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 Tuesday, November 19, 1974, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Black
Mr. Bucher
Mr. Clay
Mr. Coldwell
Mr. Holland
Mr. Kimbrel
Mr. Mitchell
Mr. Sheehan
Mr. Wallich
Mr. Winn

Messrs. MacLaury, Mayo, and Morris, Alternate Members of the Federal Open Market Committee

Messrs. Balles, Eastburn, and Francis, Presidents of the Federal Reserve Banks of San Francisco, Philadelphia, and St. Louis, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Guy, Deputy General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Brandt, Doll, Hocter, Parthemos, and Reynolds, Associate Economists

Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Coyne, Assistant to the Board of Governors
Mr. Wonnacott, Associate Director, Division of International Finance, Board of Governors
Mr. Keir, Adviser, Division of Research and Statistics, Board of Governors
Miss Pruitt, Economist, Open Market Secretariat, Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant, Board of Governors

Mr. Plant, First Vice President, Federal Reserve Bank of Dallas
Messrs. Eisenmenger, Boehne, and Scheld, Senior Vice Presidents, Federal Reserve Banks of Boston, Philadelphia, and Chicago, respectively
Mr. Garvy, Vice President and Senior Adviser, Federal Reserve Bank of New York
Messrs. Jordan and Green, Vice Presidents, Federal Reserve Banks of St. Louis and Dallas, respectively
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Keran, Director of Research, Federal Reserve Bank of San Francisco
Mr. Cooper, Assistant Vice President, Federal Reserve Bank of New York

Chairman Burns observed that there would be a luncheon today for George Garvy, who was retiring shortly from the Federal Reserve Bank of New York, and that dedication ceremonies would be held in mid-afternoon for the Board's new building, named for former

Chairman William McChesney Martin, Jr. Depending on when the Committee completed its deliberations, it might be necessary to recess the meeting at one or both points and reconvene afterwards.

Chairman Burns noted that he would not be able to be present at the luncheon for Mr. Garvy and would accordingly say a few words about him now. The Chairman then spoke of his long-standing personal association with Mr. Garvy, originally as a teacher and subsequently as a friend and colleague, and of Mr. Garvy's many professional contributions.

> By unanimous vote, the action by Committee members on November 11, 1974, increasing from $500 million to $1 billion the limit (specified in paragraph 1(b) of the Authorization for Domestic Open Market Operations) on holdings of bankers' acceptances by the Federal Reserve Bank of New York, pending further review at the next FOMC meeting, was ratified.

Mr. Holmes said he would recommend retention of the $1 billion limit on holdings of bankers' acceptances, for two reasons. First, the reaction in the acceptance market to the cessation of System guarantees of acceptances purchased for foreign official accounts had not yet run its course. A fair amount of System buying--consistent, of course, with reserve needs--could be most helpful in maintaining orderly conditions in that market during the transition period. Secondly, the higher $1 billion limit would fit in well with longer-term needs to supply reserves, affording the System a more diversified approach and guarding against the possibility of a recurrence of a shortage of Treasury issues such as occurred last summer.

Mr. Holmes added that if the Committee agreed to retain the $1 billion limit it would be desirable to issue an announcement of the action within a few days.

It was agreed that the $1 billion limit on holdings of bankers' acceptances should be retained.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on October 15, 1974, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on October 15, 1974, was accepted.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period October 15 through November 13, 1974, and a supplemental report covering the period November 14 through 18, 1974. Copies of these reports have been placed in the files of the Committee.

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

> Since the last meeting of the Committee we have seen a progressive deterioration of sentiment in the exchange markets and the emergence of thoroughly disorderly conditions. Two factors noted at the last meeting have continued to depress the dollar. First, European interest rates have been lagging behind declining rates here, and so tending to attract interest-sensitive funds. Second, there have been further indications of diversification of Arab oil money, in part, I think, reflecting the new war fears in the Middle East. So far as we can tell, the other oil producers--Venezuela, Indonesia, and Nigeria--still seem to be sticking with the dollar.
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> As the dollar rate kept sliding during the period, despite intermittent intervention by the Federal Reserve, the Germans, the Dutch, and the Belgians, market traders finally got tired of taking losses on uncovered dollar positions and so selling pressure on the dollar intensified. We have seen this phenomenon three or four times over the past year or so; as a floating rate begins to sink, it tends to keep moving down on its own with no automatic corrective appearing until the rate finally has moved far out of line with underlying balance of payments considerations.
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> In this already badly troubled market situation, Swiss and German officials made public statements which worsened conditions immeasurably. You will recall that last May I negotiated with the Swiss National Bank as well as the German Federal Bank a plan for concerted intervention, with the Swiss agreeing to buy dollars on an _ad hoc_ basis

if the rate got down to about 2.80 on the Swiss franc. This intervention plan was leaked out, with the result that the dollar rebounded and no intervention was needed. In recent weeks the dollar has been moving steadily down toward the intervention point of 2.80 that was agreed upon last May. Unfortunately, in a press conference at the Swiss National Bank about two weeks ago, some serious misunderstandings emerged regarding the Bank's intentions; the press was left with the impression, which was probably not intended, that the Bank would not intervene. As a consequence of the resulting news stories, the Swiss franc immediately moved up very sharply, dragging other European currencies behind it. Over the next few days a variety of conflicting press reports left the market totally confused as to whether or not the Swiss were going to intervene, but with some hope that a new agreement on concerted intervention would be patched together by the time of the BIS meeting on the following Monday.

In talking with the press after that BIS meeting, the President of the Swiss National Bank did, in fact, indicate that the Swiss National Bank would intervene to correct disorderly conditions, and the dollar then began to recover. Unfortunately, however, this recovery was rudely interrupted last Thursday, as Chancellor Schmidt of Germany suddenly weighed in with a statement that he didn't mind seeing the mark go up because that would help relieve inflationary pressure in Germany. This statement overlooked, of course, the other side of the coin, which was that a declining dollar rate would intensify inflation here. In any event, the mark was very strongly bid up in increasingly disorderly trading. We intervened in New York until noon last Thursday, at which point the Chairman indicated to us that we should suspend further intervention until the Germans provided some clarification of Chancellor Schmidt's remarks. So we stayed out of the market on Thursday afternoon and last Friday while the dollar was hit by further successive waves of speculation.

Yesterday morning a spokesman for the German Government finally made it clear that Chancellor Schmidt had no intention of revaluing the mark or of taking any positive action to drive up the mark rate, but that the Germans naturally were interested in getting their imports as cheaply as possible, and so had no objection to the recent strengthening of the mark rate. On the basis of this statement, there were a number of telephone conversations yesterday back and forth between Federal Reserve, German, Swiss, Dutch, and Belgian officials, and around noon we moved into the market with sizable offers of each of the four currencies. The dollar immediately moved up from the exaggerated lows it had reached, closing the day with a gain of roughly 1 per cent. Our intervention came to approximately $75 million equivalent, of which $67.6 million was financed by drawings on the German, Dutch, and Belgian swap lines. The remaining $8.7 million was done in Swiss francs as agent for the Swiss National Bank, which had given us an order for as much as $25 million.

In Europe this morning the dollar held around last night's closing levels, supported by intervention totaling $100 million by the Germans, Dutch, and Belgians. For the first time since January 1973, the Swiss National Bank is now also intervening to support the dollar, in secret operations through the BIS. My guess is that the secrecy won't last too long, and that when the news comes out it will have a positive psychological effect. The Swiss National Bank has today provided us also with a small amount of Swiss francs to offer in New York. We put in offers again of these four currencies in the New York market at 9 a.m. this morning, and small amounts were taken. The market then backed away and at 9:30 the dollar had moved up by roughly 1/2 per cent over opening rates. We are hopeful that the disorderly aspects of the situation are being corrected, although the situation is still very fragile indeed. I think we have made a positive gain in that the Swiss finally decided to break with their previous policy of absolutely no intervention. That change of policy by the Swiss National Bank has the fervent support of all of its European counterparts.

I would like to mention two other matters of interest. First, the Bank of Mexico has repaid before the first maturity the entire $180 million it drew on the swap line in late August. Secondly, I was informed at the last BIS meeting by an official of the Belgian National Bank that his Government will not accept the U.S. Treasury's proposal for a 50-50 sharing of losses on repayment of the Belgian franc swap debt outstanding since 1971. This, I think, should now open the way for new negotiations with the Treasury to make a decided move to clean up that swap debt.

In response to a question by Mr. Winn, Mr. Coombs said Italy's external situation did not look good. The Italians were continuing to lose $700 million per month in exchange market intervention, and they had now used a substantial part of the $2 billion they had borrowed from the Germans. It was particularly disturbing that Swiss commercial bankers were now openly indicating that they had run off sizable amounts of short-term credits to Italy. The danger, of course, was that other banks would follow suit, and that the Italian problem of financing current requirements would be aggravated by the need to secure new official financing to replace previous commercial financing. The Italian situation was acutely dangerous. The same was true of the British situation and might soon be true of the French.

Mr. Hayes said he had received the impression from one Swiss banker that the latter's decision to back away from an unsecured Italian loan was based in part on the very fact that Germany had extended official credits to Italy on a secured basis.

Chairman Burns remarked that that seemed to be another instance of the common situation in which government credit became a substitute for private credit. In the present case, however, it was not clear how much government credit would be available for the purpose or how soon.

In reply to questions by Mr. Coldwell, Mr. Coombs said the Italians, both official and private, had found it difficult to raise new funds on the private market for some time. With respect to outstanding credits, the interbank loans generally had no security behind them, although some commercial bankers had suggested that they might try to shift current loans to a collateralized basis. Borrowings abroad by nationalized industries, of which there was a fair amount outstanding, carried a government guarantee.

Mr. Coldwell referred to Mr. Coombs' comment that the Bank of Mexico had repaid its swap drawing on the System before maturity. He asked whether that reflected a change in the Mexican situation, or whether the need the Mexican authorities had anticipated when they made the drawing did not eventuate.

In reply, Mr. Coombs expressed the view that the Mexicans had had a real need for the funds and that the drawing had been worthwhile. As a matter of fact, the Bank of Mexico had repaid the drawing in part by borrowing on other credit lines. However, he understood that there had been a marginal improvement in Mexico's current position and a considerable improvement in its outlook for the next 6 to 12 months.

> By unanimous vote, the System open market transactions in foreign currencies during the period October 15 through November 18, 1974, were approved, ratified, and confirmed.

Mr. Coombs noted that all of the System's standby swap arrangements would reach the end of their present terms in the period from December 3 through December 31, 1974. He recommended that the arrangements be renewed for further periods of up to one year if agreeable to the other parties.

In reply to a question by Chairman Burns, Mr. Coombs observed that in recent years the swap arrangements customarily had one-year terms, although occasionally one of the System's swap partners would suggest renewal for a shorter period. Last December, for example, the Belgians had indicated that they preferred to renew the swap line for only 3 months. When that maturity was reached in March, they agreed to a 9-month renewal; accordingly, the Belgian line would now mature in December, along with the others. He was not sure he understood why they had initially preferred the shorter maturity. Although he would not rule out the possibility that some central bank might now suggest a maturity of less than a full year, he had received no indications thus far that any intended to do so. In general, the Belgians and the System's other swap partners seemed anxious to have the swap lines available for use in intervention; they evidently believed that at the moment the swap network provided the only available support to the international financial system.

Mr. Holland asked whether any of the System's swap partners had proposed modifications in the terms of the swap lines.

Mr. Coombs replied that the only such proposal had come from the Swiss, who had suggested that the System's Swiss franc arrangement with the Swiss National Bank include provisions for a 50-50 sharing of profits and losses on System drawings, like the provision now in place in the arrangements with the Germans, Belgians, and Dutch. He planned to comment on that suggestion in connection with his second recommendation.

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

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Term (months)	Maturity date
Austrian National Bank	250	12	December 3, 1974
National Bank of Belgium	1,000	9	December 20, 1974
Bank of Canada	2,000	12	December 27, 1974

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Term (months)	Maturity date
National Bank of Denmark	250	12	December 27, 1974
Bank of England	3,000	12	December 3, 1974
Bank of France	2,000	12	December 27, 1974
German Federal Bank	2,000	12	December 27, 1974
Bank of Italy	3,000	12	December 31, 1974
Bank of Japan	2,000	12	December 3, 1974
Bank of Mexico	180	12	December 3, 1974
Netherlands Bank	500	12	December 27, 1974
Bank of Norway	250	12	December 3, 1974
Bank of Sweden	300	12	December 3, 1974
Swiss National Bank	1,400	12	December 3, 1974
Bank for International Settlements:			
Dollars against Swiss francs	600	12	December 3, 1974
Dollars against other authorized European currencies	1,250	12	December 3, 1974

Mr. Coombs observed that the Swiss had made their suggestion for a 50-50 profit and loss sharing provision yesterday, in the course of a conversation he had held with them on the question of whether the Swiss National Bank planned to intervene to buy dollars outright. They expressed the view that it would be helpful if, at some point soon, the System made a small drawing of Swiss francs and used the proceeds for intervention in New York, with profits and losses to be equally shared. Personally, he thought such operations would be worthwhile so long as they were kept to relatively small amounts--like those that had been conducted in Belgian francs and Dutch guilders--and were confined to the New York market.

In response to a question by Mr. Holland, Mr. Coombs noted that the alternative to the proposed procedure, which the Swiss were now pursuing, was for them to buy dollars outright in their own market, bearing the full risk of loss. The proposal, in effect, was to put the Swiss in a position like that of the Germans, Belgians, and Dutch, who intervened to buy dollars outright in their own markets but also asked the System to help a little by drawing their currencies and intervening in New York on a risk-sharing basis. He thought there was no chance that the question would arise of risk-sharing on drawings by the Swiss National Bank, since he did not anticipate that the Bank would be borrowing from the System any time soon.

The Chairman asked whether there were any objections to including a provision for 50-50 sharing of profits and losses in the System's Swiss franc swap line, and none was heard.

Mr. Wallich said he would like to take this opportunity to comment briefly on the subject of exchange rates. He agreed that it was appropriate for central banks to act to preserve orderly conditions in exchange markets. He believed, however, that in the long run there was no way to keep the value of a currency from rising if, as in the case of Germany at present, the issuing country could maintain a large trade surplus despite heavy oil imports. He also believed that efforts to keep the value of such a currency from rising, whether by persuasion or intervention, would do serious injury to other countries that were incurring deficits. He thought Chancellor Schmidt was quite right in his judgment that the mark should appreciate. With the rate of inflation in Germany at about 7 per cent, well below that in the United States--where it was roughly 12 per cent--and below that in other industrial countries, the German trade surplus would be reduced in the long run only if the mark was allowed to appreciate, unless Germany inflated internally or permitted domestic economic activity to expand sharply.

Mr. Coombs expressed the view that that line of reasoning focused too narrowly on the German trade surplus and neglected the fact that Germany now had enormous invisible deficits--arising from tourism, payments to imported labor, and a variety of other factors--and had experienced enormous swings on capital account, including large outflows after the Bank Herstatt failure. In his judgment the recent behavior of Germany's over-all balance of payments hardly suggested the need for revaluation of the mark, or even moderate appreciation. From August through October, the Germans had found it necessary to borrow well over $1 billion from their partners in the European "snake," and their intervention in the dollar exchange markets in recent months had not involved heavy net purchases of dollars. In short, he did not think the evidence supported the argument that the mark should be allowed to appreciate. He suspected that recent comments by German officials that appreciation would help in the battle against inflation were offered in response to arguments by German exporters that the mark should be permitted to depreciate further.

Mr. Wallich asked whether Mr. Coombs would not agree that Germany had a very large current account surplus which had been offset during the past year or so by capital outflows--in other words, that the underlying situation was one of great strength.

Mr. Coombs said it was not at all clear that that situation would persist. During the past year or so the Germans had benefited--more, perhaps, than any other country--from the current phase of exaggerated expansion and inflation; in such circumstances, a revaluation of the mark would simply strengthen Germany's position still further. If there should be a return to a more competitive situation in world markets--as might happen if Italy and Britain, two of the countries with which Germany had been scoring large trade gains, should by one means or another reduce their imports--the position of Germany could change a great deal and that country could come to regret the levels to which it had pushed the mark. It was by no means a foregone conclusion that the mark should be appreciating over the next 6 or 12 months.

Mr. Hayes said he had heard private bankers express the opinion that, in terms of fundamentals, the dollar was now probably greatly undervalued against the Swiss franc and the German mark.

Mr. Wallich said he found that opinion puzzling, and would be interested in hearing the supporting arguments at some point.

Mr. Coombs commented that a traveler might well reach that view simply on the basis of comparisons of prices, which were extremely high in many European countries at present.

Mr. Holland remarked that he found it more difficult than usual to judge whether international conditions could be largely neglected at this time in reaching decisions on monetary policy, or whether the international situation argued for shading policy in one direction or the other from the posture that might seem best on domestic grounds alone. He, for one, would find it helpful to hear the views of the staff's international experts on that question.

Chairman Burns indicated that he would ask for staff comments on the question later in the meeting, when the Committee was ready to deliberate on monetary policy.

> Secretary's note: A report by Mr. Wallich on the November Governors' meeting in Basle, which was distributed to the members during this meeting, is appended to this memorandum as Attachment A.

Chairman Burns then called for the staff report on the domestic economic and financial situation, supplementing the written reports that had been distributed prior to the meeting. Copies of the written reports have been placed in the files of the Committee.

Mr. Partee made the following statement:

Almost all of the business news of the past month has been unfavorable. Orders, output, and employment are declining in manufacturing; construction remains depressed; and consumer buying in real terms continues quite sluggish, particularly in automobiles and household durable goods. Weakness is widely distributed geographically, judging from the red book[1/] reports, and it appears to be spreading into a growing number of industries. Shortages are reported to have virtually disappeared, and more and more business firms are said to be concerned about excessive inventory buildups.

The immediate outlook for economic activity, moreover, is deteriorating. Extraordinarily poor sales thus far of 1975 model-year cars have caused an abrupt and massive backup in inventories, necessitating industry-wide layoffs and plant closings. Production curtailments and layoffs also are the rule in appliances and television, construction materials, and textiles. The duration of the coal strike is an additional uncertainty at present. Some layoffs on account of the strike have already occurred, but there will be large curtailments in steel, railroads, and other industries if it lasts much longer. Altogether, the prospects point clearly to a sharp reduction in industrial production over the next few months.

Residential construction is another severe problem area. Housing starts in October remained at the 1.1 million unit level, but permit volume declined somewhat further, to an annual rate of only 800,000 units. More important, the inventory of unsold housing units remains very high, with merchant builder stocks still at more than a 10-month supply, despite some pickup in sales during September. Savings inflows to institutional lenders have recently begun to improve, and it may well be that the supply of mortgage funds will now be in an expanding phase. But with a relatively large overhang of

1/ The report, "Current Economic Comment by District," prepared for the Committee by the staff.

unsold units and an increasing number of construction projects apparently in financial difficulty, there could be an unusual time-lag before the condition of the industry permits any significant revival in new starts activity.

In view of these substantial near-term weaknesses, the staff GNP projection again lowers the outlook for real economic activity over the period from now to mid-1975. Most of the additional decline in real GNP is concentrated in the current quarter, partly because we have assumed a 4-week coal strike. But it makes little difference to the projected level of GNP if the strike is shorter than this. The effect of a quicker settlement would be to moderate the fourth-quarter cutback in steel and coal inventories, but then to provide less support to the expected rate of inventory investment early next year than we have assumed in our projection.

The size of the projected decline in output is now approaching normal recession proportions, even without including the energy-related decline of the first quarter of 1974. Thus, in the five quarters through mid-1975, real GNP is expected to fall by about 3-1/2 per cent and unemployment to rise by close to 2 percentage points. But the distribution of the projected weakness is somewhat unusual. It is concentrated in consumption, residential construction, and net exports, while capital spending and inventory investment hold up better than has been the case, on average, in other post-war recessions.

We will be looking more critically into these projected relationships to see whether further adjustments are warranted, and we also plan to extend the time horizon of our projection, in a chart presentation at the December Committee meeting. As of now, however, our projection incorporates capital spending levels for 1975 only about 2 percentage points below the results indicated by the McGraw-Hill survey. We have done this on the basis of recent weakness in new orders for capital goods and a growing list of cancellations and stretchouts of individual projects as reported in the press. Also, we are projecting that inventory investment will fall only to about a zero rate, rather than turning strongly negative, as would probably occur if there is a general inventory liquidation.

Unless a major downturn in capital spending develops and barring major shocks in financial markets, there still appears to be a good prospect of an economic upturn beginning some time in the second half of next year. Housing activity should be rising significantly by then, the round of inventory adjustments should be largely completed, real personal incomes should be rising again as the overall rate of price increase slows, and consumers--with their debt burdens reduced and their stocks of durable goods aging--should be in a better mood to buy. The size of the prospective upturn that these sources of strength may bring, however, is still very much an open question.

At present, we do not see the basis for a sizable recovery, so that the unemployment rate continues to drift upward in our projection, approaching 8 per cent by the end of the year. It should be remembered, however, that our projection does not assume any significant move to more stimulative public policies. Monetary expansion remains moderate, as indexed by an M_1 growth of slightly less than 6 per cent, which implies that interest rates will tend to rise abruptly as soon as nominal GNP growth begins to quicken. And Federal outlays are assumed to continue on a growth track characterized by fiscal 1975 outlays slightly below $300 billion, with no cut in tax rates. We plan to reconsider these assumptions, and to present alternative courses for monetary policy also, in next month's chart show presentation. Meanwhile, in considering its immediate policy stance, I believe that the Committee should take as its economic setting the probability that the business downturn will be quickening, that unemployment will be rising sharply, and that there will be increasing reports of financial distress and bankruptcy. At the same time, however, average wage rates and prices almost certainly will continue to advance at an exceptionally rapid pace.

Mr. Black asked if the staff thought that the high rate of failures among housing contractors would appreciably slow the eventual upturn in housing activity.

Mr. Partee replied that it was customary for large numbers of firms to move in and out of the housing industry in connection with the sharp swings in activity characteristic of that industry. What he found most disturbing in the current situation was that a considerable number of very large builders were in serious financial difficulty and might very well go bankrupt. Furthermore, many large uncompleted and unsold projects, especially condominiums, were overhanging the market. Although the problems with condominiums were most serious in California, Texas, and Florida, they appeared to be widespread; for example, he had heard reports of projects in difficulty in New Jersey, Washington, D. C., and various resort areas.

Mr. Partee observed that the financial difficulties of contractors could slow the housing upturn in two ways. First, it was possible that the number of surviving contractors would not be sufficient to develop new projects at the rate customary in a recovery period. Second, it was conceivable that a large number of bankruptcies would make lenders reluctant to extend credit to contractors even if funds were available.

Mr. Black asked if the recent improvement in the corporate bond markets was likely to encourage corporations to revive capital spending projects that had been postponed or canceled earlier, when the bond markets were experiencing difficulties.

In response, Mr. Partee noted that there had been a large volume of bond issues, particularly by manufacturing firms, during the past month and the forward calendar was also heavy. However, it was his impression that that borrowing was more for the purpose of restructuring balance sheets than for financing further capital spending. Although high interest rates had certainly been a factor in many of the earlier postponements of spending projects, those projects would not necessarily be revived as interest rates declined because in the interim market prospects had weakened. A project which had previously appeared likely to be profitable at an interest cost of, say, 9 per cent might now, given current market prospects, appear unprofitable at that interest cost. In short, moderate declines in interest rates probably would not have a marked effect on capital spending plans.

Mr. Mitchell noted that in a conversation yesterday a senior official of the Federal Home Loan Bank Board had indicated great pessimism about the outlook for housing construction. The official had expressed particular concern about the overhang of unsold houses; he believed that a reduction of that inventory was a _sine qua non_ for recovery in the housing industry. He also thought that it would be necessary for mortgage rates to fall below 8-1/2 per cent or for the economic climate to change considerably before housing sales would turn up.

Chairman Burns observed that similar worries about the capacity of the construction industry to revive had been expressed in every previous housing recession. While such worries might be justified in the present instance, it was worth noting that the recovery capacity of the industry had been consistently under-estimated in the past.

Mr. Partee said he agreed with the official Mr. Mitchell had quoted that a recovery in housing would depend on some decline in mortgage rates--perhaps to 9 or 8-1/2 per cent--and, more importantly, on the kind of change in the economic climate that would be associated with an improvement in consumer attitudes. On the whole, the views of the FHLBB official did not appear sharply inconsistent with the staff's projection for housing. He might note that that projection did not call for an upturn in starts until the second quarter of 1975, and that the rate of increase anticipated over the rest of that year--roughly 100,000 units per quarter--would be slower than in any other postwar cycle. Moreover, all of the increase was expected to be in single-family homes; no upturn in construction of apartments or condiminiums was assumed. The staff projection was near the low end of the range of the forecasts being discussed publicly by officials of the housing and savings industries, but the latter might be leaning toward optimism in an effort to improve market psychology.

Mr. Partee added that if housing starts did not turn up by at least the moderate amount projected the consequences could be devastating. There would be no recovery in real GNP in the second half of 1975--particularly if, as he anticipated, real spending on plant and equipment was declining in that period.

Mr. Winn remarked that rent increases could improve the economic environment for apartment builders. With unemployment at current levels, however, it might be difficult to raise rents.

Mr. Partee agreed. He noted that actions to restrain rent increases were being taken by many local jurisdictions. Increases of 25 per cent or more would be required to cover the recent advances in apartment operating costs and capital values, and it was highly unlikely that such increases could be obtained in the current economic and political climate.

Mr. Coldwell asked for further detail regarding the expected sources of downward pressure on the economy in 1975.

In particular, he wondered about the extent to which the expected weakness was related to the inventory cycle.

Mr. Partee replied that an anticipated decline in inventory investment was one of the main sources of weakness in the staff projection. The rate of accumulation of nonfarm inventories was expected to move down from the recent high of about $10 billion in the second quarter of 1974 to about zero in the second quarter of 1975. The other major element of weakness in the outlook was the expectation of continued slackness in consumer spending. Such spending had now been weak for some time, and had worsened recently--a development that probably was not yet fully reflected in output and employment figures. Capital expenditures were projected to level off in nominal terms, which implied some decline in real terms. While housing starts were expected to turn up in the second quarter, the stability anticipated until then--at an annual rate of about 1.1 million units--could be considered another element of weakness.

Mr. Partee added that, while the staff projection did not imply a sharp further decline in real GNP in 1975, the cumulation of five successive quarterly declines--excluding the decline in the first quarter of 1974, which reflected special factors--would result in an aggregate reduction in real CNP of about the magnitude of that experienced in the 1953-54 and 1957-58 recessions. The reduction would be somewhat larger than that in other postwar recessions.

Mr. Holland noted that in past contractions prices usually had softened more than indicated in the staff projections. He had received the impression on recent trips around the country that price cuts were already occurring or were in prospect in housing, autos, appliances, and other lines. He wondered whether the staff projections reflected a different judgment or whether the staff was simply waiting for more evidence on the point.

Mr. Partee replied that the staff had reduced the size of the average price increases it projected for consumer nondurables and durables to the minimum it judged consistent with expected increases in unit labor costs. That, of course, implied a profit squeeze in those industries. Furthermore, service prices were rising rapidly in association with sharply rising costs, and it appeared likely that food prices would remain high through next summer. Some softness was apparent in industrial prices; for example, there had been a 20-point drop since April in the Federal Reserve basic commodity price index. However, given the outlook for prices of services and foods and the expectation that unit labor costs would be rising at a rate of 9 or 10 per cent, it was hard to envision prices rising much less than projected. It was conceivable that the rise in average prices would be slowed by widespread distress or bankruptcy sales in an atmosphere of crisis. That sort of atmosphere was unlikely to develop, however, unless business activity was considerably weaker than implied by the projection.

Mr. Kimbrel remarked that there had appeared to be a shift recently in consumer buying patterns toward lower grades of merchandise and toward purchases in budget departments. For example, one large department store in Tennessee reported an increase of 16 per cent in budget department sales, in contrast to a 2 per cent rise in total sales. He wondered whether the staff thought that shift was general and, if so, whether it had been taken into account in the projections.

Mr. Partee replied that he also had heard reports from economists at large department stores of a tendency for consumers to favor lower-priced merchandise in such lines as furniture and appliances. While it appeared that sales of luxury goods also were going rather well, on balance, it seemed likely that rising prices and declining real incomes would encourage consumers to economize. He might note that the staff projection called for a quite moderate volume of consumption expenditures, which was consistent with recent reports of consumer attitudes.

Mr. Hayes said it seemed to him that greater efforts to conserve gasoline were warranted, in view of the predictions of difficulties in the Middle East and possible disruption of oil supplies in coming months. The present voluntary system appeared inadequate; for example, the 55 m.p.h. speed limit was not being generally observed. It would be unfortunate if the nation found itself in an emergency situation like that created by the oil embargo of last winter without having made adequate preparations.

Mr. Partee replied that in terms of the broader issues, there certainly was need for more effective conservation measures. Oil imports were tremendously costly, and little had been done on the international scene to cope with the problem. There was also the possibility of another embargo. In terms of market economics, however, the situation was one of surpluses of almost every type of petroleum product. Stocks of gasoline in some areas were so large that price wars were occurring.

Chairman Burns observed that, under such circumstances, a more effective conservation policy could have depressing effects in the short run on various sectors of the economy. Automobile manufacturers, for example, were quite concerned about the consequences for them of a strong conservation policy. He offered that observation as a statement of fact, without implying any views on policy.

Mr. Hayes remarked that the injury to the economy at the time of a disruption of oil supplies would be greatly increased if adequate preparations had not been made, and the Chairman agreed.

Mr. Winn observed that the coal industry represented one bright spot in the economic picture. For example, the situation in one formerly depressed coal town in Kentucky was reminiscent of the gold rush. Moreover, the high volume of coal exports was likely to require considerable investment in port facilities and railroad equipment.

Mr. Sheehan remarked that even a doubling in employment at soft coal mines would have little impact on the over-all rate of unemployment or level of economic activity.

The Chairman observed that a sizable increase in employment at coal mines might have beneficial secondary and tertiary effects on the economy. He agreed, however, the over-all impact would not be great since employment in coal mining was relatively small.

Mr. Partee noted that some of the benefits from the improvement in the coal industry were evident in the October McGraw-Hill survey of anticipated plant and equipment expenditures in 1975. The survey reported plans for a 63 per cent increase in mining industry expenditures and a 29 per cent increase by railroads. In dollar volume terms, however, those expenditures were not large.

Mr. Winn then asked whether the staff had given any thought to the consequences for the domestic economy of possible major international crises.

Mr. Partee responded in the negative. In general, the staff did not attempt to predict wars or financial collapses; instead, it tried to take account of such developments when they occurred.

Mr. Mayo asked whether Chairman Burns would care to make any observations on the outlook for fiscal policy.

In reply, the Chairman said the fiscal outlook was deteriorating. It was likely that Federal spending in fiscal 1975 would significantly exceed the President's $300 billion budget, and a large budget deficit was in prospect for fiscal 1976, even excluding possible new programs. There were several new projects which could prove very costly if enacted by Congress, including a national health insurance plan; a new welfare program which might take the form of a guaranteed annual wage; and the fund for inter-country lending, recently mentioned by Secretary of State Kissinger and Treasury Secretary Simon, which might involve a sizable budgetary outlay. Moreover, the chances for enactment of the tax surcharge recommended earlier by the President now appeared quite poor; indeed, it was possible that Congress would legislate some modest tax reductions in the current session and perhaps larger reductions next year. Therefore, he was not optimistic about the fiscal outlook. He added that he was not addressing himself at this point to the question of the appropriateness of a large budget deficit in the present economic situation.

Mr. Balles remarked that, in his judgment, a failure to foresee the rate of inflation that had developed abroad was the major reason for the consistent underestimation of the domestic rate of inflation in recent staff projections. It seemed to him that the main cause of the world-wide inflation was the near-doubling of the world money supply that had occurred between 1970 and 1973, although the situation had been exacerbated by the crises in oil and food supplies.

It was true that foreign trade represented less than 10 per cent of U.S. GNP, Mr. Balles continued. However, the

San Francisco Bank staff estimated that 15 to 20 per cent of GNP was accounted for by products that, while not necessarily traded in international markets, were subject to price pressures from abroad. Until there was a reduction in the rate of inflation in other nations, there was likely to be strong upward pressure on domestic prices in spite of the weakness in U.S. economic activity. In that connection, he would be interested in staff views on the outlook for prices in other countries.

Mr. Reynolds replied that the staff expected only a gradual slowing in the rate of inflation abroad, in spite of announced anti-inflationary programs by various nations. Most of the participants in the recent OECD short-term forecasters' meeting had similar expectations. Forecasters generally expected the rise in prices to continue at an annual rate of over 10 per cent through 1975 in European countries other than Germany, where the rise had been held to a 7 per cent rate. A high rate of price advance also was anticipated for Japan.

Mr. Reynolds went on to say he agreed that inflationary developments abroad and in the U.S. had been reinforcing each other. The problems were stubborn and worldwide, and this year they had been greatly exacerbated by disappointing crops. One could only hope that crop conditions would be more normal in 1975.

Mr. Partee observed that the magnitude of the problem in Japan was reflected by some comments made by a Japanese economist in a recent conversation. The economist, who was chairman of a Japanese governmental commission on wages and prices, had remarked that his government hoped to reduce the year-over-year rate of increase in consumer prices to 15 per cent by March 1975, with the expectation that that would help to reduce the annual rate of wage increases to not more than 20 per cent. A 20 per cent rate of wage advance would be a considerable improvement; this year the rate was 32 per cent.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of System Open Market Account covering domestic open market operations for the period October 15 through November 13, 1974, and a supplemental report covering the period November 14 through 18, 1974. Copies of both reports have been placed in the files of the Committee.

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

> During the period since the Committee last met, open market operations were somewhat less restrictive with respect to the provision of nonborrowed reserves. In line with the Chairman's recommendation of October 31, a Federal funds rate of 9-1/2 per cent was sought after that date. Despite a heavy schedule of Treasury financing and an unusually large corporate

calendar, interest rates declined in all maturity areas, as further indications of a weakening economy confirmed market expectations of a continuing decline in rates.

The Treasury's November refunding was highly successful, with prices of coupon issues rising steadily throughout the financing. Dealers were heavy participants in the refunding, and they have been making good progress in distributing the three new issues offered by the Treasury to final investors. The Board's recent action with respect to reserve requirements strengthened the general feeling that interest rates were on the decline, and long-term investors appeared anxious to step in at prevailing yields. In yesterday's regular Treasury bill auction, an average rate of just over 7-1/2 per cent was established for the 3-month bill. This is down about 20 basis points from the rate established just prior to the last meeting of the Committee.

The tax-exempt market proved to be something of an exception to the good atmosphere prevailing in other markets. Banks continued to display a cautious investment attitude and other institutional investors appeared more interested in corporate and Government securities.

The suspension of the Federal Reserve guarantee of bankers' acceptances for foreign official account lent a note of caution to that market. So far there has been an orderly adjustment, with the main impact a widening of rate spreads for acceptances of lesser known banks. Dealer positions have been running at record levels, however, and there is some concern that financing the acceptances of lesser known banks may become something of a problem. Through last week our activity in the market remained at a high level as we were in the process of completing a substantial foreign order for guaranteed acceptances. We still don't know how much foreign interest there will be in unguaranteed acceptances, and there could well be some market reaction as the over $2 billion of guaranteed acceptances that foreigners hold run off in a steady stream.

Since the last meeting open market operations were largely devoted to absorbing a part of the reserves made available to the banking system by market factors--particularly a substantial decline in the Treasury's balance. As you know, the Treasury has just gone through a tight cash bind and on November 7, in fact, had to utilize its newly reenacted ability to borrow directly from the Federal Reserve. As you also know, the Treasury will be raising $4-1/2 billion in cash in the Treasury bill market over the next week.

Our operations over the period involved a steady stream of repurchase agreements made on behalf of a handful of foreign accounts that had a large volume of monetary reserves to put to work on a temporary basis; $3.2 billion of these transactions were made with the System Account, providing, along with $500 million outright sales to foreign accounts, a convenient and unobtrusive method of absorbing reserves.

Looking ahead, there should be a substantial seasonal need to supply reserves over the weeks ahead. The net reduction in required reserves will add about $3/4 billion to reserves in the week beginning December 12, but there is a large need before that time. Dealer positions in Treasury bills, Treasury and agency coupon issues, and acceptances are quite high--recently at their highest level in over 2 years--and we should not run into any supply problems, barring any unexpected bulge in the continuing stream of foreign orders.

In reply to a question by Mr. Eastburn, Mr. Holmes remarked that the Treasury's sale of bills over the next week was likely to be accomplished quickly and would not raise any even-keel considerations.

In reply to a question by Mr. Coldwell, Mr. Holmes observed that in the next inter-meeting period the Desk would have opportunities to purchase both Treasury and agency coupon issues, because

Government securities dealers had good positions. He thought that it would be desirable to purchase such issues.

Mr. Black said he inferred from Mr. Holmes' remarks that long-term interest rates had declined for the most part because market participants believed that rates had passed their peaks, and he asked whether investors also assumed that the rate of inflation would be substantially reduced.

Mr. Holmes replied that investors were still seriously concerned about the rate of inflation and had not yet concluded that it would subside. However, they feared that they would miss the turning point in interest rates; that fear might keep some institutional investors active in the long-term market for a while. The increase in dealers' portfolios indicated that some of the buying was for short-term speculative purposes, but at the same time the dealers had been able to handle a heavy calendar of new issues surprisingly well.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period October 15 through November 18, 1974, were approved, ratified, and confirmed.

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

Growth in M_1 for 2 to 3 months now has been slow relative to the rates desired by the Committee. In order to promote growth, the Federal funds rate has declined about 4 percentage points since early July. Because of the cumulative positive impact on money demand from this easing, our staff analysis indicates that only a slight further decline in the funds rate may develop if and as enough reserves are provided to accelerate money growth markedly between now and the year-end.

Because member bank borrowing was high throughout the summer and early fall, enough reserves have to be provided through open market operations both to accommodate a reduction in member bank borrowing as market interest rates decline and to support deposit expansion. We believe that growth in nonborrowed reserves will have to average about 12 per cent at an annual rate in November and December to help bring M_1 growth back to path.

If money demand is not as strong as we expect, the Federal funds rate and interest rates more generally would tend to drop more sharply if nonborrowed reserve growth is pushed ahead. A weakness in money demand could stem from three partly interrelated causes. First, with the level of interest rates and hence the opportunity cost of holding cash still high, it may take a relatively sharper decline in rates to induce the public to hold additional cash than if interest rates were lower. Second, the economy may be even weaker over the next few months than the staff is projecting. And third, it may be that the decline of short-term interest rates since summer is not being associated with as much easing in lending terms and conditions as one might usually expect.

Institutions are, I believe, remaining very cautious in their lending policies in these highly uncertain and confusing times. Bank credit growth has been quite slow in recent months. Although the prime loan rate has been gradually declining, banks appear to have been continuing to scrutinize loan applications with great care. Concern about their own capital and liquidity positions is one reason. Uncertain employment, income, and profit prospects of their business and consumer customers is another reason. At thrift institutions, the first concern appears to be to reconstitute liquidity rather than to increase mortgage loan commitments as fund flows improve. Thus, under present circumstances, because stringent lending standards seem to be persisting, we may not be achieving the easing in credit conditions that might ordinarily be expected as short-term rates decline.

At the same time, we believe that the public too is being quite cautious in its saving habits in view of gathering economic uncertainties. The large rise in consumer-type time and savings deposits at banks in October and early November and the rather substantial return flow of funds to thrift institutions may be evidence of such caution. The flows appear to be larger than would have been expected purely from the decline in market interest rates that took place.

With these greater increases in time and savings deposits, both M_2 and M_3 are projected to show about 2 percentage points more growth at an annual rate in the fourth quarter than was indicated at the last meeting, given the M_1 path leading to a 5-3/4 per cent longer-run growth rate. Thus, read literally, M_2 and M_3 would be behaving more expansively. If this develops, the liquidity position of savings institutions and individuals will have improved, but the prevailing cautionary attitudes may well keep that improvement from being translated into any greater economic stimulus.

Mr. Mitchell remarked that he was uncertain about the effect on M_1 growth of the lower rate of expansion in nominal GNP that the staff was now projecting for the current quarter. He asked whether, in view of the improved flows of funds into consumer-type time and savings deposits at banks and at nonbank thrift institutions, it would be reasonable to accept some trade-off in growth between M_1 and M_2.

Mr. Axilrod replied that in the present circumstances of uncertainty, people--to the extent that they could--might be limiting spending and increasing savings deposits at banks and at nonbank thrift institutions. He believed that the increase in the rate of growth in M_2 relative to that in M_1 was a reflection of the weakening in economic activity rather than a positive stimulus. As he had indicated in his statement, the banks and the nonbank thrift institutions for a time were likely to respond to the improved inflows by improving their liquidity positions rather than by easing their lending standards and terms. Considering the uncertainty about the creditworthiness of their borrowers and about their own capital structures and liquidity positions, the financial institutions might respond more slowly than at other times in easing lending standards and terms. Therefore, he would not regard the increase in the M_2 growth rate over the near term as an acceptable trade-off for growth in M_1. However, if the recent rate of growth in M_2 persisted for 5 or 6 months and attitudes toward economic prospects improved, his view of the trade-off then clearly would be different.

In response to a question by Mr. Coldwell, Mr. Axilrod observed that under current conditions banks most likely would have been slow to ease lending terms in any case, but that System efforts to encourage banks to improve their capital structures and their liquidity positions had been a marginal influence. The need for such improvement and the effort to achieve it probably was confined mainly to large banks, including the larger regional banks.

Mr. Morris remarked that the short-run projections of M_1 were of greater importance now than ordinarily. He asked whether it was correct to infer from Mr. Axilrod's comments that the probabilities were greater that M_1 growth would fall short of rather than exceed the projections for the November-December period contained in the blue book.[1/]

In response, Mr. Axilrod observed that he had stressed the forces that might cause M_1 growth to fall short of the projected rates, at given levels of interest rates. And while errors in the projections in the past had occurred on both sides, recently they had been in the direction of overestimation of M_1 growth. At the present time the economy was changing so rapidly that attitudes toward holding different types of assets no doubt were changing in ways that could not be readily projected. Consequently, the projected relationships between interest rates and growth in the aggregates should be viewed with more than the usual uncertainty.

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

Mr. Eastburn asked what effect more cautious bank attitudes might have on the relationship between reserves and M_1.

Mr. Axilrod replied that the projections of growth in M_1 for the period ahead might well be overestimates--given nonborrowed reserves and the funds rate--because of underestimation of (1) the reduction in member bank borrowings, (2) the increase in banks' demands for excess reserves, or (3) the effect of restrictive lending terms on growth in nominal GNP and, over time, on the demand for money.

Mr. Eastburn remarked that all three of those forces tended to suggest that the rate of growth in reserves might have to be greater than projected in order to achieve the desired rate of growth in M_1. He asked what the chances were that the relationship between reserves and M_1 would turn around so that growth in the latter would prove to be excessive.

Mr. Axilrod replied that there was no certain way to anticipate how errors in the projected relationships among M_1 growth, reserves, and money market conditions would shift about. The staff had not been able to find a consistent bias in its estimates, but there had been instances of runs of overestimations or of underestimations that had been reversed after a period of time.

Chairman Burns then called for the Committee's discussion of monetary policy and the directive. He noted that earlier in the meeting Mr. Holland had inquired about the implications that international conditions might have for monetary policy, and he asked Messrs. Reynolds, Wonnacott, and Coombs to comment briefly.

Mr. Reynolds observed that changes in exchange rates were not determined wholly, or even primarily, by movements in interest rate relationships. The fluctuations in exchange rates in recent weeks had been provoked by casual statements by foreign public officials concerning their expectations for changes in exchange rates rather than by interest rate movements. Moreover, concern about the prospects for the exchange rate for the dollar against leading foreign currencies had been inspired at least as much by fears of deep recession in the United States as by declines in interest rates here relative to rates elsewhere. Consequently, market participants might worry more if they thought that the System would pursue a policy that would be too tight for too long rather than a policy that they perceived to be reasonable and prudent.

Mr. Reynolds added that interest rates abroad also had been declining, although less rapidly than rates in this country. Discount rates had been reduced in Germany, Holland, and Canada, and bank lending rates had been reduced in those countries and in others as well. There were signs that the French and the Japanese also were considering easing actions, although they had taken none as yet. In summary, while the decline in interest rates had started in this country, rates were following the same course in some other countries and soon would be in still others.

Mr. Wonnacott said he agreed with Mr. Reynolds' implication that it would not be desirable to alter monetary policy significantly because of recent changes in exchange rates. In theory, it was appropriate in the face of exchange rate movements to adjust monetary policy from what otherwise would have been desirable, in order to offset the inflationary effects of currency depreciation, especially those working through changes in aggregate demand. In practice, that aggregate demand effect had been sufficiently large during 1971-73 that it was an adequate cause for adjusting monetary policy. That was not the case now. Although there had been wide swings in exchange rates over the past year, there had been no strong trend. Aggregate demand effects of such changes were quite small compared to other uncertainties in the present outlook. In his view, they were not large enough to warrant a modification of monetary policy at this time.

Mr. Coombs remarked that, in his opinion, international considerations should not exert a decisive constraint on monetary policy. However, there was a danger that a decline in the exchange rate for the dollar against leading foreign currencies would be accentuated by speculation to a degree that would have serious inflationary effects. In an effort to avoid that sort of development, it would be desirable to confer with other major countries--which shared the U.S. interest in avoiding a cumulative downturn in economic activity--in order to enlist their cooperation in following System actions toward easier monetary conditions without undue time lags. Recession appeared to be a world-wide phenomenon, and all countries would benefit from concerted action.

The Chairman then asked Mr. Partee for his policy recommendations.

Mr. Partee observed that little could be done now to affect the deterioration in the economic situation that appeared in prospect for the next 4 or 5 months, other than to be prepared to extend emergency credit and to provide support to the securities market in the event that real financial instability developed. At this point, in his view, the most important objective of policy was to assure reasonable, supportive growth in the monetary aggregates over the months to come. More specifically, he would like to see a substantial reflow of funds into consumer-type time deposits at banks and at thrift institutions and an annual rate of growth in M_1 on the order of 6 per cent. For the November-December period staff projections suggested that growth in M_1 and M_2 would be sizable even without much further reduction in money market interest rates, and it was important to achieve those growth rates. In the event that monetary growth appeared to be falling short, the Committee should be prepared promptly to reduce money market rates. However, lower interest rates should not be sought if the aggregates appeared to be growing in line with the projected rates. Such a policy course would not have much effect on the deepening recession, but as he had said, the System could not do much to affect the immediate situation in any event.

Mr. Eastburn remarked that he, like Mr. Partee, believed that the System could not do much now to arrest the current decline in economic activity. However, it was a good time to increase moderately the Committee's longer-run target for M_1 growth; he would suggest that the targeted annual rate of growth be raised from 5-3/4 per cent to 6-1/4 per cent for the period from August 1974 to March 1975. Such an increase would establish a public record of the Committee's concern to achieve more rapid monetary growth in that period. For the November-December period he would specify an M_1 range of 7 to 10 per cent, rather than the 7 to 9 per cent suggested under alternative B,[1/] in order to allow for slightly more rapid growth. He would specify a Federal funds rate range of 8 to 10 per cent, which was in between the ranges under alternatives A and B.

Mr. Hayes commented that he shared the general concern about the economic outlook. However, he attached as much importance, or a little more, to resisting the rate of inflation in prospect. There was some evidence of official interest abroad in defending the exchange value of the dollar, which was a key currency for many countries, and that was immensely important in this period when faith in currencies in general had reached a low ebb. Those considerations called for a rather steady policy over coming weeks; although he would be willing to see some modest further decline in short-term market interest rates, he would not raise the longer-term targets for the aggregates. The language and the specifications of alternative B in general were acceptable, although--in contrast with Mr. Eastburn--he would prefer to shade the November-December range for M_1 down to 6 to 8 per cent.

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

Concerning the discount rate, Mr. Hayes said it would be prudent to delay somewhat longer any reduction, especially in view of the recent reduction in reserve requirements. The spread between market interest rates and the discount rate had not yet widened to an extent that constituted a strong argument for a reduction, and if one were made prematurely, it could be interpreted as an overt signal that the System was shifting attention sharply from inflation to recession. Quite a lot had already been done to ease monetary conditions, and many Committee members long had contended that a fairly extended period of business stagnation probably was essential if inflation was to be brought under control. It might be necessary to make such an overt shift in policy if signs of a cumulating recession became more pervasive, but until then he would prefer to follow a rather cautious policy.

Chairman Burns observed that in view of the recent change in reserve requirements, it was highly important that the Committee pursue a cautious policy in the period until the next meeting and avoid any abrupt change. Confidence in the Federal Reserve System was one of the country's important assets, and the Committee should do nothing that would risk dissipating that confidence. Concerning specifications, he would recommend the longer-run targets under alternative B, thus continuing the M_1 target of

5-3/4 per cent that the Committee had had for some months. The December meeting--at which the staff would make a chart presentation on the economic situation--would afford a good opportunity for review of those targets. For the November-December period he would suggest the following: annual rates of growth of 6-1/2 to 9-1/2 per cent for M_1; 8 to 10-1/2 per cent for M_2; and 2-1/2 to 5-1/2 per cent for RPD's. He would recommend a Federal funds rate range of 8-1/2 to 10 per cent for the period until the next meeting; the midpoint of that range was 9-1/4 per cent--the same as under alternative B in the blue book--and the rate at present was about 9-1/2 per cent.

Mr. MacLaury said he would judge that by the time of the December meeting the staff projections of real GNP would be revised downward again; he expected that the indicators of business capital investment would be weaker, that a more serious inventory adjustment would be in prospect, and that the foreign trade situation would deteriorate. While agreeing with the Chairman's assessment that fiscal policy was likely to be more expansive than was assumed now for purposes of the staff projections, he believed that it should be more expansive. However, that did pose a dilemma for the Committee: the prospect of an easier fiscal policy suggested that monetary policy should remain more restrictive than otherwise, but such a restrictive monetary policy might provoke more fiscal stimulus than otherwise. Moreover, the existing degree of monetary restraint, or even some tightening, could not be very helpful in dealing with the prospective inflationary pressures, which would result from large wage increases and reductions in supplies of foods. With that kind of inflation in prospect, wage and price controls were likely to be imposed by the middle of next year.

Accordingly, Mr. MacLaury continued, the Committee should not delay in making some adjustment in policy. Like Mr. Eastburn, he would raise the longer-run target for M_1. However, he would accept the alternative B short-run targets for the aggregates, because of the expectation that monetary growth would be fairly rapid in the November-December period. While the Committee should not strive to achieve higher short-run rates of growth than indicated under alternative B, it should make sure that the alternative B rates were achieved. For that reason, he favored a funds rate range of 8 to 10 per cent.

Mr. Morris remarked that he was less concerned about changing the longer-run target at this time than he was about moving more rapidly toward achievement of the target that the Committee had established. In the 4 months from June to October M_1 had grown at an annual rate of a little more than 2 per cent, and if the November-December rate proved to be 8 per cent--as projected under alternative B--growth in the second half of 1974 would be at a rate of about 4 per cent. That would be well below the Committee's target, and in his view, it would be about the lowest rate that might represent a defensible policy. Moreover, the risks of a shortfall in the November-December period appeared to be greater than the risks of an overshoot, and the rate of growth in M_1 might prove to be no more than 2 or 3 per cent in the second half of the year.

Continuing, Mr. Morris observed that at this time a shortfall from the projected rate of growth would create more problems for the System than would an overshoot. A 2 or 3 per cent rate of growth in the second half would be difficult to justify, especially in light of the Committee's target for the period. Furthermore, considering Chairman Burns' recent testimony before the Joint Economic Committee to the effect that monetary growth was too slow in the third quarter and that every effort would be made to raise the growth rate, the System would suffer some loss of public confidence in its ability to control the aggregates reasonably well. On the other hand, if growth in the aggregates proved to be stronger than projected and the November-December rate for M_1 was as high as 12 per cent, the rate for the second half still would be only about 5.5 per cent--which was in line with the Committee's target. It seemed to him, therefore, that it would be wise for the Committee to lessen the risks of a shortfall in the November-December period. Accordingly, he would accept the short-run targets of alternative A while continuing the Committee's longer-run target for M_1, and he would instruct the Manager promptly to aim for the 8-1/2 per cent midpoint of the range for the Federal funds rate.

Chairman Burns commented that while Mr. Morris' assessment of the risks of an overshoot might be correct in terms of the rate of growth for the second half of the year, rates of growth for individual months also received public attention. In his judgment, a 12 per cent rate of growth in the November-December period would provoke editorial comment and expressions of opinion from the business and financial community, from the Congress, and from abroad to the effect that the Federal Reserve had thrown in the sponge with respect to the fight against inflation.

Mr. Mitchell remarked that the Committee had one problem with respect to its public image and credibility and another problem with respect to the effects of monetary policy on real economic activity. To a degree, he was sympathetic with Mr. Eastburn's views. For several years M_1 had grown at a rate of about

6 per cent while the price level had not been rising very rapidly. In the second half of this year, however, growth in M_1 would be down to a rate of 4 or 5 per cent while the GNP implicit deflator would rise at a rate in excess of 10 per cent. Clearly, monetary policy was more restrictive than it appeared to be. In reviewing its longer-run targets, the Committee needed to consider the effect of the rising price level on M_1, but he was content to deal with that issue at the next meeting.

Regarding the effect of policy on economic activity, Mr. Mitchell observed that the Committee had to be concerned about the course of business capital spending and of construction activity. Both required some action that would help to lower long-term interest rates, although he was uncertain how far the Committee could go in that direction. For the period immediately ahead, he could accept the Chairman's recommendation for the Federal funds rate. With respect to the aggregates, he anticipated more positive effects from a substantial rate of growth in M_2 than had been suggested by Mr. Axilrod. Under present circumstances a considerable decline in the funds rate might be required in order to increase the rate of growth in M_1 appreciably, and for that reason he would not be greatly concerned if such an increase were not accomplished.

Mr. Balles commented that while business prospects had deteriorated, the outlook for the rate of inflation also had worsened. Another year might be required to moderate significantly the worldwide inflation and to reduce substantially its impact on the domestic price level. The consensus forecast seemed to be that the inflation rate in this country would be down to about 7 per cent by the fourth quarter of next year, but in his judgment it would be somewhat higher. The unprecedented inflation, if allowed to continue, would have severe costs beyond raising unemployment and producing chaos in the construction industry.

Mr. Balles observed that if the inflation rate now were down to 5 or 6 per cent, probably everyone would favor the monetary growth rate of alternative A or even a more generous rate. But if the Committee eased monetary policy in the face of double-digit inflation, it would run a great risk of shattering investors' confidence and increasing their reluctance to commit funds. He hoped that the System would avoid giving the impression that it had thrown in the sponge in the fight against inflation. Therefore, in view of the conflicting goals of policy, he favored continuing the Committee's longer-run target for the time being, and in general he favored the specifications set forth under alternative B.

Mr. Mayo commented that he subscribed to the specifications suggested by the Chairman. He was also sympathetic to the Chairman's view concerning the public interpretation of a November-December rate of growth in M_1 as high as 12 per cent. Even a rate in the range of 7 to 9 per cent was likely to be interpreted as a significant easing in policy. In addition, he was concerned that easing money market conditions in the direction of alternative A might create a situation by next spring that would call for a reversal at a most inopportune time.

Nevertheless, Mr. Mayo continued, he would not object to a funds rate range of 8 to 10 per cent--rather than the range of 8-1/2 to 10 per cent that the Chairman had suggested--in order to give the Desk additional flexibility around a midpoint of 9 per cent; he would not necessarily expect the Desk to aim immediately for a rate of 9 per cent. Consideration of a change in the longer-run targets could be delayed until the December meeting. For the directive, he preferred the language of alternative B--although he would continue to call for a "resumption of" moderate growth in the aggregates, as in the directive issued at the October meeting. Thus, he would say, "...the Committee seeks to achieve bank reserve and money market conditions consistent with resumption of moderate growth in monetary aggregates over the months ahead."

Mr. Black remarked that the Committee's most important task was to attempt to restore the aggregates to a path of moderate growth, and if the blue book projections were reasonably good, the groundwork had already been laid for a substantial pickup from the slow rates in the third quarter. The Federal funds rate and other key rates had declined substantially over the past 4 months, and the full effects of those declines would not be felt until next year. Like Mr. Mayo, he believed that the Committee now had to consider carefully the danger of easing money market conditions too much, thereby provoking overly rapid growth in the aggregates a quarter or so ahead and leading to the stop-and-go sort of policy that had occurred too often. While he would have liked to see a more rapid rate of growth in M_1 recently, he saw positive effects of the substantial growth in the more broadly defined money stock. Finally, like Mr. Coombs, he believed that interest rates in this country should not decline too rapidly in relation to rates in other major countries.

Mr. Black said he favored alternative B, with the modified specifications that the Chairman had suggested, because it represented a slight further easing in money market conditions with a continuation of the Committee's longer-run targets for the aggregates.

And he agreed with Mr. Mayo's suggestion for the operational paragraph of the directive.

In reply to a question by Mr. Winn, Mr. Axilrod remarked that growth in banks' time and savings deposits other than large-denomination CD's recently had been somewhat more rapid than was consistent with the historical relationship between deposit growth and interest rates. Growth was projected to be slightly less rapid in the period immediately ahead and to be more consistent with the level of interest rates.

Mr. Winn commented that he shared Mr. Mitchell's view with respect to the importance that should be attached to growth in M_2 versus that in M_1; the substantial pickup in M_2 growth in October was encouraging. For the period ahead, he would like to see as much ease in money market conditions as could be obtained without provoking the necessity for a reversal later on. In his view, System operations over the next month would be especially important in terms of the consequences for the rate of inflation. He could accept alternative B.

Mr. Francis observed that his views on policy reflected his judgment that the current slowdown in economic activity differed in important respects from those in the past. In his opinion, the slowdown--which began last year without having been preceded by policy actions to dampen demand--was not induced by a weakening in demand but rather was the result of a number of unusual forces. He would like to see M_1 grow at the alternative B rate of about 8 per cent in the November-December period. If it did, the growth rate on a quarterly average basis would slow from 6.5 per cent in the first half of 1974 to about 4 per cent in the second half, and would be about 5.5 per cent for the year as a whole. That was not far from the Committee's longer-run objectives and, in light of his assessment of the nature of the downturn in economic activity, would represent rather good policy for 1974. He believed it would be appropriate to move into 1975 with the growth rates projected under alternative C, including a 5 per cent rate of growth in M_1 for the first quarter of 1975. He agreed with the staff's projections suggesting that economic activity would begin to move back up after midyear.

Mr. Kimbrel remarked that in the present gloomy atmosphere it might be tempting to ease policy progressively, but he rejected such a course. The rate at which reserves had been provided and the recent reduction in reserve requirements were appropriate responses to the situation, and the decline in interest rates that had occurred was welcome. At the same time, however, domestic and international inflation was still a source of concern, and the

System should not ease policy to a degree that would suggest that it had abandoned its publicly proclaimed goal of waging the fight against inflation to a successful conclusion.

Mr. Kimbrel observed that in late spring and summer individuals had purchased an unusually large number of large-denomination CD's, suggesting the possibility that they had shifted funds out of equities and demand deposits. He was concerned that a reversal of the shift out of demand deposits might result in a faster rate of growth in M_1 than projected by the staff. He was also concerned that the Federal budget would become considerably more stimulative next year. Accordingly, he was quite wary of any overt moves to ease monetary policy further, which in any case were unlikely to have significant effects on economic activity before mid-1975. He would accept the longer-run M_1 target of 5-3/4 per cent and the short-run specifications for the aggregates that the Chairman had suggested. For the Federal funds rate range, however, he preferred a lower limit of 9 per cent, and would aim for a rate toward that level only if other short-term rates tended to move up or if growth in the aggregates appeared to be falling considerably short of the projected rates.

Mr. Holland said alternative B, modified in the way suggested by the Chairman, represented the right policy prescription at present. At the same time, he believed that a continued gradual relaxation in financial market conditions was desirable. Accordingly, he would like to see the funds rate drift down into the 9 to 9-1/4 per cent area. The Desk should avoid raising the funds rate within its range unless the aggregates appeared to be growing at rates significantly above their specified ranges, and he would set the top of the funds rate range at 9-7/8 per cent, rather than 10 per cent, in order to indicate that the Desk should not aim for a two-digit rate before the Committee had had an opportunity to consider its consequences.

Chairman Burns remarked that he also believed that a significant reversal of the recent course of interest rates would definitely be undesirable at this stage. Accordingly, unless there was some change in circumstances, he would want to consult with the Committee if the movement in the monetary aggregates appeared to call for raising the target for the funds rate toward the 10 per cent level.

At this point the meeting recessed. It reconvened at 1:45 p.m., with the same attendance as at the morning session.

Mr. Wallich remarked that he viewed the outlook with some apprehension because in successive staff projections, all of which suggested an upturn in real GNP in the second half of next year, the rate of inflation projected for that period had been raised progressively. Once activity began to expand again, the rate of increase in prices, as well as interest rates, was likely to turn up. If the expansion began with prices rising at a rate of 7 or 8 per cent and with interest rates to match, there was no way of knowing how rapid the inflation would become and how high interest rates would go.

Mr. Wallich said he concluded that alternative B was about right, and he would hesitate to shade it in a more liberal direction. He hoped that the funds rate could be held within the 8-1/2 to 10 per cent range suggested by the Chairman, which provided a little downward leeway to the midpoint of the range in association with an 8 per cent rate of growth in M_1 in the November-December period. Actually that was a rather high rate to report to the public, even if it did not fully make up for the third-quarter shortfall.

Mr. Bucher observed that over the past 6 months or so his policy position had been one of caution with respect to restraint, and now it was one of caution with respect to ease. Like Mr. Holland, he would be concerned about the possible effects on market expectations if the funds rate backed up to 10 per cent; every effort should be made to avoid giving the market the impression that policy had changed course. At the same time, he would be hesitant to move aggressively in an easing direction. Although, like Mr. Mitchell, he was particularly concerned about long-term interest rates and about the problems of the construction industry, there were limits to the effect of declines in short-term rates on the long-term rates. As long as inflation continued at a rapid rate, it would remain a factor in the long-term market.

Mr Bucher remarked that, as many had feared, a major economic downturn was in process, but there was little that monetary policy could do to affect activity in the near term. Therefore, the Committee's attention should be directed toward longer-term goals. He was more concerned now than he had been in the recent past about the possibility of a high rate of inflation toward the end of next year. One factor in that concern was the likelihood that there would be an over-reaction to the downturn in fiscal policy, which emphasized the need for caution in easing monetary policy.

With regard to specifications in the period ahead, Mr. Bucher said he preferred a range of 8 to 10 per cent for the funds rate--a slightly lower range than that under alternative B. Considering recent declines in the funds rate, a further easing to only about 9-1/4 per cent would be very small and might be interpreted by the market as a shift from the recent trend of policy, leading to a backing up of other short-term rates. Consequently, he would like to see the funds rate moved down to around 9 per cent. As had been suggested, if the behavior of the aggregates appeared to call for raising the funds rate back near a level of 10 per cent, the Committee should take a long and hard look at the situation. With respect to the aggregates, he could wait until the December meeting to review the longer-term targets, and he could accept the short-run ranges of tolerance that the Chairman had proposed.

Mr. Coldwell commented that the economic situation had deteriorated a little more over the past month than he had expected. He hoped that the Committee would not over-react, as long as the recession remained gradual, and it seemed that a majority of the members were not recommending a major easing in policy. In his view, tolerance was still high among the people and in the Congress for continuing efforts to reduce the rate of inflation. Over the remainder of 1974 policy should be eased only slightly; any overt moves should be held to a minimum because some expectation of continued weakness in the economy was necessary in order to dampen wage and price increases.

Concerning specifications, Mr. Coldwell said he had been prepared to accept alternative B, although like the Chairman he preferred a range of 8-1/2 to 10 per cent for the funds rate. He was slightly concerned about the Chairman's suggestion to widen the short-run ranges of tolerance for the aggregates, but he thought that growth in the aggregates could not be projected very well in this period and that the behavior of the aggregates would not offer much guidance for policy decisions. Accordingly, he preferred a directive which placed more emphasis on the money market conditions that he wanted to achieve. Thus, he would say "...the Committee seeks to achieve further slight easing of money market conditions, with the expectation that there will be a resumption of moderate growth in monetary aggregates over the period ahead." He hoped that in the period coming the Desk would take advantage of any opportunities that arose to purchase coupon issues, in order to give some support to the market for longer-term securities

Mr. Plant remarked that in view of the indications of a further decline in economic activity and of a deeper recession, a definite, but not very great, step toward ease should be taken. He had been in favor of the specifications of alternative B, but he could accept those that the Chairman had recommended.

Mr. Sheehan observed that over the past year he probably had been more bearish about economic prospects than any other member of the Committee, and the worst of his fears had eventuated. He did not think that should be attributed to Federal Reserve policy, even though--given the rate of inflation--the System's policy had been extremely tight. However, this was not the time to take actions that might signal to the market a shift in policy to an anti-recession stance.

While the recession in activity was worse than he had anticipated, and the slack in resource use was greater, inflation was a very severe problem. In the weeks and months ahead, the System would have to ease further, but this was not the time to do so. In view of the substantial declines in the Federal funds rate and in other short-term rates over the past 4 months, he was prepared to hold the current position for the next 30 days. He could accept the specifications that the Chairman had suggested.

Mr. Clay said there was little that monetary policy could do now to prevent a further decline in real output over the next few months and that, consequently, policy should focus on setting the stage for recovery in a manner consistent with significant progress in reducing the rate of inflation. He preferred a longer-run target of 5-1/2 per cent for M_1, but he would accept 5-3/4 per cent for the moment and would plan to work the rate down. Actually, even 5-1/2 per cent was high from an historical standpoint, although it was lower than the rate that had prevailed over recent years and would represent progress toward an appropriate rate.

Chairman Burns asked the members to indicate informally whether they preferred the language that Mr. Coldwell had suggested for the operational paragraph of the directive, which gave more emphasis to money market conditions, or whether they preferred the language of alternative B, without distinguishing for the moment between the form presented by the staff and that suggested by Mr. Mayo.

A majority of the members indicated a preference for one of the versions of alternative B.

The Chairman then asked the members to indicate informally whether they preferred the language of alternative B as presented by the staff or as modified by Mr. Mayo to speak of a "resumption of" moderate growth in monetary aggregates over the months ahead.

A majority of the members indicated a preference for the language of alternative B as presented by the staff.

Chairman Burns said he believed, on the basis of the discussion, that a majority of the members favored continuation of the longer-run target for M_1 that the Committee had adopted at its last meeting along with the associated targets for M_2 and the credit proxy. He then asked the members to indicate whether they could accept his earlier recommendations for the short-run ranges of tolerance for the aggregates and for the Federal funds rate.

A majority of the members indicated acceptance of those ranges.

Chairman Burns proposed that the Committee vote on a directive consisting of the staff's draft of the general paragraphs and alternative B for the operational paragraph. It would be understood that the directive would be interpreted in accordance with the following specifications. The longer-run targets--namely, the annual rates of growth for the period from August 1974 to March 1975--would be 5-3/4, 8, and 5 per cent for M_1, M_2, and the bank credit proxy, respectively. The associated ranges of tolerance for growth rates in the November-December period would be 2-1/2 to 5-1/2 per cent for RPD's, 6-1/2 to 9-1/2 per cent for M_1, and 8 to 10-1/2 per cent for M_2. The range of tolerance for the weekly average Federal funds rate in the inter-meeting period would be 8-1/2 to 10 per cent.

By unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions for the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that real output of goods and services is falling significantly further in the current quarter while price and wage increases are continuing large. In October industrial production declined--after having changed little since May--and the unemployment rate increased further, from 5.8 to 6.0 per cent. In recent weeks sizable cutbacks in automobile production have been announced, and claims for unemployment insurance have continued to increase. There are major uncertainties concerning the duration of the coal strike; a lengthy shutdown would have substantial effects on other industries. The October rise in wholesale prices of industrial commodities, although substantial, remained well below the extraordinarily rapid rate in the first 8 months of the year; prices of farm products and foods increased sharply.

In recent weeks the dollar has declined further against leading foreign currencies. In the third quarter the U.S. foreign trade deficit was substantially larger than in the second quarter, but U.S. banks sharply reduced their foreign lending.

Growth of the narrowly defined money stock picked up from the slow pace of the third quarter to an annual rate of about 5 per cent in October. Net inflows of consumer-type time and savings deposits at banks and at nonbank thrift institutions also improved in October, and the money supply measures more broadly defined expanded appreciably. Bank credit outstanding changed little, and banks reduced their borrowing through Euro-dollars and large-denomination CD's. Since mid-October markets for short- and long-term securities have improved, despite heavy Treasury financing and a large volume of corporate security issues. Interest rates on market securities in general have declined further, and mortgage yields also have fallen somewhat. On November 13 the Board of Governors announced a restructuring of member bank reserve requirements, which will have the effect of releasing reserves to the banking system in the week beginning December 12.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resisting inflationary pressures, supporting a resumption of real economic growth, and achieving equilibrium in the country's balance of payments.

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

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

It was agreed that the next meeting of the Committee would be held on December 16 and 17, 1974.

Thereupon the meeting adjourned.

Arthur L. Broida

Secretary

ATTACHMENT A

November 19, 1974

TO: Federal Open Market Committee SUBJECT: Basle meeting of November 11, 1974

FROM: Henry C. Wallich

At the Basle meeting on November 11, the principal topics discussed, in addition to the usual review of economic conditions, were bank regulation matters and recycling.

Governor Richardson reported on the outcome of his approach to consortium banks of which he had requested an expression of support, by the shareholding banks. He considered the results very satisfactory. All of the 29 consortium banks had either supplied the desired type of assurance or given indication that it would soon be forthcoming. Some of the statements received contained qualifications such as "to the extent possible" or "subject to applicable laws and regulations," and, of course, it was understood that the promise of support was a moral and not a legal commitment. In the course of further discussions it became evident that various central banks had taken different attitudes toward the Richardson operation, some of them working closely with their banks in formulating a reply, others, such as the Federal Reserve, assuming the role of an interested bystander.

The Bank of England will now repeat the process with respect to the much larger number of subsidiaries of foreign banks. Richardson expects that eventually all subsidiaries will receive a request of the kind described; however, these requests are expected to be presented on the occasion of contacts with the banks that may occur for other reasons. No great urgency seems to be attached.

The discussion of recycling focused on a proposal made by Zijlstra on behalf of the BIS and, in a sense, of the Secretary General of OECD. It would involve the issuance of obligations either by the BIS or, more likely, a body created by the OECD, guaranteed by the OECD members on a quota basis, i.e., a joint but not several guarantee. The proceeds would be loaned to oil-importing countries having difficulties obtaining funds. The OPEC countries might be among the buyers of the bonds, but the bonds would be offered to the general market, and no special approach would be made to the OPEC countries. Zijlstra stressed that the BIS should never be in a position of actively soliciting OPEC funds. As regards the use of the funds, loans would be decided by the OECD or a body appointed by it. Zijlstra added that the proposal would be discussed at the meetings of OECD bodies in Paris which are going forward this week.

The plan described has many similarities with the American plan put forward by Secretaries Kissinger and Simon. It differs principally in what might possibly turn out to be a greater involvement of OPEC lenders, in the exclusive use of government guarantees in lieu of possible contributions of appropriated funds, and in the focus on oil deficits as contrasted with general balance-of-payments or even domestically motivated borrowing needs.

In a smaller group, there was discussion of exchange market intervention to deal with the upward tendency of the Swiss franc and the German mark. This led to a communication to the press on the part of the Swiss which appeared on the Reuters ticker in the following form: "The Federal Reserve, the Bundesbank, and the National Bank of Switzerland are prepared to enter the foreign exchange market as and when they see fit to preserve orderly market conditions, informed sources said. They said that there was no need for any formal agreement between the three sides on this cardinal point of principle nor did the arrangement imply intervention would necessarily take place at an early date.

Asked to comment on this arrangement, President Leutwiler said the Swiss National Bank had no special interest in defending the dollar at any given level against the Swiss franc. The Swiss authorities would, however, watch the situation closely and take any appropriate action."

More detailed comments on the market impact of this press report and on the market intervention undertaken is contained in the report of the Special Manager for the statement week ended November 13, 1974.

ATTACHMENT B

November 18, 1974

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on November 19, 1974

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that real output of goods and services is falling significantly further in the current quarter while price and wage increases are continuing large. In October industrial production declined--after having changed little since May--and the unemployment rate increased further, from 5.8 to 6.0 per cent. In recent weeks sizable cutbacks in automobile production have been announced, and claims for unemployment insurance have continued to increase. There are major uncertainties concerning the duration of the coal strike; a lengthy shutdown would have substantial effects on other industries. The October rise in wholesale prices of industrial commodities, although substantial, remained well below the extraordinarily rapid rate in the first 8 months of the year; prices of farm products and foods increased sharply.

In recent weeks the dollar has declined further against leading foreign currencies. In the third quarter the U.S. foreign trade deficit was substantially larger than in the second quarter, but U.S. banks sharply reduced their foreign lending.

Growth of the narrowly defined money stock picked up from the slow pace of the third quarter to an annual rate of about 5 per cent in October. Net inflows of consumer-type time and savings deposits at banks and at nonbank thrift institutions also improved in October, and the money supply measures more broadly defined expanded appreciably. Bank credit outstanding changed little, and banks reduced their borrowing through Euro-dollars and large-denomination CD's. Since mid-October markets for short- and long-term securities have improved, despite heavy Treasury financing and a large volume of corporate security issues. Interest rates on market securities in general have declined further, and mortgage yields also have fallen somewhat. On November 13 the Board of Governors announced a restructuring of member bank reserve requirements, which will have the effect of releasing reserves to the banking system in the week beginning December 12.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resisting inflationary pressures, supporting a resumption of real economic growth, and achieving equilibrium in the country's balance of payments.

OPERATIONAL PARAGRAPH

Alternative A

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

Alternative B

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

Alternative C

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

ATTACHMENT C

November 19, 1974

Points for FOMC guidance to Manager in implementation of directive		Specifications (As agreed, 11/19/74)
A. Longer-run targets (SAAR): (September plus fourth and first quarters, combined)	M_1	5-3/4%
	M_2	8%
	Proxy	5%
B. Short-run operating constraints:		
1. Range of tolerance for RPD growth rate (November-December average):		2-1/2 to 5-1/2%
2. Ranges of tolerance for monetary aggregates (November-December average):	M_1	6-1/2 to 9-1/2%
	M_2	8 to 10-1/2%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		8-1/2 to 10%
4. Federal funds rate to be moved in an orderly way within range of toleration.		

5. Other considerations: account to be taken of developments in domestic and international financial markets.

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