that the Federal Reserve would avoid fostering financial conditions that would produce a recession in 1974. Market participants, observing the recent contraction of M_1 , had concluded that the System would supply more reserves and thus put downward pressure on the Federal funds rate. He believed that the Committee should not destroy that expectation, and he saw nothing to be gained by waiting a week or two before permitting the funds rate to decline. As for the possible impact of a lower funds rate on the balance of payments, he felt that it would be short-sighted to focus on immediate effects only. To keep short-term interest rates from declining now would be to generate conditions that would require a much greater decline in early 1974, and consequently more serious balance of payments problems at that time.

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Mr. Balles agreed with Mr. Morris that the Committee should not attempt to offset the effects of current market expectations. He thought that, among other things, market participants were discounting a slowdown in real economic growth of the kind projected by the Board staff and generally anticipated in business and financial circles. If the System tried to resist rate declines induced by market expectations, it was quite likely to undershoot its longer-run targets for the monetary aggregates and to incur some risk of turning an economic slowdown into an actual recession. For such reasons, as well as those expressed by Mr. Morris, he favored alternative 1.

Mr. Mayo said that while he agreed in principle with Messrs. Morris and Balles, he personally did not consider alternatives 1 and 2 to be mutually exclusive. The Committee could instruct the Manager to seek the 10-1/2 per cent funds rate mentioned in alternative 2 over the next 3 or 4 days, and plan on reducing the target to 10-1/4 per cent in the following week unless circumstances changed. In effect, then, alternative 2 would serve as specific guidance for the short run within the general philosophy underlying alternative 1. He would not be deeply disturbed if the funds rate turned out to be 10-1/4

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rather than 10-1/2 per cent this week. At the same time, he would not want the Manager to feel that he had to reduce the rate immediately to 9-3/4 per cent simply because the Committee had decided to seek somewhat easier market conditions.

Mr. Daane said he had heard nothing this morning to suggest significant changes in prior views on the economic outlook, the seriousness of the inflation problem, or the international situation. Market developments since the previous meeting had served to bear out his belief that expectational factors were of particular importance at this time. For that reason he would be concerned about the possible consequences even of alternative 2, since overt actions to reduce the funds rate to 10-1/2 per cent could be interpreted by the market and the world at large as an easing of policy. While he could accept alternative 2, he would be happier if it were modified to call for passive acceptance of any tendency for the funds rate to decline to 10-1/2 per cent rather than for overt actions to that end.

Mr. Daane offered two further observations. First, just as the Committee had been accused in the past of money market myopia, there was now a tendency within its ranks towards myopia with respect to short-run movements in the monetary aggregates. He did not believe there would be any significant difference in

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the growth rates of the aggregates if the funds rate during the next week or two were 10-1/2 rather than 10-5/8 or 10-3/4 per cent.

Secondly, Mr. Daane continued, he felt that the Committee could not ignore international considerations at this time. He agreed with the Special Manager's view that widening interest rate differentials might pose a threat to the incipient recovery of the dollar, and during his recent trip abroad he had encountered reactions to the recent changes in domestic interest rates similar to those Mr. Hayes had described. In contrast to Mr. Morris, he believed that the adverse effects of domestic interest rate declines on the U.S. balance of payments would be much smaller in early 1974 than now because the U.S. payments position was likely to be much stronger then. At present, when the position of the dollar in foreign exchange markets was still far from secure and interest rates abroad were under upward pressure, a decline in domestic rates would be particularly undesirable. In his view international considerations alone offered grounds for avoiding overt easing of money market conditions.

Mr. Brimmer observed that the Committee's task today was to resolve the inconsistencies that had developed in the instructions it had issued at its September 18 meeting. Although

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he had not been present at that meeting, he understood that the Committee had sought to achieve only a slight easing in interest rates and had not intended to make a basic change in the stance of monetary policy. He felt that the wisdom of avoiding an appreciable change in policy at this time had been confirmed by the evidence on economic and financial conditions presented by the staff this morning.

As he interpreted the present situation, Mr. Brimmer continued, market expectations were outrunning the Committee's intentions. In his judgment, the Committee could implement its September decision in an orderly fashion by adopting alternative 2 today. Although he was inclined toward the approach Mr. Daane had suggested, he thought the need to supply reserves noted by the Manager would make it impractical for the Desk to adopt a passive stance at this time.

Mr. Brimmer said he would want the Desk to exercise a good deal of caution in moving toward a Federal funds rate of 10-1/2 per cent. He would not want the funds rate to fall substantially below 10-1/2 per cent over the next week or two because he feared that the cumulative consequences of rate declines could undermine the monetary restraint in train. He agreed that the Committee should give some weight to balance of payments considerations at this time, as it did customarily.

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In sum, Mr. Brimmer said, he favored adopting alternative 2 as a short-run measure. The Committee could review its decision in the near future, giving more weight to the growth of the aggregates if that appeared desirable.

Mr. Sheehan remarked that in its discussion today the members had been focusing on the Federal funds rate and not giving the monetary aggregates the kind of attention anticipated under the experiment the Committee had launched in February 1972. According to the latest staff estimates, the September-October growth rates for all of the aggregates were below the ranges the Committee had agreed upon at its September meeting. M_1 was showing virtually no growth over the third quarter and--accepting current projections for November and December--it would expand at only about a 1-1/2 per cent rate over the second half of 1973. If such a low growth rate persisted for long it might well lead to a recession.

Mr. Sheehan observed that at its September meeting the Committee had not decided to maintain the funds rate at 10-1/2 per cent for the following 4 weeks. According to his recollection, the Committee had decided (1) that the Desk should avoid probing actions during the first few days following the meeting; (2) that it should aim for a Federal funds rate of 10-1/2 per cent in the following week; and (3) that it should make subsequent operating

decisions according to the procedures in effect for the past 18 months--namely, permitting the funds rate to vary within a specified range of tolerance while attempting to achieve growth rates for the aggregates within ranges specified for them.

Mr. Sheehan said he favored alternative 1. The adoption of that alternative would not necessarily mean that the Desk would have to press the funds rate down to the lower limit of the 9-3/4 to 10-3/4 per cent range the Committee had set on September 18; it could be consistent with a funds rate at 10-1/4 per cent, the midpoint of the range. Such an outcome would be quite satisfactory to him.

In a concluding observation, Mr. Sheehan said a decision to permit some easing in money market conditions should not be equated with a decision to completely reverse the course of policy. At the September meeting the Committee had agreed to back off slightly from a very tight posture, not to move to so easy a posture as to stimulate inflationary forces.

Mr. Bucher said he would associate himself with the views expressed by Messrs. Sheehan, Morris, and Balles. While he agreed with Mr. Mayo that alternatives 1 and 2 were not mutually exclusive, he would be concerned about adopting alternative 2 because of the possibility that the Committee

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would not be prepared to take the next step and let the funds rate decline further if other conditions suggested that that was desirable. Accordingly, he supported alternative 1.

Mr. Bucher observed that he wanted to continue giving the monetary aggregates the weight they had been receiving for some time. Money market rates had been permitted to increase when the Committee was concerned about excessive growth in the aggregates, and while he had occasionally resisted specific decisions of that kind, he saw no reason for not pursuing a generally symmetrical policy and permitting interest rates to decline when the aggregate growth rates were obviously too low. The degree of monetary restraint now in place was considerable, and he was concerned about the possible effects of that restraint on the economy next year. Finally, he was not greatly concerned about possible market reactions; as he had indicated at the September meeting, he would not want to permit the market, in effect, to tell the Committee how to manage monetary policy.

Mr. Holland said he agreed that some gradual movement toward a less restrictive monetary policy would be prudent at this time, in view of the evidence of a transition in the economy and of slowing in all of the key aggregates--including M_1 , M_2 , M_3 , and the bank credit proxy. Such a move would be desirable not only to deal with the immediate problem but also to establish a better policy stance for the somewhat longer run.

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While he wanted to get the aggregates growing again, Mr. Holland continued, he was aware that their growth rates responded not just to the Federal funds rate but to the whole family of money market rates that influenced the behavior of banks and their customers. The Committee had been using the funds rate as a surrogate for that larger family, and it was necessary to avoid "Federal funds myopia" at times when the changes in that rate differed from those of other money market rates. In his judgment, other money market rates were now moving enough to begin to generate growth in the aggregates, given the usual time lags, and he was reasonably satisfied with the situation. However, it was important to avoid a sharp change in money market conditions that would reverse the recent rally and wipe out most of the declines in rates. That would be counterproductive not only in terms of expectations but also from the point of view of the desirable posture for policy over coming months.

Against that background of thinking, Mr. Holland remarked, he could support alternative 2 today. He would add, however, that if money market rates other than the funds rate were to back up substantially in the period before the meeting scheduled for October 16, he would hope the members would consult again--by telegram, in a telephone conference,

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or in a Washington meeting--about the desirability of permitting the funds rate to decline below 10-1/2 per cent, in order to preserve the spirit of the policy course decided upon at the September 18 meeting.

Mr. Francis associated himself with those who had expressed support for alternative 1. He remarked that the Committee found itself now, at the half-way point between the September 18 and October 16 meetings, in a situation where the growth rates in the monetary aggregates were below, and the Federal funds rate was above, the ranges agreed upon at the September meeting. It seemed to him that the appropriate course was to supply sufficient reserves to get the aggregate growth rates back within the target ranges. He was not concerned about the effect on the funds rate.

Vice Chairman Hayes stated that his own position was similar to that of Messrs. Daane and Brimmer. He felt that it would be dangerous to confirm the widespread market expectations of a System move to a substantially easier position. He agreed with Mr. Holland that the Committee should take into account the substantial drop in the general level of interest rates that had already occurred and the implications those rate declines had for the future behavior of the aggregates. He gathered from Mr. Holmes' comments that while there might

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be some backup in rates, it was unlikely that they would return to their peak levels. He would support alternative 2, although his philosophical bent inclined him toward alternative 3.

Vice Chairman Hayes then remarked that the differences of view among the Committee members were more pronounced today than usual. It seemed to him that a slight majority favored alternative 2.

After some further discussion, it was suggested that the members be polled on their preferences. The poll indicated that six members (Vice Chairman Hayes and Messrs. Daane, Holland, Mayo, Mitchell, and Brimmer) favored alternative 2 and five members (Messrs. Balles, Bucher, Francis, Morris, and Sheehan) favored alternative 1. In expressing their preference for alternative 2, Messrs. Holland, Mayo, and Mitchell indicated that they intended the instruction contained in that alternative to apply only for the next several days.

Vice Chairman Hayes remarked that it was always understood that the Committee would consult about open market operations outside of regularly scheduled meetings if circumstances so required. It was likely that another telephone conference, or perhaps a meeting in Washington, would be called for early next week, if a number of members believed then that further consultation was desirable.

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Mr. Mitchell remarked that more evidence would be available later this week on the behavior of the market and on growth rates in the aggregates. A final decision regarding the need for further consultation might be deferred until that evidence was in hand. It also would be desirable to review the question with Chairman Burns, who was expected to arrive in Washington over the weekend.

A discussion then ensued of the way in which today's meeting would be reflected in the FOMC policy record. In the course of the discussion Mr. Daane noted that more general deliberations on the manner in which the Committee's decisions should be recorded in the policy record were contemplated for an early date, and that it would be undesirable at this time to prejudge the outcome of those deliberations.

Thereupon the meeting adjourned.


Arthur L. Suroda
Secretary