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 18, 1975, at 9:00 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Baughman
Mr. Bucher
Mr. Coldwell
Mr. Eastburn
Mr. Holland
Mr. Jackson
Mr. MacLaury
Mr. Mayo
Mr. Mitchell
Mr. Wallich

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

Messrs. Clay, Kimbrel, and Morris, Presidents of the Federal Reserve Banks of Kansas City, Atlanta, and Boston, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Mr. Gramley, Economist (Domestic Business)
Messrs. Boehne, Davis, Green, Kareken, Reynolds, and Scheld, Associate Economists

Mr. Holmes, Manager, System Open Market Account
Mr. Pardee, Deputy Manager for Foreign Operations
Mr. Sternlight, Deputy Manager for Domestic Operations

Mr. Coyne, Assistant to the Board of Governors
Mr. Keir, Adviser, Division of Research and Statistics, Board of Governors
Mr. Gemmill, Adviser, Division of International Finance, Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Ferrell, Open Market Secretariat Assistant, Board of Governors

Messrs. Leonard and Williams, First Vice Presidents, Federal Reserve Banks of St. Louis and San Francisco, respectively

Messrs. Eisenmenger, Parthemos, and Doll, Senior Vice Presidents, Federal Reserve Banks of Boston, Richmond, and Kansas City, respectively
Messrs. Hocter, Brandt, Balbach, and Keran, Vice Presidents, Federal Reserve Banks of Cleveland, Atlanta, St. Louis, and San Francisco, respectively
Mr. Ozog, Manager, Securities and Acceptances Division, Federal Reserve Bank of New York

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on October 21, 1975, were approved.

Before this meeting there had been distributed to the members of the Committee a report from the 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 21 through November 12, 1975, and a supplemental report covering the period November 13 through 17, 1975.

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

> After having declined by some 4 to 5 per cent prior to the last meeting of the Committee, dollar rates leveled off through most of the period under review. Although rates were generally more stable, it was only a surface calm. Widespread concern over the New York City situation, a continuing decline in U.S. interest rates, growing doubts in the market over the sustainability of the U.S. economic recovery, and discouraging wholesale price figures for this country all weighed on the dollar in the exchanges.
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> In earlier episodes since the dollar was floated, widespread concern over one phase or another of U.S. economic policy, combined with declining U.S. interest rates, invariably led to sharp, cumulative drops of the dollar in progressively disorderly markets. This ultimately brought the Federal Reserve into the exchanges in a big way, with the System drawing on the swap lines. Over the last month, however, no cumulative decline occurred. Moreover, with the New York exchange market relatively quiet, we did not intervene once in support of the dollar during the period, and not because we at the Desk have relaxed our vigilance in any way.
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> The essential balance of the market was maintained, I believe, by three factors. First, the underlying position of the dollar remains strong, as reflected in our continuing string of near-record trade surpluses, and this fact is now widely recognized in the market place. Second, the European central banks, under their various interpretations of intervention arrangements, were prepared to intervene promptly and in volume to resist serious slippage in dollar rates. In this connection, the Bank of France intervened particularly heavily, but other central banks have

been equally quick to operate. On several occasions, the German Federal Bank bought sizable amounts of dollars openly at the daily fixing. The result was that foreign central banks absorbed close to $1.5 billion over the first 3 weeks of the period. In the absence of that intervention, in my judgment, the dollar clearly would have fallen further, and the selling of dollars, which seemed strongest abroad, would have boiled over into the New York market place. Finally, as distinct from earlier periods of heavy speculation against the dollar, the market recognized that the political dispute over New York's finances could end at any moment, through some compromise or other, and that any trader who went short of dollars in any size ran the risk of being caught with a big loss. Consequently, there were few large positions built up against the dollar, and when a political compromise seemed to emerge last week, the dollar advanced but no scramble for dollars developed. This morning dollar rates are some 1 to 2 per cent above their recent lows.

Looking ahead, fundamentals remain favorable and, as long as the compromise on New York City finances does not come apart, the dollar should continue to firm.

I might add that New York City's difficulties temporarily removed the spotlight from sterling as the most discussed concern of the international trading community and sterling was generally firmer throughout October and early November. The British have done better. So far the "6 pound" pay policy introduced in June has been honored. In addition, the Labor government has recently shifted its priorities away from social welfare and consumption toward the stated objective of making British industries more competitive. We may be skeptical of the ability to fulfill this objective, but it is definitely a step in the right direction. In addition, the United Kingdom has asked for a $2 billion equivalent drawing from the IMF, using both the oil facility and regular drawing rights. This package may not be completed until January.

In reply to a question, Mr. Pardee indicated that the Desk had purchased some German marks during the recent interval, on days when the dollar was buoyant against the mark.

> By unanimous vote, the System open market transactions in foreign currencies during the period October 21 through November 17, 1975, were approved, ratified, and confirmed.

Mr. Holmes noted that, as Mr. Pardee had reported, the British would be drawing about $2 billion in various currencies from the IMF, but the transaction might not be completed until some time in January. If sterling should come under pressure before then, there was a possibility, perhaps remote, that the British might want to draw temporarily on the swap line with the System in the expectation that proceeds from the IMF loan would be used to repay the drawing. Such a request, if received, would appear to involve a reasonable use of the swap line and he hoped the drawing would be acceptable to the Committee.

An aspect of the British Fund drawing of special interest to the System, Mr. Holmes continued, was that it could include a fairly sizable amount of Belgian francs. Both the Belgian and the British authorities had been advised that the System would be interested in acquiring those francs if the terms were

satisfactory. Otherwise, he was afraid that there was nothing constructive to report on the negotiations relating to the repayment of the System's Belgian franc debt. The Belgian Minister of Finance was reported to have been heavily involved in other activities and he had not made a decision on the applicable exchange rate--a matter that had been agreed upon in principle a long time ago. He (Mr. Holmes) had been assured that the delay was only temporary and that a decision would be made soon. If it was not, he thought the System should exert more pressure to get at least that part of the problem resolved. The dollar was improving somewhat against the Belgian franc and other currencies, and he thought the System should not miss any opportunity to purchase francs in the market for the purpose of making repayments on the swap debt.

Mr. Holmes indicated that no outstanding drawings would mature in the period ahead, but all of the System's swap arrangements would come up for renewal on various dates during December. In view of other activity in the international area--the recent Rambouillet summit meeting and the coming Jamaica meeting of the IMF Interim Committee, among others--he would recommend that the renewals be made in a routine, low-key manner with no changes in the underlying agreements.

In reply to a question by Mr. Holland, Mr. Holmes said he did not have enough information to comment on the operational

implications of the agreement between the United States and France reached at the Rambouillet meeting. Also, he did not know whether the agreement was intended to be implemented only after the Jamaica meeting or at some point in the interim.

Chairman Burns observed that the practical consequences of the agreement remained to be seen, but its language definitely suggested that market intervention on a larger scale was contemplated. Apart from that apparent intent, he did not think anything definite could be said at this stage. Presumably the matter would be clarified as conversations went forward.

Mr. Holland said he had raised the question partly because the agreement seemed to imply an increase in Federal Reserve activity in the foreign exchange market. In that event, the System would be in an untenable position if the Treasury were to remain an obstacle to the System's repayment of its swap debts. Accordingly, he thought the System should promptly and vigorously press the Treasury to work out understandings with respect to repayments of those debts.

Chairman Burns said he thought Mr. Holland had made a fair statement.

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, 1975
National Bank of Belgium	1,000	12	December 19, 1975
Bank of Canada	2,000	12	December 29, 1975
National Bank of Denmark	250	12	December 29, 1975
Bank of England	3,000	12	December 3, 1975
Bank of France	2,000	12	December 29, 1975
German Federal Bank	2,000	12	December 29, 1975
Bank of Italy	3,000	12	December 31, 1975
Bank of Japan	2,000	12	December 3, 1975
Bank of Mexico	360	12	December 3, 1975
Netherlands Bank	500	12	December 29, 1975
Bank of Norway	250	12	December 3, 1975
Bank of Sweden	300	12	December 3, 1975
Swiss National Bank	1,400	12	December 3, 1975
Bank for International Settlements:			
Dollars against Swiss francs	600	12	December 3, 1975
Dollars against other authorized European currencies	1,250	12	December 3, 1975

Secretary's note: Notes by Governor Wallich on the November BIS meeting, which were distributed at this meeting, are 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. Gramley made the following statement:

Developments of the past several months have pointed increasingly towards the likelihood of a significant slowing in the rate of economic

expansion from the rapid pace of the past summer. In the third quarter a sharply rising level of production was generated by a marked swing of inventory investment from deep liquidation toward accumulation. Growth of final sales slowed appreciably, however.

In the consumer sector, the stimulus to spending from the tax rebate and special social security checks sent out in May and June largely ran its course by July. Since then new car sales have been essentially flat, as have retail sales outside of the auto category. Total retail sales in current dollars rose 1 per cent last month, but this rise just offset the September decline now indicated by revised estimates.

Other sectors of final demand have not yet strengthened sufficiently to make up for the diminished thrust from consumer buying. Business fixed investment--a sector which sometimes lags in the early phase of a recovery--seems to have bottomed out, but there are few indications yet of an impending upturn. The housing recovery, meanwhile, has continued at a moderate pace. We will get a report on starts in October later today, and we expect some further increase. But we believe that the basic weaknesses plaguing the housing industry have not yet been fully corrected.

In view of the moderating pace of final sales, businesses have now apparently begun to pull back to await further indications as to the basic strength of recovery forces. This is, I believe, the interpretation to be placed on the distinct slowing in the rise of production and employment in October. Industrial output last month is estimated to have risen 0.4 per cent--compared with average monthly gains of 1-1/2 per cent during the third quarter. Output of materials, which had been advancing very rapidly over the summer, is now rising at a more sustainable pace. The rate of increase in output of final products has also moderated; production of business equipment declined somewhat last month, following increases in both August and September.

Labor market data for October also indicate a moderating pace of expansion. Nonfarm payroll employment rose about two-thirds as fast as the

average of the previous several months; the percentage of industries adding to their work forces declined; and the length of the workweek in manufacturing was unchanged. The over-all unemployment rate rose from 8.3 to 8.6 per cent, but a large part of this increase was probably due to difficulties of seasonal adjustment.

Rates of real growth during cyclical expansions vary considerably from one quarter to the next, and a slowdown is not infrequently followed by resumption of vigorous growth. In the staff's judgment, however, a return to anything like the rate of expansion of this past summer is unlikely. The inventory sector should provide further thrust to economic expansion over the next several quarters, but much less than in the immediate past. The principal support for growth from here on out will have to come from the major sectors of final demand.

The staff's view of the prospects in final demand sectors has not changed greatly over the past month, and so the contours of the GNP projection for 1976 in this green book[1/] are about the same as they were a month ago. It still appears to us that the consumer will be a relatively passive element in the recovery--increasing his spending in response to rising disposable income, but showing only a limited willingness to purchase big-ticket items or to increase indebtedness. However, we continue to expect a good cyclical recovery in business capital outlays, though advance indicators of plant and equipment spending have thus far remained mixed. New orders received by the capital goods industries have not shown much strength recently, and construction contract awards for commercial and industrial buildings--though bottoming out--have still to turn up. The recent McGraw-Hill survey of business plans for capital spending, on the other hand, does not seem inconsistent with rising real capital outlays next year. That survey indicated plans for a 9 per cent year-over-year increase of current dollar outlays

1/ The report, "Current Economic and Financial Conditions," prepared for the Committee by the Board's staff.

in 1976, and expectations of a 9 per cent rise in prices. But these anticipation surveys tend to understate spending plans in the first year of recovery by around 5 or 6 percentage points, on average. Accordingly, our staff projection of a 6 per cent real increase in business fixed investment in 1976, on a year-over-year basis--which translates to a 12 per cent rise from fourth quarter to fourth quarter--still seems viable.

Our staff projection for housing has been strengthened a bit since the last green book, mainly because pressures on short-term market interest rates, and hence on conditions in the mortgage market, seem likely to be less intense than we earlier had thought. For example, we now project a rise in the 3-month Treasury bill rate to around 8 per cent late next year, compared with 8-3/4 per cent a month ago. Commensurately, we have assumed that the change in Regulation Q ceilings formerly projected to take place at the turn of the year would be put off until mid-1976.

For the State and local sector, financial considerations have led the staff to reduce projected expenditures somewhat further since the last green book. We now are estimating State and local purchases of goods and services in the fourth quarter of 1976 at a level $3 billion less than a month ago and $8 billion less than 2 months ago, reflecting the increased fallout of the New York City crisis in the market for tax-exempt securities and also the budget strains under which many municipal governments find themselves. I hardly need remind the Committee that estimates of the probable effects of a financial crisis whose ultimate outcome is yet to be resolved are bound to be highly uncertain. I should remind you, also, that in our projections we have not allowed for any large adverse expectational effects of the New York City problem on business and consumer confidence and spending plans.

Let me turn now briefly to recent wage and price developments and their implications for the likely course of inflation.

The rise in industrial commodity prices at wholesale over the past several months has been disconcerting and a good deal larger than we had expected. Special factors have been partly responsible, and it may be, too, that the index has been overstating the rise in transactions prices recently. For example, we hear reports of discounts from posted steel prices that may not have been reflected in the WPI. But prices generally seem to be going up a lot sooner and faster in this recovery than we had bargained for.

Nonetheless, the staff is still holding to the view that the rate of inflation in 1976 will stay in the 5 to 6 per cent range and might improve somewhat over the course of next year. Several factors have influenced our thinking.

First, recent developments, we believe, have increased the probability that real economic growth will be moderate next year and that substantial slack will continue to prevail in labor and product markets. Second, supplies of most agricultural commodities look rather favorable now, so that prices of food may rise no faster than those of nonfood commodities and services. Third, it appears that the uncertain state of controls over oil prices may be resolved on the side of near-term stability, or possibly even some decline, in prices of petroleum products. Fourth, if the rise in food and fuel prices is limited, wage rate increases are more likely to stay within the range of recent experience. In that event, increases in the general price level at about the rate of rise in unit labor costs--which we projected at around 5 per cent or so--would permit substantial further growth in aggregate corporate profits. This would remove some of the urgency that seems to underlie current efforts of businesses to improve profits by raising prices.

The next month or two may tell whether our relative optimism on the price front is warranted. We should also learn whether the strengthening of final demands on which a solid economic expansion next year is predicated will be forthcoming. My own feeling is that the probabilities at this

> moment lean in the direction of a somewhat less robust expansion in real activity than the staff is now projecting and--at the same time--a somewhat higher rate of wage and price inflation. Unfortunately, the short-run tradeoff between real activity and prices still seems to be a long way from satisfactory.

Chairman Burns remarked that it would be desirable if Committee members' comments on the economic situation and outlook emphasized any points on which they differed significantly from the staff analysis.

Mr. Black noted that the staff projection of State and local government purchases of goods and services had been reduced over the past 2 months in large part because of the effects of the New York City crisis, and he asked whether resolution of that crisis and, consequently, improvement in the municipal bond market would be viewed by the staff as grounds to revise the projection upward again.

Mr. Gramley replied that recent developments in the municipal bond market were likely to have an impact on financial planning of State and local governments for some time to come. He believed that resolution of the New York City crisis in a way that amply protected creditors would bring about improvement in the municipal bond market and in prospects for State and local government purchases, but the projected levels were likely to remain below those of 2 months earlier.

Mr. Bucher remarked that he had heard a great deal about restrictive lending policies of banks, and references were sometimes made to "a new generation of depression loan officers." He asked whether the staff had a view concerning the impact of such policies on the course of bank loans and on the progress of the recovery in economic activity.

In response, Mr. Gramley observed that in conversations with people in the banking community, members of the staff had concluded that a significant element of conservatism did exist in the lending policies of banks--although it appeared that the banks, even those in New York City, were still competing aggressively to make loans to businesses of good quality. The restrictive policies were reflected in the staff projection as a significant, but not a major, element. In contrast with earlier postwar recoveries, business demands for external financing were expected to remain moderate, and even with conservative policies, the banks would meet most of the demand for business loans.

Mr. Holland remarked that his expectations for the structure of savings differed somewhat from the structure suggested by the staff projection. He asked for an explanation of the projected rise in the personal saving rate in the latter part of 1976. With respect to corporate savings, he had a

feeling that recent market developments were tending to raise the rate to a higher level that would persist for some time.

Mr. Gramley replied that the staff projection of the personal saving rate essentially was stable around 7-3/4 per cent over the period through the fourth quarter of 1976. The projection did suggest that the rate would rise from 7.8 per cent in the third quarter of next year to 8.0 per cent in the fourth quarter, but the rise was not significant; it was accounted for by an expected Federal pay raise that, as in the past, would not be fully smoothed out by the seasonal adjustment procedures. With respect to corporate savings, he agreed that the rate was likely to move up and be sustained on a higher level. Corporations were likely to attempt to limit their external financing by following conservative dividend policies. More importantly, they were raising prices in an effort to assure an improvement in profits and profit margins from the relatively poor performance of the late 1960's and early 1970's.

Mr. Holland then asked whether the current effort to improve profit margins by raising prices was likely to be a one-time adjustment, so that the stepped-up rate of increase in prices in recent months would prove to be a temporary bulge.

Mr. Gramley replied that the staff projection did suggest that the rise in prices would slow during 1976 to about the rate of increase in unit labor costs. That implied that profit margins would not change very much further, although aggregate profits would continue to rise along with expansion in economic activity.

Mr. Partee said, in connection with the expected increase in corporate savings, the flow of funds projection suggested that nonfinancial corporations' net borrowing--that is, their borrowing less investment in financial assets--would be only about $35 billion next year, compared with $51 billion in 1973 and $58 billion in 1974. Net borrowing, which was at an annual rate of $7 billion in the first half of this year and was expected to be at a rate of $13 billion in the second half, was projected to rise to a rate of $33 billion in the first half of 1976. Thus, the big shift was expected to occur in the period just ahead.

Mr. Winn observed that, should the staff projection of prices prove to be correct, price performance next year was likely to be considerably better in this country than in other industrial countries. He asked whether, in making its projection of business fixed investment, the staff had taken into account the effects that the better price performance here would have on foreign investment in this country and on U.S. corporations' decisions to invest in this country rather than abroad.

Mr. Gramley said the uncertainties concerning business fixed investment next year were so great that no explicit account was taken of possible developments of the kind that Mr. Winn suggested.

Mr. Reynolds commented that surveys of plans of U.S. corporations indicated that they intended to raise investment expenditures abroad even more next year than they were raising them this year. Of course, those plans could be changed.

Mr. Wallich remarked, with respect to financing the economic expansion, that a number of corporations which normally would raise funds by selling stocks, bonds, or commercial paper in the public markets would be forced by the problems in those markets to seek bank loans. In light of that, he asked whether the banks--with the various constraints they were subject to--would be able to expand outstanding business loans to the extent necessary.

Mr. Gramley said he felt some uncertainty about the answer. Conservative attitudes appeared to be quite general, affecting investors as well as lenders. The staff had tried to make allowance for the effects of those attitudes, but he could not be sure that it had made sufficient allowance.

Mr. Wallich then asked whether, as he believed was the case, the banks' share of total funds supplied had been shrinking.

In response, Mr. Gramley observed that according to the staff projection, the banking system would account for about 25 per cent of the funds supplied to the nonfinancial sector in the year ahead, which was much below the shares in 1973 and 1974. In the staff view, however, the relatively low share reflected weak demands for business loans to a much greater extent than conservative policies on the part of banks.

Mr. Mitchell remarked that the high shares accounted for by the banking system in 1973 and 1974 were associated with excessive increases in the short-term debt of the nonfinancial sector.

Mr. Partee commented that the banking system's share of funds supplied to the nonfinancial sector included banks' investment in Government securities as well as loans to business, and the staff had assumed that in the coming year banks would increase their holdings of Government securities further. With respect to the loan policies of banks and their potential effects on the course of the economy, he had raised questions a month ago. Since then he had questioned many bankers about the situation, and the most common response was that they probably would be more selective in making loans if loan demand were strong, but in fact, loan demand was weak.

Mr. Volcker said he did not differ with the staff view of the economy to any great extent, although he would place somewhat different emphasis on some elements in the situation. Over time, he had become more and more concerned about the ramifications of the New York situation, even though the financial markets had discounted them to a considerable extent. One important issue, which Mr. Gramley had mentioned, was the degree of protection afforded creditors of the City. In the event that the Federal Government did not assist New York and the City defaulted, creditors might well be at the end rather than at the beginning of the line, for two reasons. Because of a strong instinct for self-preservation, the City would be under strong pressure to maintain regular services despite a large shortfall in revenues in coming months. As a result, little thought had been given to developing an orderly plan to deal with creditors' interests. The second reason was the sheer volume of legal issues that would arise and would need to be resolved before any planned composition could be agreed to. The number of law suits and counter suits that would ensue would delay orderly handling of the situation for a considerable period of time. Even with a new bankruptcy law--and it might be helpful for the Federal Government to enact one--substantial and fundamental legal issues would arise.

The first suit, Mr. Volcker went on to say, was likely to test whether the Federal Government had jurisdiction. While there were solid arguments that it did, there also were arguments that it did not, and a Federal judge could not assume control of the situation while the issue was being resolved. Once that issue was settled, the way would be open for suits by creditors--including suppliers and all other creditors of the City as well as holders of securities--to contest any proposed plan of composition. Lengthy memoranda had been written listing the particular legal issues that had never been and would need to be resolved before a plan of composition could be agreed upon. In view of the enormous cash shortfall that would exist, City administrators would have incentives to defer resolution of the issues.

Mr. Volcker observed that the consequences for State agencies could be very serious. Some of them were particularly vulnerable because of the importance of City lease payments to their revenues in key programs. Once the City was in default, City administrators might regard these payments as relatively unimportant. Thus, the cash flow of the agencies would not be maintained. There would also be repercussions on the cash position of the State in that its revenues would be reduced and its expenditures increased. That would make it much more difficult for the State

to resume financing in the market next spring, when it would need to borrow $3-1/2 billion to $4 billion. Should the State not be able to borrow then, the financial problems of New York City and of other cities would be aggravated; two-thirds of State expenditures were local government support payments, which bulged in the spring. Some form of Federal assistance, either before or after a default, would go a long way toward creating conditions in which the financial problems could be handled in a more orderly way, although it would not help in dealing with the legal issues.

Finally, Mr. Volcker commented that uncertainties over whether New York City would be able to meet all of its financial obligations contributed to pressures for conservative and selective lending policies and, therefore, increased his feeling of uncertainty about the outlook for residential construction and fixed business investment. Actually, the staff of the New York Bank had projected a slightly lower rate of growth in real GNP over the period to mid-1976 than had the Board staff. The real issue, however, was whether some danger existed that the recovery in economic activity would stall. With that possibility in mind, he would watch the situation very carefully over the next few months.

Chairman Burns remarked that there was a fair chance that the New York situation would be cleared up rather shortly.

Mr. Winn, with reference to questions raised earlier by Mr. Wallich, observed that it might be better to pay more attention to total credit and less to that part of the total accounted for by the bank sector. He had gained the impression from institutional investors that insurance companies recently had experienced inflows of funds in excess of their earlier projections and, consequently, had large amounts of funds to invest. In the circumstances, long-term credit might be substituted for short-term credit, and the over-all credit situation might be better than one might judge from developments in the short-term sector alone.

Chairman Burns commented that outstanding business loans at commercial banks had increased appreciably in October.

Mr. Baughman remarked that a week earlier he had participated in an annual conference of large correspondent banks held under the auspices of the American Bankers Association, during which he had experienced two surprises. The officers responsible for correspondent activities were intensely interested in the measurement of creditworthiness of banks to whom they extended credit. In the several conferences that he had attended in earlier years

he had never observed a comparable degree of interest in that particular issue. The heightened interest, in his view, was another indication of the rather conservative attitude of bankers at present. It was consistent with comments of loan officers at banks in the Dallas District.

The second surprise, Mr. Baughman continued, was the desire on the part of those bank officers to have access to examination reports in order to evaluate the creditworthiness of the banks to whom they extended credit. He was particularly surprised that they were not easily diverted from pursuing the subject. They maintained that their interest in being able to distinguish the good from the bad among the smaller banks was the same as that of the supervisory authorities and, therefore, that they should not be precluded from having access to the reports.

In reply to a question by Mr. Holland, Mr. Baughman remarked that the bankers had replied in the negative to his inquiry as to whether they would be willing to provide their own examination reports to suppliers of Federal funds.

Concerning business activity, Mr. Baughman observed that at a meeting during the preceding week the directors of his Bank expressed much less confidence than earlier that the

recovery would proceed with significant strength. He sensed that they would have been ready to take action to reduce the discount rate, had such action been encouraged. The shift in their views reflected a number of developments. One was the liquidation in the cattle industry, which was continuing at a substantial rate, particularly in the Southwest, and was being intensified by the effects of a shortage of rainfall on grazing capacity. There also was some concern about next year's wheat crop, although that seemed premature. Reports of retail sales in the District were consistent with the national figures. It was disconcerting, moreover, that retailers reported a feeling that their suppliers were maintaining very conservative policies with respect to inventories, which meant that the retailers had to run the risk either of being short of goods to sell or of carrying the inventories themselves. The retailers also reported that suppliers maintained a strong posture with respect to prices, which were up significantly from earlier orders; suppliers showed little willingness to negotiate.

Mr. Kimbrel remarked that retailers in his District were optimistic about pre-Christmas sales, but they also reported having encountered inventory problems. Delivery of items already ordered was being delayed and a couple of national firms indicated that they were spending a great deal of time trying to get deliveries.

The items involved generally were soft goods. Some retailers now were suggesting that they would lose a certain amount of sales in the Christmas season because of inadequate supplies. He asked whether those developments were likely to bring about a change in inventory policies and whether they were reflected in the staff projection.

Mr. Gramley replied that the projection reflected an expectation that businesses would continue to maintain cautious inventory policies. With respect to the availability of supplies, he seriously doubted that the problems being encountered were sufficiently widespread to limit retail sales, and no such limitation was reflected in the projection. Inventory-sales ratios tended to support the conclusion that no general shortage existed. In September the ratio for total trade was 1.36, compared with a more or less normal figure in a range of 1.30 to 1.35. For retail nondurable goods stores alone, the September ratio was 1.16, compared with a normal figure in a range of 1.15 to 1.20. He had heard of only one case in which sales were being significantly limited by the availability of supplies, and that was foreign automobiles. Inventories had been reduced from about 600,000 units at the beginning of the year to less than 250,000 currently, and the current stock represented around a 60-day supply.

Chairman Burns remarked that the questions that had been raised were of sufficient interest to justify making inquiries of several large retailers across the country, and he asked the staff to undertake such an inquiry.

Mr. Eastburn observed that the information available on developments in his District tended to support the staff projection. For example, the number of unit messages received, which was reported by the telephone system, was virtually unchanged in recent months, suggesting relatively moderate progress in the economy. With respect to the staff projection, he noted that the assumption of less upward pressure on interest rates than had been assumed earlier had a significant effect on residential construction. He would have thought that the effects on consumption expenditures and on business fixed investment would have been larger than suggested by the projection.

Mr. Gramley commented that the Board's econometric model did suggest somewhat larger effects on consumption and business fixed investment from the assumption of lower interest rates, but the staff was not prepared to accept those results. In the business sector, signs had not yet appeared to suggest even the kind of expansion in expenditures that the staff was projecting. And consumers still appeared to be relatively pessimistic about the economic outlook. Surveys of consumer confidence had not

yet shown the kind of improvement that the staff had expected. One would have to wait and see whether lower interest rates and perhaps also rising prices in the stock market would induce consumers to have a more buoyant outlook.

Mr. Partee remarked that, for the latest projection, the staff had assumed that the Regulation Q ceilings on longer-term deposits would be raised at midyear, rather than in the first quarter. Consequently, even with the assumption of lower interest rates than in the previous projection, flows of funds into the thrift institutions were not very much larger than they had been and the upward revision in the projection for residential construction was less than it would have been.

Mr. Kimbrel asked whether the cutback in planned borrowing and spending by State and local governments would not be offset to some extent as the funds that would have been invested in municipal securities were invested in other kinds of financial assets, thereby lowering interest rates and stimulating activity.

Mr. Gramley replied that in principle he agreed that such effects would occur. However, the reduction in State and local government purchases, compared with the previous projection, was only $3 billion by the fourth quarter of next year, and the effects on other sectors were not large enough to be identified.

Mr. MacLaury said he and the directors of the Minneapolis Bank thought that the economic outlook was stronger than suggested by the staff projection. In his District, he too had heard major retailers comment on shortages and on problems of getting deliveries, particularly of soft goods, in time for Christmas. Whether it was because of the improved harvest in the region or for other reasons, consumers were showing up in the stores, and sales in October were better than had been expected. Despite uncertainties with respect to financial markets, particularly because of the New York situation, he still thought that growth in real GNP from 1975 to 1976 would be on the order of 7 per cent, rather than 6 per cent as projected by the staff.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period of October 21 through November 12, 1975, and a supplemental report covering the period of November 13 through 17, 1975. Copies of both reports have been placed in the files of the Committee.

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

In seeking to attain Committee objectives for moderate monetary growth, System operations since the last meeting of the Committee have been directed at fostering a somewhat readier availability of reserves. In turn, this helped produce a fairly buoyant atmosphere in most sectors of the credit market, a notable exception being municipal bonds which were in the shadow of threatened default by New York City and related entities.

The Desk was prepared initially after the last meeting to aim for conditions of reserve availability that would bring the Federal funds rate down from the then-current 5-3/4 per cent area to around 5-1/2 per cent by the end of the October 29 statement week. A temporary indication of strengthening monetary growth shortly after the meeting caused the Account Management to temper the easing trend for a brief time, and the Desk delayed implementation of the 5-1/2 per cent objective until the end of October, when fresh signs of weakness appeared in the aggregates. As it turned out, a great overabundance of reserves developed toward the end of the November 5 week, exacerbated by some computer problems within the System and by the partial holiday on November 4, so that Federal funds eased sharply and the weekly average effective rate fell nearly 1/2 percentage point to 5.17 per cent. By this time--early November--still weaker data on the monetary aggregates caused the Desk to aim for reserve availability consistent with the 5-1/4 per cent lower bound of the Committee's range. Most recently the data on monetary growth strengthened again, but given the close proximity of today's meeting, and also in light of continuing uncertainty in the markets related to the New York situation, the Desk's reserve posture was held steady. Thus, Federal funds have traded around 5-1/4 per cent since early November.

Reserves were provided early in the period through purchases of $284 million of agency issues and nearly $1 billion of bills, supplemented by day-to-day repurchase agreements. Later in the period, operations were mainly in a reserve-absorbing direction, undertaken through sales and redemptions of bills which more than offset earlier bill purchases, and

through substantial use of short-term matched sale-purchase transactions. Yesterday, however, some current and anticipated reserve needs were met through purchases of about $355 million of Treasury coupon issues.

Buoyed by the news of weak monetary growth accompanied by evidence of a more accommodative System stance, most interest rates declined over the recent interval. The decline was most pronounced for Government securities, where demand was reinforced by investor emphasis on quality in the face of uncertainty about the possible impact of a default by New York City or other related borrowers. In this atmosphere the Treasury's November refunding offer of $2.5 billion 7-year notes and $1 billion of reopened 25-year bonds was well received. Dealers took large amounts of both issues, and subsequently have distributed part of their purchases--although secondary demand, at least for the bonds, has been somewhat sluggish. Late in the period yields backed up again, reflecting renewed concern over inflation, a feeling that the System's recent easing had run its course, and a growing view that New York's financial difficulties might be moving closer to resolution--thus lessening the previous degree of quality preference. For the whole period, yields on short-term coupon issues were down a net of 20 to 40 basis points, while intermediate- and longer-term issues were unchanged to 10 or 20 basis points lower.

Bills enjoyed broad demand despite net Treasury issuance each week and net System redemptions, so that rates were lower by some 30 to 45 basis points over the period. In yesterday's auctions, 3- and 6-month bills were sold at average rates of about 5.47 and 5.80 per cent, respectively, down from 5.89 and 6.16 per cent just prior to the last meeting.

The municipal market experienced varying rate increases during the period, depending on the quality of the issue and proximity to New York, but it showed some improvement toward the close of the period in the wake of optimism about New York. Quotes on issues of New York's Municipal Assistance Corporation, which had dropped several points following President Ford's

speech to the National Press Club on October 29, regained some of that decline in recent days. Currently, attention is riveted on efforts to strengthen the budgetary situation of New York City and New York State and its various agencies, and to ameliorate the City's onerous debt burden. There remains a widespread market view that some sort of Federal role is needed to permit an orderly resolution of the financial situation and to maintain vital governmental functions.

In addition to the municipal market, another sector that was affected by the New York situation was the market in bank CD's, particularly those of New York money market banks. It was not that dealers and investors feared for the solvency of major New York banks; rather, there was a concern about the liquidity of CD holdings. In the past, several major New York banks, along with a major West Coast bank, had enjoyed an ability to place CD's at rates perhaps 10 or 15 basis points lower than those of other large money center banks. Following aggressive CD issuance by New York banks up to early October and then growing concern about a City default, these differentials were removed or reversed, and by early November CD's of some major New York banks were quoted about 25 or more basis points above those of other money center banks. Most recently, we understand that these differentials have narrowed again, possibly because of a better feeling about New York City, but also because the New York banks have been deliberately unaggressive about seeking additional funds in a highly sensitive market.

Mr. Baughman indicated that he had participated in the daily conference call with the Desk in the period since the previous meeting. It had been a period characterized by large and distorting developments and he wanted to compliment the Account Management on its skill in coping with those developments as it carried out the Committee's instructions.

Chairman Burns said he thought Mr. Baughman's praise was well deserved. He added that the Committee tended to be insufficiently mindful of the difficulties encountered by the Desk and the skill with which open market operations were conducted.

Mr. Winn remarked that he was somewhat concerned by the computer difficulty referred to by Mr. Sternlight. He wondered whether the System might have a problem of insufficient computer capacity.

Mr. Sternlight commented that the facility for wire transfers of Government securities had been over-taxed on one day during the period when a new issue had to be delivered and traffic was otherwise very heavy. The Desk had discussed the problem with technical staff at the New York Bank. Apparently, the problem resulted from overloaded facilities at the New York Bank and at some other Reserve Banks that were heavily engaged in clearing securities. As he had indicated, one consequence of the failure to clear all the securities had been the temporary provision of extra reserves.

Mr. Winn observed that the problem had occurred during a period of relatively light activity at the Reserve Banks. He wondered if more serious problems could be anticipated during a period of booming activity.

Mr. Sternlight indicated that the System's facilities for transmitting securities had been handling a substantial volume of transactions. While those facilities might occasionally tend to be strained, he understood that they were fairly independent of general computer usage in the System.

In response to a question by the Chairman, Mr. Coldwell indicated that System officials were looking into the System's over-all communications capability and were developing plans to expand that capability.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period October 21 through November 17, 1975, were approved, ratified, and confirmed.

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

> One principal change has been made in the outlook for interest rates presented in the blue book[1] prepared for this meeting. We have projected less upward pressure on interest rates over the short and longer runs than at recent meetings.
>
> The actual stock of money has been running well short of what either our quarterly or monthly money market models would have predicted for some time now, given actual GNP and interest rates. Thus, it seems probable that the public's demand for money may be in the process of change--that is, the public may be in the process of accustoming itself to getting along with less money than it normally has held relative to GNP in the past.

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

A number of reasons can be advanced for this.

First, one can cite the developments of substitute assets in which to keep highly liquid funds and even transactions balances--NOW accounts and money market funds, among others. But these are at beginning stages of development, I believe, and would not seem to account for much of the shortfall in M_1 at this point relative to model predictions.

A second reason could be that the very high interest rates by the summer of 1974 may have shocked the public into much more active efforts to conserve on non-interest-earning cash balances. These efforts might well have been intensified because the exceptional rates of inflation in 1974 provided a strong incentive to find every possible means of protecting oneself against declines in the real value of assets. And shifting out of cash into interest-earning assets would be one way of doing so.

Our analysis also has to give weight to the fact that velocity does, however, tend to rise much more than average in the early stages of a business upswing, and that the extent of rise is to a great degree unpredictable, depending as it does on such changeable--not to say intangible--factors as the state of public confidence. While the increase in the income velocity of M_1 in the third quarter was not too far from past cyclical experience, it was on the high side. Moreover, the increase that seems to be in store for the fourth quarter appears to be unusually high. This adds some weight to the view that a longer-run downward shift in the demand for money is occurring along with, and adding to, the impact on velocity of the usual cyclical increase in the public's willingness to utilize existing cash balances.

Taking these various considerations into account, we now assume, as I noted earlier, that short-term interest rates will be under less upward pressure next year--perhaps in the order of a percentage point or so. I hasten to add, though, that we may now be bending over backward in the other direction. Insofar as the public has by now accomplished a one-time shift out of cash into other assets in response to earlier very high interest rates and inflation, it

> is possible that the public's demand for money will once again begin increasing at a pace consistent with previous experience. And interest rates as a result could come under somewhat more upward pressure than we are now projecting.
>
> Most recently, M_1 has shown signs of revival. All of the alternatives in the blue book, therefore, encompass a sizable rate of increase in the 2-month November-December period. Given the shortfalls in growth during late summer and early fall, a large expansion in M_1 between now and year-end would still lead to no more than a quite modest rise in M_1 from the third to the fourth quarter. In that context, and given uncertainties with respect to the meaning of recent money supply behavior as well as still unresolved issues affecting the municipal market, the Committee may wish to consider giving somewhat more weight than usual to money market conditions in framing its instructions--whatever the alternative it chooses--and to being somewhat more tolerant than usual of deviations in M_1 behavior on the upside from expectations.

Chairman Burns said he thought Mr. Axilrod's comments today had been especially stimulating.

Mr. Holland asked whether the 2-month projections of M_1 by the Board and New York Bank staffs differed significantly.

Mr. Volcker said he understood that for November and December combined both staffs projected about the same growth. However, the Board staff projected a sharp increase in the growth rate for November and a substantial slowing for December, whereas the New York Bank staff projected growth rates of about the same magnitude for both months.

In reply to a further question by Mr. Holland, Mr. Axilrod said he would not place any great stock in the particular

month-by-month configurations, given the uncertainties attaching to the projections. The differences in question appeared to result in part from differences in the expected weekly patterns; the Board staff projected stronger growth early in the period. As Mr. Volcker had pointed out, however, for the 2-month period the projections were about the same.

Mr. Williams observed that staff at the San Francisco Bank felt that the financial markets could absorb a failure by the System to achieve its targets for the aggregates much more readily than the economy could. He asked Mr. Axilrod to comment.

Mr. Axilrod said that while he had not addressed himself to that question in his statement, he thought financial markets were more than usually sensitive currently in light of the New York City situation and other uncertainties that were affecting bank lending policies. Under such circumstances, if growth in the aggregates proved to be well above the Committee's targets and the Federal funds rate rose substantially over a short period of time, he believed that there would be a sharp reaction in financial markets and that the lending policies of financial institutions would become even more conservative.

Mr. Mayo noted that in the blue book discussion of the possible impact on financial markets of a reduction in the Federal funds rate of the dimensions contemplated under

alternative A,[1] there was a reference to the accompanying use, if any, of other monetary policy instruments. He asked Mr. Axilrod to elaborate on what the staff had in mind.

Mr. Axilrod said the staff believed that if a decline in the Federal funds rate of the sort assumed under alternative A were not accompanied by a reduction in the discount rate or in reserve requirements, it would probably be viewed by the market as temporary, but that a funds rate decline that was followed up by other easing actions would be considered to reflect a more permanent change in policy and would lead to more substantial declines in market rates.

In reply to a question by Mr. Coldwell regarding reserve needs over the balance of the year, Mr. Axilrod said the Desk would have to supply a sizable amount of reserves in the coming statement week. It was his impression that further needs would be small over the rest of the year, but he would have to check the staff's projections to be sure. He would report his findings later in the meeting.

Mr. Leonard noted that Mr. Axilrod had devoted much of his statement to comments on velocity. He and his associates at the St. Louis Bank were inclined to view as limited the usefulness of velocity, however defined, as a predictive tool, because it was subject to many unmeasurable, and in some cases imponderable,

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

influences. He and others at the St. Louis Bank considered the green book projection of GNP to be reasonable--their own was a little weaker but not significantly so--and he hoped that the money supply would grow at the rate assumed in making that projection. If this was the case, then velocity would simply be as an arithmetic "fall out" of the growth rates in GNP and money.

The Chairman then suggested that the Committee turn to its discussion of monetary policy and the policy directive.

Mr. Morris observed that he would support alternative B but he would modify the ranges of tolerance for growth in the monetary aggregates during the November-December period along the lines suggested by Mr. Axilrod--that is, he would raise the upper limits of those ranges in order to allow for the possibility of a faster rate of growth in M_1 than now projected by the staff. Specifically, he would propose an M_1 range of 6-1/2 to 10-1/2 per cent rather than 6-1/2 to 8-1/2 per cent as shown under alternative B in the blue book. Given the 11 per cent annual rate of growth projected for November, a 10-1/2 per cent upper bound would permit a rate of growth in December of about 10 per cent. Uncertainty stemming from the New York situation, evidence suggesting an apparent slowing in the economic expansion, and--most importantly--indications that monetary growth was falling short of the Committee's longer-term targets led him to favor accommodating strong M_1 growth in December, should it occur.

Chairman Burns remarked that, without necessarily endorsing the figure proposed by Mr. Morris, he would agree that the upper limit for the M_1 range of tolerance should be raised. However, he would widen the range in both directions in the hope that large fluctuations in interest rates over the period ahead might thus be avoided.

Mr. Volcker said he felt rather strongly that the right approach to policy today was to hold interest rates fairly steady. The System had fostered a substantial easing of interest rates in recent weeks to stimulate growth in the monetary aggregates, and he did not like the idea of encouraging further declines that might have to be reversed in the relatively near future. Moreover, Mr. Axilrod's remarks, which he had found stimulating and even persuasive, provided a further indication of how little was known about the short-term relationship between interest rates and the money supply. On the other hand, because he was concerned about the uncertainties in the business outlook and the possible implications of the New York City situation, he would not want to raise interest rates even if the monetary aggregates should strengthen in the period immediately ahead.

To overstate his position a bit, Mr. Volcker continued, he would hold interest rates steady over the coming month almost

regardless of the performance of the monetary aggregates. He could not conceive of any likely increase in the money supply that would worry him at this juncture. While a substantial decline in the money supply would be of some concern, he did not think that was likely and he would not be disturbed if the aggregates came out a little below the ranges associated with alternative B.

Accordingly, Mr. Volcker observed, the Chairman's suggestion for broadening the 2-month ranges for the aggregates definitely appealed to him. He would specify a narrow range for the Federal funds rate, centered around the current level of 5-1/4 per cent. He would be prepared to change the Federal funds rate range if during the course of coming weeks he saw persuasive indications that something was happening in the economy that he did not like or had not expected, and he would want to review the range if it appeared that M_1 was continuing to decline.

In reply to a question by Mr. Mitchell, Mr. Volcker said he could accept a funds rate range of, say, 5 to 5-1/2 per cent.

Mr. Kimbrel observed that he shared Mr. Volcker's views about the desirability of maintaining interest rates at about prevailing levels--although the technical operations necessary to keep the funds rate within a 5 to 5-1/2 per cent range might

be almost impossible. He also shared Mr. Gramley's concern about the possibility of renewed inflation. Evidence of inflationary pressures was still apparent in the attempts of businesses--for example, in the steel and aluminum industries--to raise prices even in light of slack demand. He was somewhat encouraged by the prospects of a satisfactory resolution to the oil control problem and by the reduced threat of disintermediation. He was encouraged also by the indications that businesses were building up liquidity--as noted in recent speeches by Messrs. Mitchell and Wallich. Banks, too, seemed to be moving in that direction, as evidenced by their increased acquisitions of Government securities.

Those considerations led him, Mr. Kimbrel said, to favor a steady course designed to provide some stability and calm in the financial environment at this time. To his mind, the specifications of alternative B would fit that policy prescription. He might note in passing that he would also favor taking advantage of any opportunity that might arise in the near term to reduce reserve requirements. Such an action would serve the dual purpose of providing reserves and of stemming the attrition in Federal Reserve membership that continued to confront the System.

Mr. MacLaury remarked that he had found quite useful the tables provided by the staff at the previous meeting showing the GNP growth rates associated with alternative longer-run paths of money supply growth. He was disappointed that such information had not been included in today's materials. While he recognized that generally the Committee would not want to reexamine its longer-run targets at each meeting, he thought it was useful to know what the implications for the economic outlook would be if the longer-run targets were revised. Without that information, the Committee was left only with a staff analysis of alternative short-run paths consistent with a single longer-run goal. He would prefer to have information on alternative longer-run paths as well.

Turning to the short-run specifications, Mr. MacLaury said he favored raising the upper limit of the 2-month M_1 range to a level higher than shown under any of the blue book alternatives--to, say, 10 or 10-1/2 per cent. But because he favored relatively high rates of growth in the aggregates for the period ahead--and he would want the short-run targets to reflect that preference--he would argue against reducing the lower limits of the M_1 range. While he recognized that the System's ability to influence the aggregates in the short run was limited, he would not be disturbed by a further decline in short-term

interest rates. For the funds rate he favored a range of 4-1/2 to 5-1/2 per cent, which would provide a leeway of 3/4 of a percentage point on the downside and 1/4 of a percentage point on the upside from the current 5-1/4 per cent level. If the early-November signs of growth in the aggregates were not confirmed by later data, he would advocate moving the funds rate into the lower part of that range.

Mr. Coldwell commented that his policy position was identical to Mr. MacLaury's; he agreed with the latter's remarks and saw no need to elaborate on them.

Mr. Eastburn said he did not agree with the consensus on policy that seemed to be developing around the table. To help explain his position he had had two charts, relating to levels of M_1 and nonborrowed reserves, distributed to the Committee today.[1/] In his opinion the charts provided a useful perspective for viewing recent developments.

In the first chart, Mr. Eastburn continued, the actual monthly levels of M_1 from March through October 1975, and projected levels for November, were contrasted with the monthly levels that would have been associated with steady growth in M_1 at annual rates of 5 and 7-1/2 per cent--the upper and lower

1/ Copies of the charts, which had been prepared at the Federal Reserve Bank of Philadelphia, are appended to this memorandum as Attachment C.

limits of the one-year target ranges the Committee had agreed upon. The Committee had successively applied those one-year ranges to three different bases--March, the second quarter, and the third quarter of 1975--and the figures on each of the three bases were shown on the chart.

As was evident from the chart, Mr. Eastburn observed, the "front-end loading" of M_1 that had occurred in the spring had disappeared by September; and after the decline in October, M_1 was below the lower limit of the Committee's target range no matter which of the three bases was used. Even if M_1 were to grow in November at the relatively rapid rate projected by the Board's staff--and he was skeptical about the staff's ability to forecast money growth over the rest of the year--it would remain below all three lower limits.

As he had indicated at the previous meeting, Mr. Eastburn remarked, his own preference was to foster growth in M_1 at a rate near the top end of the 5 to 7-1/2 per cent range. However, even if the objective was growth at the 6-1/4 per cent midpoint, it was obvious that some "rear-end loading" would be needed. For example, to achieve 6-1/4 per cent growth between the third quarters of 1975 and 1976, M_1 would have to increase at about a 7.5 per cent rate from October 1975 to the third quarter of 1976; and to achieve 6-1/4 per cent growth

between the two second quarters, M_1 would have to increase at about a 9 per cent rate from October to the second quarter.

After referring to Mr. Axilrod's comments on some of the possible reasons for the lagging growth in the money supply, Mr. Eastburn said he thought the Committee could not ignore one basic fact illustrated by his second chart, on non-borrowed reserves--namely, that the System recently had not been providing the reserves needed to support growth in M_1 at the desired rate. The System had to become more aggressive in supplying reserves, and unless it did so promptly it might find itself in the position of having to stimulate monetary growth in the latter part of 1976, when political circumstances would make such a course difficult.

Accordingly, Mr. Eastburn observed, he favored the specifications of alternative A. Even under that alternative, according to the staff's projections, M_1 would be below the lower limit of the current longer-run target range in December and in the lower half of that range in the first quarter. He would be willing to accept a higher Federal funds rate in the third quarter of 1976 if that were the price of acting to stimulate monetary growth now.

It had been suggested today, Mr. Eastburn continued, that greater attention should be paid to money market conditions

at this time. He felt otherwise. In fact, in alternative A of the draft directives he would be inclined to delete the reference to money market conditions from the clause "...the Committee seeks to achieve somewhat easier bank reserve and money market conditions over the period immediately ahead." He would not press that suggestion now, since to some extent it anticipated the Committee's discussion of the work of the Subcommittee on the Directive. However, he would note that he thought the Federal funds rate had been a misleading indicator for implementing the Committee's objectives with respect to the money supply.

In a concluding observation, Mr. Eastburn said he would urge the Board to consider a reduction in reserve requirements at this time.

Chairman Burns said he thought Mr. Eastburn's comments were useful in reminding the Committee that the money supply, narrowly defined, was not conforming to the longer-run growth range adopted by the Committee. However, he found himself in a basic disagreement with Mr. Eastburn's approach to policy. Mr. Eastburn had referred to the money supply as if it were an objective in its own right. In his opinion, however, the Committee had not set out to make a particular growth rate come true. Rather, its purpose was to adjust monetary policy--

whether considered in terms of the monetary aggregates or interest rates or both--so as to serve the needs of the economy. The members had to remind themselves continually that they should not become prisoners of particular projections that the Committee had adopted. Those projections merely indicated the members' best thinking at the time they were made, and the Committee should feel free to change them as conditions changed. That thought was fundamental; indeed, it was reflected in the Concurrent Resolution adopted by the Congress.

Mr. Eastburn said he did not think anything basic had changed in the economic situation since the Committee had adopted its longer-run targets at the previous meeting. He therefore felt that the Committee should be doing what was necessary to accomplish those targets.

Mr. Holland commented that he preferred to think of the numbers applicable to the longer-run paths of the aggregates not as targets but--to use a phrase emanating from the discussions of the Subcommittee on the Directive--as "intended values." The Committee set those values on the basis of its views of the economic outlook and the type of monetary policy that it believed would make a constructive contribution to the economy. Shortfalls or overshoots of those values would call for introspection--and not reflex actions. To his mind, that was the essence of the

Chairman's frequent statement to the effect that the Committee should not be prisoners of the numbers but that it should not disregard them either.

Indeed, Mr. Holland continued, persistent deviations from the targets--indicating that the System's actions were not generating the kind of monetary growth the Committee had judged to be consistent with its over-all economic objectives--would give the Committee a clear signal that it should attempt to assess the underlying factors and determine what needed to be done. In the current case, for example, he believed that recent staff presentations--including Mr. Axilrod's remarks today and at last month's meeting--had provided some support for the view that a weakening in the demand for money relative to GNP might be occurring. On the other hand, he saw enough weakness in measures of money other than M_1 to suggest that there were other contributory factors. Reports on economic activity seemed to indicate that the recovery was proceeding at a more moderate pace than in the third quarter--a development that he welcomed. That seemed to suggest that the Federal Reserve's work would be a little less difficult in the unfolding economic environment than in the atmosphere previously anticipated, in which harsh choices between sharply higher interest rates and uncomfortably high rates of growth in the

aggregates would have had to be faced. The current outlook portended choices between more moderate values on both scores.

As a general principle, Mr. Holland commented, he thought the Committee's objectives should be related to the monetary aggregates in an analytical way. Despite the sensitivity of the financial markets to the New York City situation, he would urge the Committee not to set the aggregates aside, but rather to re-evaluate its judgment of the appropriate "intended values" for M_1, M_2, and M_3 over the next few months, and to set whatever ranges for the funds rate appeared reasonable. He would then emphasize to the Manager the instruction which had consistently been included in recent directives, to take account of developments in domestic and international financial markets--pointing out that if the New York crisis, or perhaps some other development, should create extraordinary repercussions in financial markets, that phrase would characterize the Committee's intent to allow less fluctuation in the funds rate than would otherwise be the case. To view that phrase as an operating instruction to be interpreted in the manner he had described seemed to him a much better approach than to prescribe a narrow funds rate range in the expectation that something might occur which would make fluctuations in the funds rate undesirable.

The recent shortfalls in aggregate growth had persisted for a long enough period to be worrisome, Mr. Holland said. Although data for the latest week suggested that M_1 had bounced back to a level near the desired trend path, one had to recognize that the weekly data were extremely volatile. Therefore, he would opt for a policy aimed at achieving reasonable rates of growth in the aggregates with the understanding that, should the New York situation cause disruptions in financial markets, restoration of calm in the markets should take precedence over the monetary aggregate objectives. The specifications of alternative B, with an increase in the upper limit of M_1 as suggested by the Chairman, would fit his prescription for policy.

Mr. Mayo remarked that he had been about ready to concur completely with Mr. Holland's views until the latter cited the specifications of alternative B rather than A as his preference. He agreed particularly with Mr. Holland's point that a shortfall from what the Committee viewed as an appropriate pattern of growth in the aggregates--consistent with a solid contribution of monetary policy to the economic recovery--was a major concern. The staff at his Bank had performed calculations similar to those underlying the charts discussed by Mr. Eastburn. Given his understanding of the Committee's economic objectives,

the recent performance of the aggregates would have concerned him even if the Committee had never established a 5 to 7-1/2 per cent M_1 target. He agreed with the Chairman that the Committee should not be enslaved to the targets. It seemed to him, however, that there had been enough evidence recently of the loose relationship between the funds rate and the aggregates--despite the encouraging data of the past few weeks--to suggest that the funds rate should be allowed to drop a bit further in order to achieve a somewhat higher rate of growth in M_1 in the short run.

Accordingly, Mr. Mayo said, he favored specifications along the lines of alternative A, except that he would narrow the M_1 range to, say, 7-1/2 to 8-1/2 per cent, and he would widen the funds rate range to perhaps 4-1/2 to 5-3/4 per cent in order to provide the Desk with added flexibility. The current funds rate level was near the midpoint of his proposed range. He would not take aggressive action to move that rate to a certain level, but he would allow it to move in accordance with incoming data on M_1 growth in November. For the directive, he favored the language of the "monetary aggregate proposal."

Mr. Wallich observed that he shared Mr. Mayo's sentiments. The rate of real growth in the economy now projected for the next two or three quarters was less than previously anticipated and

the rate of inflation was a bit worse. Those prospects offered an unpleasant choice. But since inflation was still projected to decline, he would now, on balance, pay more attention to the rate of real economic growth for 1976, which seemed to be tapering off rather alarmingly. In his judgment the performance of the economy in the period ahead would be consistent with the weak performance of M_1 over the past few months; likewise, the recent inadequate growth in M_1 seemed to be indicative of some underlying weakness in the economy. While he recognized that the money demand function might be changing, he was somewhat skeptical of the natural inclination to explain a deviation from expectations in terms of some new special factor. On balance, therefore, he thought the current situation called for an injection of more money into the economy; that, in turn, called for a decline in the Federal funds rate.

Mr. Wallich said he realized that that prescription for policy might be troublesome at this time. But markets were always sensitive. In the foreign exchange markets, the dollar had held up fairly well. Domestically, a great deal depended on the resolution of the New York crisis; if that resolution were favorable, the economic outlook would have to be reevaluated. Perhaps then expansive forces would take over, but one could not be certain of that. For the time being, therefore, he would set

aside concerns about over-expansion and about possible adverse effects on the dollar of a decline in U.S. interest rates. He saw no reason to retreat from the longer-run targets set a month ago. For the short run, he would favor alternative A. He would broaden the Federal funds rate range somewhat; in fact, he hoped the Committee would adopt a wider funds rate range as a general practice. For M_1, he could accept the 7 to 9 per cent range shown under alternative A, or a range with a somewhat higher upper limit.

Chairman Burns observed that the financial markets had become extremely sensitive, and he had been keeping a log on hour-by-hour developments in every market. In his judgment, a slight lowering of interest rates would not create difficulties, but any significant increase in interest rates at this time would be a great mistake.

He had several observations to make about the general economy, the Chairman continued. He did not know of any business cycle expansion in which the rate of growth of the economy had proceeded along a linear or an exponential path; a zig-zag movement was typical. Currently, there had been an increase in employment and a good increase in retail trade in October. Also, industrial production apparently had increased further--although at a much slower pace than in preceding months--but he

was not certain that the preliminary October figure would hold up when fuller data became available.

The Chairman observed that the staff's projections of prices had been off the mark recently, but that did not surprise him. Increases in wholesale prices had been in the double-digit range for the past 4 months. For the months of July through October, the wholesale price index had increased at an average annual rate of about 13 per cent, and the more significant industrial component had risen at a rate of about 11-1/2 per cent. The Board's staff and economists generally had been predicting a tapering off of inflation. He had disagreed with that forecast, although he had certainly hoped it would come true. His disagreement had stemmed basically from his analysis of business cycle history--and so far, unfortunately, events had generally confirmed predictions made on the basis of past experience. The Committee must not lose sight of the fact that inflation continued to be very much a part of life in the workings of the nation's economy. Inflation had brought on the problems the Committee now faced, and unless the Committee remained sensitive to it, inflation would lead to more serious problems further down the road.

Mr. Williams said his views were basically similar to Mr. Eastburn's. He favored more flexibility in the Federal funds rate as a means of achieving the longer-run targets for the

aggregates; the funds rate should be reduced in the event of a shortfall, and if the aggregates over-reacted, it should then be raised. For the coming inter-meeting period he agreed with Messrs. Mayo and Wallich that the specifications of alternative A would be appropriate.

Mr. Clay expressed the view that monetary policy should continue to accommodate the economic recovery and seek to achieve moderate growth in the monetary aggregates. If the pace of economic expansion were to continue, maintaining current money market conditions probably would result in stronger rates of growth in the aggregates. However, due to the somewhat puzzling behavior of the aggregates in recent months, there was considerable uncertainty about the growth rates that were likely to emerge. Therefore, until more stable patterns developed, he thought a directive emphasizing money market conditions was advisable. Accordingly, he favored the language of alternative B shown under the "money market proposals." For the funds rate, he preferred the 4-3/4 to 5-3/4 per cent range specified in alternative B. For M_1, he would choose a range of 6 to 9 per cent--encompassing the entire range shown under all three alternatives.

Mr. Mitchell said he thought the chart supplied by Mr. Eastburn on nonborrowed reserves at member banks shed

light on one of the key issues that confronted the Committee today--the failure of the aggregates, the credit proxy, and the inflows into thrift institutions to grow at satisfactory rates. The Board's flow of funds data indicated that the level of bank intermediation had declined, and he suspected that that situation would continue for a while longer. The decline in intermediation would help explain the large drop in the amount of reserves supplied by the System during 1975. Moreover, historical data showed some striking differences in the utilization of reserves because of different growth rates of demand and time deposits and the relatively low level of reserves required against the latter. In 1975 the pattern of deposit growth had been such as to minimize the need for reserves. Changes in the behavior of nonmember banks, which apparently were growing more rapidly than member banks, also could be a factor. In his judgment, however, the change in the level of intermediation was the basic explanation for sluggish growth in the aggregates.

On that basis, Mr. Mitchell remarked, he would conclude that the aggregates were conspicuously unreliable guides to policy at this particular time. A safer guide at the moment--as little as one might like it--was the interest rate level. Accordingly, he would focus on interest rates and allow the

aggregates more or less to seek their own level. For the funds rate range he would favor a lower limit of 4-1/2 or 4-3/4 per cent and an upper limit of 5-1/4 or 5-1/2 per cent.

Mr. Bucher observed that in his early days with the Federal Reserve he had told inquiring financial reporters that he was an eclectic and had an open mind about monetary policy. Now, 3-1/2 years later, he would have to say that basically he was a believer in the money market approach and a follower of interest rates.

In arriving at a preference for the money market approach, Mr. Bucher remarked, he had been influenced partly by the continual revisions in the aggregates and by the various attempts, as noted by Mr. Wallich, to develop explanations for deviations from expected patterns. He had been influenced even more by changes in the role of money--changes which had become so pervasive that traditional definitions of money were becoming obsolete and historical relationships between money and other variables were becoming difficult to accept as guideposts to policy. So, to a great extent, Mr. Mitchell's remarks reflected his own views.

Accordingly, Mr. Bucher observed, his prescription for policy in the coming inter-meeting period was similar to that of Mr. Volcker. He agreed also with the Chairman's view that

the sensitive state of financial markets should be of concern to the Committee at this time. Although he recognized that to talk in terms of sensitive markets was old hat in some respects, he thought that if ever such an approach to policy was appropriate, it was now. In fact, he would guess that even those Committee members who generally favored using the aggregates as a policy guide would be more comfortable focusing on interest rates at this time because the recent resumption of money supply growth provided some leeway in that respect.

Mr. Bucher said he would regard an increase in interest rates at this time as dangerous, primarily because of market sensitivity to the New York situation. But he would be concerned also about a decline in interest rates, for two reasons. First, like others in the financial community, he thought inflation would continue to be a problem. In that regard, he suspected that the staff's latest projections of prices would prove to be too low. Second, he was concerned about the problems that might be encountered toward the middle of next year if, as seemed likely, interest rates would be rising.

Accordingly, Mr. Bucher observed, he favored rather wide ranges of tolerance for the aggregates. He concurred in Mr. Morris' suggestion to raise the upper bound of the M_1 range, and he could accept a reduction in the lower limit as well. For the funds

rate, he favored a narrow range, although not as narrow as the 5 to 5-1/2 per cent range proposed by Mr. Volcker--perhaps 4-3/4 to 5-1/2 per cent. He would not like to see the upper limit set at 5-3/4 per cent. For the directive, he favored the language of alternative B under the money market proposals.

Mr. Jackson said he was not quite as concerned about recent increases in prices as others around the table appeared to be. It was his impression that many of the firms raising wholesale prices today were doing so in order to readjust profit margins that had declined substantially during the inflation of 1974 and that had been reduced further by the erosion of sales in 1975. Adjustments of that kind might not continue to any great extent in the months ahead, particularly in view of the weakness in export markets and the unlikelihood of a resurgence of inflationary demand pressures in the domestic economy.

In his opinion, Mr. Jackson observed, the performance of the monetary aggregates--specifically, of the broader measures, such as M_3--and the general conditions prevailing in credit markets were about right in the context of the current economic situation. And since he was not unhappy about the present course of the economy, he was inclined to share the view that monetary policy should remain about unchanged. He would set a narrow range for the Federal funds rate, although perhaps wider

than the 5 to 5-1/2 per cent that had been suggested. At the same time, he would widen the November-December range for growth in M_1 to 6 to 10 per cent or even to 5 to 10 per cent--and make comparable changes in the ranges for the other aggregates--in order to accommodate developments that might occur over the next 4 weeks without having to foster significant changes in the Federal funds rate.

Chairman Burns said he was very much concerned about the behavior of financial markets. It was in those markets that difficulties might arise which, in turn, could have a marked impact on the economy. As he had said earlier, he thought any significant increase in interest rates at this time would involve a risk that the Committee should not take. He would argue similarly about any significant declines in interest rates. If current projections about the economy and about interest rates were at all valid, it would be necessary to reverse any present declines--and to reverse them in an environment quite hostile to increases in interest rates. He would not take the risk of compounding the difficulty of that situation. To his mind, Mr. Volcker's views--although perhaps a bit extreme in relation to the thinking of most Committee members, including himself--were basically correct.

Turning to the specifications, Chairman Burns said he thought a range of 4-3/4 to 5-1/2 per cent for the Federal funds rate would be about right. He favored rather broad ranges for the monetary aggregates. As he had noted earlier, he would widen the range in both directions but he would do so asymmetrically--moving the upper limit more than the lower limit. Specifically, he would regard M_1 ranges of 5 to 9-1/2 per cent, 6 to 10 per cent, or 5-1/2 to 10 per cent as satisfactory. In sum, he would endorse the view that had been expressed by several Committee members, perhaps most eloquently by Mr. Bucher: that the Committee, as of today--it might change its mind before the next scheduled meeting--should not worry about the monetary aggregates but should worry a great deal about maintaining stability in financial markets.

Mr. Black observed that, for some time, he had been quite disturbed by the failure of the monetary aggregates to grow according to expectations. He had attributed the shortfalls largely to a failure of the projections to take full account of underlying shifts in the demand for money that came about for the reasons Mr. Axilrod had indicated. But he had had lingering fears that the shortfalls might reflect a weakness in the economy that had not yet become apparent. Consequently, he had found the recent acceleration in money supply growth quite

encouraging. He viewed it as an indication that the upward pressure on the aggregates and on interest rates that the staff had been predicting for some time now had arrived. For that reason, he was reluctant to pursue any further easing in interest rates unless growth in the aggregates showed definite signs of faltering.

On the other hand, Mr. Black continued, because there was some evidence that the pace of recovery had slowed, he would be reluctant to see interest rates move above their current levels until it became clear that recent shortfalls in the growth of the monetary aggregates had been made up. In sum, his policy prescription was similar to the Chairman's. He could accept the specifications of alternative B, but in the interest of maintaining about prevailing money market conditions, he would suggest that the funds rate not be moved out of the 5 to 5-1/2 per cent range without further consultation by the Committee. Finally, although he was emphasizing money market conditions more than he would ordinarily, he still preferred the directive couched in terms of the monetary aggregates.

Mr. Baughman remarked that if he were confident about the 11 per cent rate of growth currently projected for M_1 in November he would be quite comfortable with the specifications of alternative B. However, because the financial community and

the public at large tended to view the money supply as an indication of what the Federal Reserve was seeking to accomplish, another month of little or no growth in M_1 could have an adverse impact on confidence and on expectations. Therefore, he would find it difficult to accept a directive emphasizing money market conditions unless it were understood that the Committee would reconsider its position if there were any evidence at all that the expected growth in M_1 was not developing.

Mr. Baughman said he did not feel that the markets were as sensitive to changes in short-term interest rates as others around the table seemed to believe. Consequently, he would be inclined to permit a slow and gradual decline in the Federal funds rate if that was necessary to assure that growth in M_1 would proceed as anticipated. As he had noted, M_1 had become widely accepted as an indicator of Federal Reserve policy and its likely impact on the economy. And on the basis of attitudes he encountered in the business community, he thought the public needed some reassurance at this time. Accordingly, he could accept the specifications of either alternative A or B, except that he would raise the upper limit a bit on the funds rate range under alternative A and reduce the lower limit a bit under alternative B.

Mr. Leonard observed that he shared Mr. Eastburn's concern about the lack of growth in the monetary aggregates, partly for the reasons just noted by Mr. Baughman. Accordingly, the spirit of the alternative A directive appealed to him, although he preferred the language of the monetary aggregate proposal. For the M_1 specifications, he would have no quarrel with a range of 6 to 10 per cent--particularly in light of Mr. Eastburn's observation that a November-December growth rate of 9 per cent would be needed to return M_1 to its target path by the second quarter of 1976. As he had noted at previous Committee meetings, he generally favored a broad range for the Federal funds rate in order to provide the Desk with sufficient flexibility to achieve the Committee's targets. In the current state of the markets, however, he hoped the targets could be achieved while maintaining the funds rate near--or perhaps slightly below--its prevailing level. If the range were to be broadened, therefore, he would prefer to see its lower limit reduced.

Mr. Winn asked Mr. Axilrod if he now had the information mentioned earlier about the likely volume of reserve-supplying operations over the balance of the year.

Mr. Axilrod replied in the affirmative. As he had indicated earlier, the staff anticipated a need to supply a substantial amount of reserves during the coming statement week.

Over the balance of the year a sizable reserve need was foreseen in only one additional week--that following the mid-December tax date, when Treasury cash balances were expected to rise sharply at the Federal Reserve Banks. He did not think there would be any technical problems with respect to open market operations if a decision were reached to reduce reserve requirements by a moderate amount during this period.

In reply to a question by Mr. Coldwell, Mr. Axilrod said he would regard a reduction of around $400 million to $800 million as moderate and not likely to create technical problems. Mr. Sternlight indicated his agreement with that assessment.

Mr. Volcker observed that none of the Committee members who had spoken thus far appeared to favor tighter money market conditions. A number had, understandably, expressed concern about the performance of the monetary aggregates, but the Federal Reserve could do little to affect the aggregates in the very short run. While the System obviously could influence the aggregates over a period of months, the staff projections--for whatever they were worth--pointed to increases in the longer run.

Under those circumstances, Mr. Volcker continued, the best arguments he could see for easing were related to the possibility that the real economy might be developing unanticipated weaknesses and to the additional complications produced by

the New York City situation. He felt some sympathy for those arguments, but on the basis of the evidence so far, he was not persuaded that they added up to a compelling case for easier money market conditions. Moreover, if the Committee were to ease money market conditions now, the question of a reduction in the discount rate would immediately arise. A cut in that rate would make it even more difficult and awkward to reverse course later if both the economy and the monetary aggregates were performing in the manner suggested by the staff's basic projection. A further easing of interest rates might also be somewhat troublesome in connection with the foreign exchange markets, although he would not give major weight at this time to international considerations.

In sum, Mr. Volcker observed, the discussion had not changed the general views on policy he had expressed earlier today. He could go along with some reduction in the range for the Federal funds rate if it were understood that the lower part of the range would be used only if the New York City situation should worsen appreciably or if there should be evidence of some particularly adverse developments in the economy. However, he would not want the availability of lee-way on the downside to be interpreted to mean that the funds rate should be reduced simply on the basis of some week-to-week

movements in the aggregates, unless the movements were sharply downward.

Chairman Burns said there was hope that the New York financial crisis would be resolved, but much still had to be done. The President might reach a decision as early as this afternoon, but the Congress would still have to act and the New York State legislature also had to take action. There were, therefore, many uncertainties on the road to a solution. A default by the City could not be ruled out, and if one occurred it could have a severe impact on financial markets. In that event the System would have to forget about monetary growth rates for a time or else risk damaging the economy, perhaps permanently. The current uncertainties surrounding the New York City situation led him to conclude that for now the Committee should emphasize interest rates without losing sight of the monetary aggregates, and plan on returning to an emphasis on the aggregates in due course. He had been sympathetic to a monetary aggregates approach to policy since becoming a member of the Committee, but he thought the present was a time for putting the primary accent on interest rate stability.

Mr. Winn said he thought a combination of policies that included a reduction in reserve requirements might help the

Committee to achieve its objectives for both the monetary aggregates and interest rates. A reduction in reserve requirements would have the advantage of immediately affecting banks across the nation. The timing would also be favorable because, barring some sort of crisis, long-term interest rates seemed set to decline following a period of sizable inflows of funds to financial institutions. The increased availability of reserves to banks and an improvement in financial markets would be plus factors in terms of stimulating economic activity. On the other hand, he did not know if a reduction in reserve requirements would create a need to absorb reserves through open market operations and thereby lead to market uncertainty and possibly to sharp movements in interest rates. Sizable fluctuations in interest rates would be damaging in current circumstances.

Chairman Burns indicated that the Board was continuing to give serious thought to a possible reduction in reserve requirements. The Board had approved a modest reduction in recent weeks with a view to improving the balance sheets of commercial banks and also with the objective of stimulating growth in the monetary aggregates.

Mr. Coldwell noted that earlier he had endorsed Mr. MacLaury's position on policy. It seemed to him, however,

that the basic need was for open market operations to be accommodative over the next few weeks. By that he meant that operations should not resist any tendencies for market rates to move down a little, but that they should resist tendencies for rates to rise. To state his policy preference in the language of a bygone era, he would be inclined to err on the side of ease.

Mr. Holland said he would supplement his earlier observations by noting that he continued to be motivated by what he regarded as a reasonable possibility that the current atmosphere of caution and uncertainty was tending to lower the level of the Federal funds rate at which the banking system would generate moderate growth in the monetary aggregates. He thought the evidence for that conclusion was a little more mixed in the period since the last meeting than it had been earlier, but he believed it had by no means been reversed. If his hypothesis proved wrong, the Federal funds rate was likely to change little, if at all. If it proved correct, however, a policy of keeping the Federal funds rate where it was could in retrospect turn out to have been a mistake.

Chairman Burns observed that the members had expressed their views on policy with reasonable clarity. The positions

of a majority centered around the alternative B specifications, and there was considerable sentiment for widening the 2-month ranges for the aggregates shown under that alternative in the blue book. However, there were differences of view with respect to the inter-meeting range for the Federal funds rate, and it would be necessary to make specific tests of the members' thinking on that subject. He asked the members to indicate, first, whether they found the range he had suggested earlier--4-3/4 to 5-1/2 per cent--to be generally acceptable, and, next, whether they preferred that range to possible alternatives.

The responses revealed that a funds rate range of 4-3/4 to 5-1/2 per cent would be acceptable to a majority but was preferred by only a minority.

Mr. MacLaury remarked that his attitude toward possible ranges for the funds rate would depend on how they were intended to be used.

The Chairman noted that at a number of recent meetings the Committee had placed qualifications on the use of a part of the range it specified for the funds rate. However, that procedure had resulted in some confusion and unhappiness, and of late the Committee had returned to its earlier strict

practice of making the full range available for use. He suggested that henceforth the Committee hold to the position that the full range could be used, subject only to a possible word of advice to the Manager regarding the timing of movements.

Chairman Burns then asked the members to indicate their preferences among 4-1/2, 4-3/4, and 5 per cent for the lower limit of the funds rate range.

A majority expressed a preference for a lower limit of 4-1/2 per cent.

Mr. Mitchell asked about the funds rate the Manager would be expected to seek early in the period if the Committee agreed upon a range of 4-1/2 to 5-1/2 per cent for the full period. In particular, he wondered whether the Manager would be expected initially to maintain the present funds rate or to seek a lower rate.

The Chairman replied that in the absence of any special instructions from the Committee, the Manager would be expected to move to reduce the funds rate to 5 per cent, the midpoint of the range Mr. Mitchell had mentioned. He would certainly hope, however, that the Committee would advise the Manager to wait a week before making such a move, in order to determine how the aggregates were behaving.

In response to the Chairman's request for comment, Mr. Holmes said it had been the usual practice following Committee meetings to await an additional week's data on the monetary aggregates before acting to implement new funds rate specifications. Such a procedure appeared particularly desirable at times like the present, when the latest week's data for the aggregates were strong, because data for an additional week would be helpful in deciding whether or not that strength was likely to persist.

Mr. Mayo, noting that he had been among those expressing a preference for a 4-1/2 per cent lower limit for the funds rate, said he had expressed that preference on the presumption that the Desk would await the additional week's data before acting.

Mr. Coldwell observed that he had shared that presumption. He added that, given an upper limit of 5-1/2 per cent for the funds rate range, he preferred 4-1/2 over 4-3/4 per cent for the lower limit because he wanted the midpoint to be 5 per cent--rather than 5-1/8 per cent, which was close to the present level.

Mr. Eastburn said that while he favored 4-1/4 per cent as the lower limit of the range for the funds rate, he was

concerned about a more basic question: whether, as had been suggested in the discussion today, emphasis should be placed on interest rates, with the aggregates permitted to go where they would. As he had indicated in his earlier remarks, he thought emphasis should be placed on the aggregates.

Chairman Burns commented that the two positions Mr. Eastburn had contrasted reflected a fundamental difference of view about the current situation. Ordinarily, he would be inclined in the direction of Mr. Eastburn's position. He was not so inclined at this particular time, however, because of the sensitive condition of financial markets.

Mr. Volcker said he appreciated the point that it would be desirable for the Desk to await another week's data on the aggregates before deciding on its objective for the funds rate. He was not sure, however, what particular funds rate objectives would be associated with various possible outcomes for the aggregates. For example, if after a week the aggregates appeared to be in line with the staff's estimates, would the Desk be expected to maintain the existing funds rate or to seek a different rate?

Mr. Holmes replied that under the customary practice, when the aggregates appeared to be at about the midpoints of their ranges the Desk aimed at a funds rate at about the midpoint

of its range. When the aggregates were in the lower parts of their ranges, the objective for the funds rate was reduced. If the aggregates remained in the lower part of their ranges during subsequent weeks of the period, the funds rate objective would be progressively reduced within its range.

Mr. MacLaury observed that, as suggested by Mr. Holmes' comment, one could not say what objective for the funds rate would be associated with particular growth rates in the aggregates unless the ranges for the aggregates had already been specified. One might amplify Mr. Holmes' explanation of the customary practice in the following terms: if the range specified for the funds rate for a 4-week inter-meeting interval was 1 percentage point in width, and if the aggregates persisted in the lower parts of their ranges throughout the interval, the Desk would be expected to reduce its target for the funds rate by 1/4 of a percentage point each week--so that the full 1-point range would have been used by the time of the next meeting. That described a rather mechanical procedure, which was not necessarily the most logical one.

Chairman Burns remarked that, by and large, Mr. MacLaury had accurately described the procedure the Committee had elected to follow.

Mr. Holmes noted that the operational paragraph of the directive usually included an instruction to take account of developments in domestic and international financial markets. He presumed the Committee would not want the Desk to make its operating decisions solely on the basis of movements in the aggregates if, for example, the dollar came under heavy pressure in foreign exchange markets.

The Chairman concurred in Mr. Holmes' observation.

Mr. Holland said he would like to suggest two modifications of the Committee's customary procedures that might make it easier for the members to reach a consensus today. First, assuming the Committee adopted a 4-1/2 to 5-1/2 per cent range for the funds rate, he thought the Desk should be instructed not to reduce its objective to the midpoint of that range automatically if after a week the aggregates appeared to be growing at rates near the midpoints of their ranges; rather, the Desk should aim at an unchanged funds rate unless the growth rates in the aggregates appeared to be drifting toward one end or the other of their ranges. Such an instruction seemed particularly desirable at present in view of the strength in the aggregates during the latest statement week and in light of the desirability of avoiding false signals of the Committee's intentions.

Secondly, Mr. Holland continued, it should be stressed that in the event developments with respect to the New York City situation had or threatened to have major market effects, the Desk was empowered to act in the manner in which it traditionally responded to such market problems. That authority could be underscored by modifying the customary clause in the directive which called for account to be taken of developments in domestic and international financial markets to call for taking "more than usual" account of such developments. The Committee would, in effect, be adopting a contingency plan for dealing with any undesirable market consequences of New York developments. In his judgment, that would be preferable to agreeing to a one-shot change in the System's posture, to be carried out no matter how the New York situation evolved.

Mr. Mitchell observed that many members of the Committee had indicated that in the period immediately ahead they did not wish the Desk's objective for the Federal funds rate to be tied so closely to the behavior of the aggregates. It was his impression that the members who, like himself, preferred to focus on interest rates fell into two groups: those who favored no significant change in the funds rate, and those who wanted some slight reduction--perhaps of 1/8 of a percentage point. He could associate

himself with either group. If the decision was to reduce the funds rate slightly, he thought some delay would be desirable in order to permit the Manager to make the reduction in the most effective manner.

Mr. Mitchell added that he had no objection to Mr. Holland's second suggestion for modifying the directive to take more specific account of the possible market effects of New York City developments. It might seem a little odd, however, that the Committee decided to do so now when it had not done so earlier.

Chairman Burns remarked that if a majority of the members favored a 5 per cent midpoint for the Federal funds rate range, a choice would still remain between a relatively narrow and a wider range around that midpoint. He asked the members to indicate their preference between ranges of 4-1/2 to 5-1/2 per cent on the one hand, and 4-3/4 to 5-1/4 per cent on the other hand.

A majority expressed a preference for the wider range.

The Committee then considered the ranges for growth rates in the aggregates in the November-December period. At the conclusion of the discussion it was agreed that the range for M_1 should be 6 to 10 per cent, and the ranges for M_2 and

RPD's should be those determined by the staff to be consistent with the indicated range for M_1.[1/]

The Chairman noted that the staff's proposals for the operational paragraph of the directive included one labeled "monetary aggregate proposal"--which was similar to the paragraph incorporated in other recent directives--and three alternatives under the heading of "money market proposals." He asked the members to indicate their preference between the two types of operational paragraphs.

A majority expressed a preference for a "monetary aggregate" paragraph.

The Chairman asked whether there was any objection to the addition Mr. Holland had proposed, and none was heard.

Mr. Clay said he questioned two statements in the proposed general paragraphs of the directive. The first was the statement reading "Retail sales are reported to have risen in October, after 2 months of little net change." The underlying figures indicated that retail sales increased by 0.5 per cent in August, declined by 0.9 per cent in September, and rose by 1.0 per cent in October. He thought those figures would be summarized better if the second clause of the sentence was revised to read "offsetting the decline in September."

1/ Consistent ranges were determined by the staff to be 7-1/2 to 10-1/2 per cent for M_2 and 4-1/2 to 8-1/2 per cent for RPD's.

Mr. Partee observed that the language suggested by the staff was based on the expectation that the Committee would want to emphasize the fact that most recently there had been some increase in retail sales.

After discussion, it was agreed to retain the statement in the form shown in the staff's draft.

Mr. Clay remarked that his second comment related to the second clause of the sentence reading "Average wholesale prices of industrial commodities increased more in October than in the immediately preceding months, and prices of farm and food products rose sharply further." It was his understanding that, while prices of food products had been rising, farm prices recently had declined sharply.

It was noted in the ensuing discussion that the declines to which Mr. Clay referred had occurred since mid-October. The Committee agreed that a sentence mentioning those declines should be added following the sentence which Mr. Clay had cited.

Mr. Wallich referred to the sentence in the draft general paragraphs reading "M_1 declined in October, after having grown from the second to the third quarter at a 6.9 per cent annual rate." While the latter part of that statement was accurate in terms of the change shown by quarterly average figures, he

thought it was misleading because M_1 grew relatively little during the individual months of the quarter.

Mr. Holland noted that for many years the Committee's documents had discussed quarterly developments in the monetary aggregates in terms of the change between the final months of the quarters involved. He believed that measures based on quarterly averages had analytical advantages, and he hoped that in the future the Committee would regularly use such measures in its documents. The problem which Mr. Wallich had noted might be dealt with by adding a sentence describing the month-to-month movements within the quarter.

Chairman Burns expressed the view that Mr. Holland's proposal was a reasonable one, and other members concurred.

There also was general agreement with a suggestion by Mr. Coldwell that the staff's draft be amended to indicate that the 6.9 per cent rise mentioned related to the change in quarterly average figures.

Mr. Wallich noted that the 2-month range for M_1 agreed upon today--6 to 10 per cent--was wider and higher than the 5 to 7-1/2 per cent range included among the longer-run targets. To avoid possible misunderstandings, it might be desirable to include language in the operational paragraph indicating that in the Committee's view the short-run objective was consistent with the longer-run target.

After discussion, it was agreed that such additional language was not needed.

The Chairman then proposed that the Committee vote on a directive consisting of the general paragraphs as drafted by the staff, with the changes just agreed upon, and the "monetary aggregate proposal" for the operational paragraph, with the addition Mr. Holland had suggested. It would be understood that the directive would be interpreted in accordance with the following short-run specifications. The ranges of tolerance for growth rates in the November-December period would be 6 to 10 per cent for M_1, and the ranges for M_2 and RPD's determined by the staff to be consistent with that M_1 range. The range of tolerance for the weekly average Federal funds rate in the inter-meeting period would be 4-1/2 to 5-1/2 per cent. He asked whether there were any questions before the vote was taken.

Mr. Volcker observed that the proposed specifications involved relatively wide ranges for both the Federal funds rate and the monetary aggregates. He was unclear about the operational implications for the funds rate.

Chairman Burns said it appeared from the earlier discussion that, while the funds rate might fluctuate in response to market forces, the Committee would not want the Desk to seek any change in the rate for at least a week, when new data would be available on the monetary aggregates.

Mr. Volcker asked whether there was a presumption that the Desk would seek to change the funds rate at that time if the growth rates in the aggregates appeared to be within their ranges.

The Chairman responded that there would be such a presumption only if the growth rates in the various aggregates--not M_1 alone--deviated significantly from the midpoints of their ranges. Under the customary procedure, a deviation of one percentage point or more would be considered significant.

Mr. Partee observed that a question might be raised as to whether the "midpoint" of the funds rate range was to be interpreted literally--that is, as 5 per cent for a range of 4-1/2 to 5-1/2 per cent--or whether the present level of about 5-1/4 per cent would be considered the midpoint for operating purposes.

Chairman Burns remarked that--a bit unfortunately, in his view--it appeared to be the sense of the Committee that the midpoint of the funds rate range should be taken as 5 per cent. The Desk would be expected to aim at such a funds rate if the date becoming available a week from now suggested that the various aggregates were growing at rates near the midpoints of their ranges.

Mr. Wallich remarked that the Chairman's formulation seemed to suggest that the funds rate would dominate the aggregates, in the sense that if the aggregates were at the

midpoints of their ranges and the funds rate was not, the funds rate would be changed--even though that might cause the aggregates to deviate from their midpoints.

Chairman Burns observed that, while the Committee used the Federal funds rate as a "handle" for achieving its objectives for the aggregates, within a period as short as a month the effect of a change in the funds rate on the aggregates was negligible.

Mr. Mitchell commented that some unhappiness was generated by the uncertainties regarding the precise nature of the short-run relationship between the funds rate and the aggregates. In his judgment, however, the differences of view today with respect to the appropriate funds rate were not large enough to matter much.

Mr. Jackson remarked that if the relationship between the funds rate and the aggregates was as weak as had been suggested, the practice of using the former as a handle for the latter was equivalent to riding a blind mule. At a minimum, the Committee should establish narrow fences, as he had suggested earlier. The mule would still be blind, but it would be less likely to fall into the ditch.

With Messrs. Volcker, Eastburn, and Jackson dissenting, 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 output of goods and services--which had increased sharply in the third quarter--is expanding more moderately in the current quarter. Retail sales are reported to have risen in October, after 2 months of little net change. Industrial production and nonfarm payroll employment continued to recover, although at a less rapid rate than in the summer months. The unemployment rate rose to 8.6 per cent from 8.3 per cent in September, reflecting a sizable increase in the civilian labor force. Average wholesale prices of industrial commodities increased more in October than in the immediately preceding months, and prices of farm and food products rose sharply further. However, since mid-October prices of many agricultural products have declined. The advance in average wage rates in October was substantial.

Since mid-October the exchange value of the dollar against leading foreign currencies has moved in a narrow range. The U.S. foreign trade surplus in September remained substantial, as both exports and imports rose moderately. Bank-reported private capital flows appear to have shifted to net outflows since September, and the volume of offerings of new foreign bonds in the U.S. market has been at record levels.

M_1 rose at a 6.9 per cent annual rate from the average level during the second quarter to the average level during the third quarter. However, M_1 grew relatively little in the months of the third quarter and it declined in October. Inflows of consumer-type time and savings deposits to banks and to nonbank thrift institutions remained moderate in October, and growth in M_2 and M_3 slowed further. Most short- and longer-term interest rates have declined further in recent weeks. Conditions in markets for State and local government securities have continued to be adversely affected by New York's financial problems.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic recovery, while resisting

inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking more than usual 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 after the meeting, are appended to this memorandum as Attachment D.

The Chairman then asked Mr. Sternlight to summarize the report of the staff committee on bankers' acceptances.

Mr. Sternlight made the following statement:

The report of the staff committee on bankers' acceptances to the Federal Open Market Committee, dated March 11, 1975,[1] recommended that the System operate in finance acceptances as well as trade-related bills. When our staff committee reported to the Federal Open Market Committee in early 1974, recommending certain liberalizations in the definitions of trade-related acceptances eligible for System purchase, we also indicated a favorable leaning toward operations in finance bills, but we suggested further study to evaluate market attitudes, and to weigh whether such System operations might adversely affect the market in trade-related acceptances. The Federal Open Market Committee instructed us to make that further study, and we have done so. We concluded that most market participants would favor an expansion of System operations to include finance bills and that such an expansion would not damage the market in trade-related bills.

At the same time, our further review left standing some reservations about possible effects of System operations in finance bills, and to some extent diminished the force of one of the

1/ A copy of this report has been placed in the Committe's files.

arguments cited earlier for entering this field. Thus, our staff committee's present conclusion and recommendation rests on a weighing of potential plus and minus elements. While we struck the balance on the plus side, we recognize that these factors could be weighted differently.

Summarizing the plus factors: first, acceptances stand essentially on the name of the accepting bank. Apart from carryovers from the "real bills" doctrine, there seemed no clear reason why the System should discriminate against certain acceptances just because they were not tied to a particular shipment of goods or a warehouse receipt.

Second, the finance acceptance could develop into a useful means for providing some liquidity to bank loan portfolios, under conditions that would still be subject to System control over bank credit formation through the reserve requirement.

Third, the finance acceptance could provide another useful vehicle for open market operations. It is this third reason that seems less forceful now than earlier in view of the very ample supply of Treasury securities.

On the negative side, the System would have to make credit judgments on additional banks that might enter the acceptance market. There is not only the question of whether a particular bank's acceptances are "prime," but also the delicate matter of how to implement an adverse decision, since a System decision to discontinue purchases of a particular bank name could add to that bank's problems. This could be a troublesome factor.

A second reservation is that development of the finance acceptance may accentuate the "tiering" or marketability gradations among the acceptances of different banks.

A third potential drawback is that, notwithstanding the reserve requirement, development of finance acceptances could provide banks with another elastic means for weakening the System's control over the pace of credit expansion.

To repeat, our staff committee conclusion was that the potential advantages outweighed the negative factors. The proposed change can be

> implemented by adding a reference in the authorization for domestic operations to acceptances that arise out of the provision of general financing to the drawer of the accepted draft.
>
> Finally, our report recommended, not to the Federal Open Market Committee but to the Board of Governors, that consideration be given to amending Regulation D to remove the reserve requirements on those trade-related acceptances that are now eligible for System open market purchases but are not eligible for discount.

Mr. Wallich remarked that a Committee decision to begin operating in finance bills at a time like the present, when the public was rather sensitive about the condition of banks, might well be misinterpreted.

Mr. Sternlight said he would agree that this was not the ideal time to make the change.

Chairman Burns expressed the view that it would not be desirable to pursue the staff's proposal at this time, and several other members concurred.

Mr. Holland remarked that the authority for the Desk to buy finance bills could prove to be a useful additional tool in times of serious banking and market difficulties. While ideally it would be desirable to acquire some experience with that tool before an emergency arose, he agreed that action to grant the authority should not be taken now because of possible announcement effects. However, the Committee should keep in mind the potential usefulness of the tool in dealing with

troublesome situations. In his judgment, there were circumstances--admittedly, rather special ones--in which purchases of finance bills would have real advantages over loans at the discount window, on the one hand, and open market operations on the other.

Chairman Burns asked Mr. Holland about the advantages that purchases of finance bills might have over discount window operations in a crisis atmosphere.

In reply, Mr. Holland said the main advantage was that when the System purchased such bills no debt would appear on the accepting bank's balance sheet other than the contingent liability normally shown for bankers' acceptances.

The Chairman commented that the most useful procedure in a crisis atmosphere probably would be to provide lendable funds to every member bank by an across-the-board reduction in reserve requirements.

Mr. Holland agreed. He added that he had meant to suggest not that purchases of finance bills would be the most useful tool in a crisis, but that they could be a useful additional tool.

Mr. Kimbrel referred to Mr. Sternlight's observation that if the Desk was authorized to buy finance bills it would have to make judgments about creditworthiness. He thought it

would be highly undesirable for the System to begin making such judgments in the present sensitive atmosphere.

Mr. Volcker remarked that while the authority to buy finance bills might be useful in emergencies, as Mr. Holland had suggested, he was not sure how important that use would be. More generally, he had reservations about the proposal apart from considerations of timing. If the System were to begin buying finance bills one might ask why it should stop there, and not go on to buy CD's and bank loans. It was true that one could now ask why the System bought trade-related acceptances. However, there was a special historical rationale for the purchase of such acceptances, and that rationale differed from the one Mr. Holland had mentioned.

Mr. Coldwell expressed the view that the original rationale for System operations in acceptances no longer applied. Rather than broadening the types of acceptances eligible for purchase, he would favor discontinuing all operations in that instrument.

Mr. Eastburn said his thinking was similar to Mr. Coldwell's. While there was a long history to Federal Reserve operations in acceptances, it was his impression that the System had unnecessarily mothered the market. He thought the Committee should review the general role of operations in

acceptances as a part of its open market operating techniques. In that connection, it would be useful to have the views of the Manager on the value of acceptance operations in implementing monetary policy.

Mr. Holmes said he would have a memorandum on that subject prepared.

Mr. Mitchell remarked that from the longer-run standpoint there were advantages in being able to carry out open market operations in paper other than Treasury securities. While he agreed that this was not a good time to begin buying finance bills, he would be inclined under different circumstances to broaden somewhat the range of acceptances in which the System operated.

Mr. Holland observed that he would not urge the Committee to approve the staff's recommendation today. He wanted only to note that operations of the kind proposed could be useful in certain situations, and that the Committee might want to authorize them on short notice if such a situation appeared likely to arise.

Mr. Mayo said he could see some possible usefulness to operations in finance bills under certain circumstances, but in connection with regular open market operations he thought the disadvantages far outweighed the advantages. In any case, he

agreed that it would be highly undesirable at this time for the System to begin making judgments about creditworthiness on a large scale. He suggested that the matter be deferred, at least pending a study of the value of acceptance operations in general.

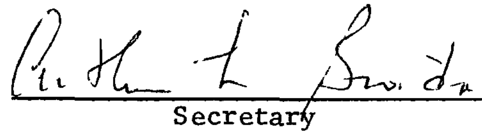
Chairman Burns noted that the question of System judgments regarding the credit standing of banks that issued acceptances had arisen recently in another connection. A request had been received from Chairman Reuss of the House Banking Committee and Chairman St. Germain of the Subcommittee on Financial Institutions for information on System holdings of acceptances of individual banks on three recent dates. The fact that the System happened not to hold the acceptances of certain banks on the dates in question could mistakenly be interpreted to mean that it had doubts about their credit standing. Ways of dealing with that problem were now being considered; one possibility might be to supply the information sought for a number of dates in addition to the three requested.

Mr. Volcker expressed the view that the release of names of individual banks with which the System did business would establish a dangerous precedent. While he was not sure that doing so would be seriously damaging in this particular instance--except for the reason the Chairman had mentioned--he would be concerned about the precedent that would be established.

Chairman Burns then observed that it appeared to be the sentiment of the Committee to take no action on the recommendation for operations in finance bills.

It was agreed that the next meeting of the Committee would be held on December 16, 1975, at 9:00 a.m.

Thereupon the meeting adjourned.



Secretary

ATTACHMENT A

Henry C. Wallich
November 18, 1975

Summary of BIS meeting: November 9-10, 1975

At the meeting of "technicians" on gold transactions, the means of implementing the Washington agreement on gold were discussed. A working paper by Zijlstra suggested three main points for discussion: how to define and prevent price pegging, how to fix and protect the ceiling on the gold stock, and how to regulate buying by central banks under the ceiling.

On all three issues as well as on others that came up, the predominant tendency of the group was to try to soften up the detailed terms. The U.S. representatives opposed this on every point and received some support from the Canadian as well as the IMF representative. Particularly troublesome was a proposal to make the official gold stock flexible upwards by allowing it to exceed the ceiling "temporarily," with reliance mainly on anticipated sales by the IMF for subsequent correction. There was also a reluctance to report on gold transactions and holdings as frequently as seemed technically possible.

The technicians did not complete their agenda and were subsequently requested by President Zijlstra to reconvene in December to deal also with some issues not definitively treated in the governors' meeting.

In the governors' meeting, Zijlstra eliminated from discussion the controversial question of the effective starting date of inter-central bank transactions -- whether after the Jamaica meeting of the Interim Committee in January, or only after amendment of the IMF Articles perhaps 18 months thereafter. Mr. Szasz, chairman of the technicians' group, presented his report of the technicians meeting. Mr. Dale (IMF) reported on a discussion of the IMF board in which the U.S. executive director had argued that central bank gold purchases should be allowed only after amendment and somewhat surprisingly had received some support from spokesmen of LDC's.

The discussion of the governors focused principally on the question of admission to the group of countries participating in the gold agreement. It was noted that, while adherence to the agreement was open to all IMF members, monthly discussion of gold problems in Basle with a greatly enlarged group would fundamentally change the nature of the Basle discussions and should be avoided.

At a separate meeting of the governors, the Blunden Committee report on cooperation among supervisory authorities was discussed. In line with guidance received from the Board of Governors, I pointed to the ambiguities inherent in the report and noted that as regards the division of supervisory responsibilities among host country and parent country authorities, the U.S. would like to see its freedom of action protected. Mr. Blunden agreed that the division of responsibility in his report allowed for action by both host and parent authorities. I also urged the Blunden group, without aiming for coordination of

supervisory procedures, to work toward improvement in procedures in each country. It was noted in the discussion that several countries have problems of confidentiality in passing along information to foreign supervisory authorities, but that progress in relaxing these restraints, including through legislative action, is being made in several countries.

At the dinner meeting, New York City was the topic of general discussion. After a fairly detailed exposition by the U.S. representatives, some members of the group said that they were unconvinced of the wisdom of U.S. Government policies as they then stood, while others said that they had found our presentation convincing.

ATTACHMENT B

November 17, 1975

Drafts of Domestic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on November 18, 1975

GENERAL PARAGRAPHS

The information reviewed at this meeting suggests that output of goods and services--which had increased sharply in the third quarter--is expanding more moderately in the current quarter. Retail sales are reported to have risen in October, after 2 months of little net change. Industrial production and nonfarm payroll employment continued to recover, although at a less rapid rate than in the summer months. The unemployment rate rose to 8.6 per cent from 8.3 per cent in September, reflecting a sizable increase in the civilian labor force. Average wholesale prices of industrial commodities increased more in October than in the immediately preceding months, and prices of farm and food products rose sharply further. The advance in average wage rates was substantial.

Since mid-October the exchange value of the dollar against leading foreign currencies has moved in a narrow range. The U.S. foreign trade surplus in September remained substantial, as both exports and imports rose moderately. Bank-reported private capital flows appear to have shifted to net outflows since September, and the volume of offerings of new foreign bonds in the U.S. market has been at record levels.

M_1 declined in October, after having grown from the second to the third quarter at a 6.9 per cent annual rate. Inflows of consumer-type time and savings deposits to banks and to nonbank thrift institutions remained moderate in October, and growth in M_2 and M_3 slowed further. Most short- and long-term interest rates have declined further in recent weeks. Conditions in markets for State and local government securities have continued to be adversely affected by New York's financial problems.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic recovery, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

OPERATIONAL PARAGRAPH

"Monetary Aggregate" Proposal

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 "Money Market" Proposals

Alternative A

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve somewhat easier bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates do not appear to be growing at rates above those currently expected.

Alternative B

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

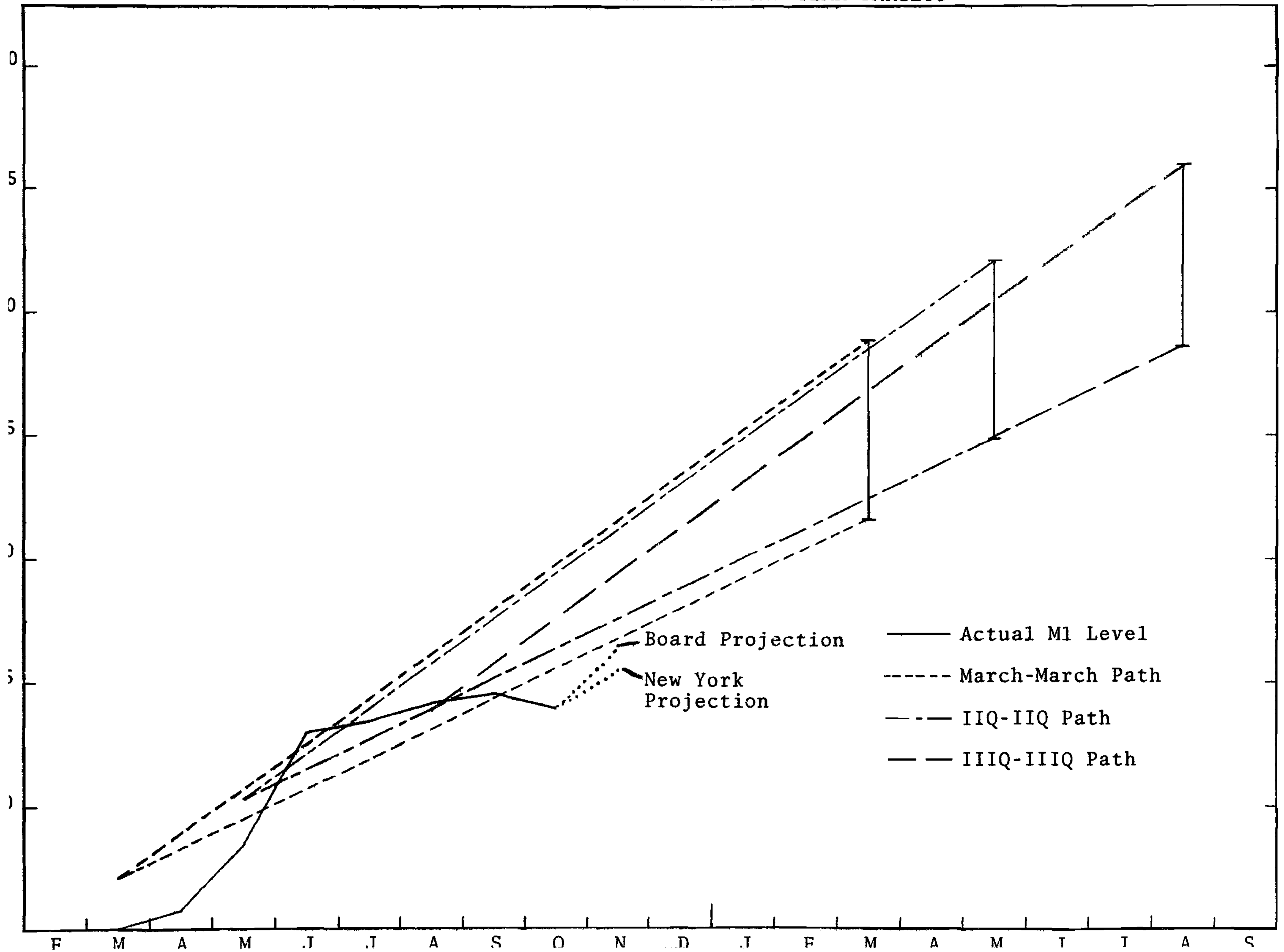
Alternative C

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve somewhat firmer bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates do not appear to be growing at rates below those currently expected.

ATTACHMENT C

November 18, 1975

Charts prepared at the Federal Reserve Bank of Philadelphia


BILLIONS OF DOLLARS
ACTUAL M1 LEVELS RELATIVE TO THE ONE-YEAR TARGETS
Board Projection
New York Projection
Actual M1 Level
March-March Path
IIQ-IIQ Path
IIIQ-IIIQ Path
F
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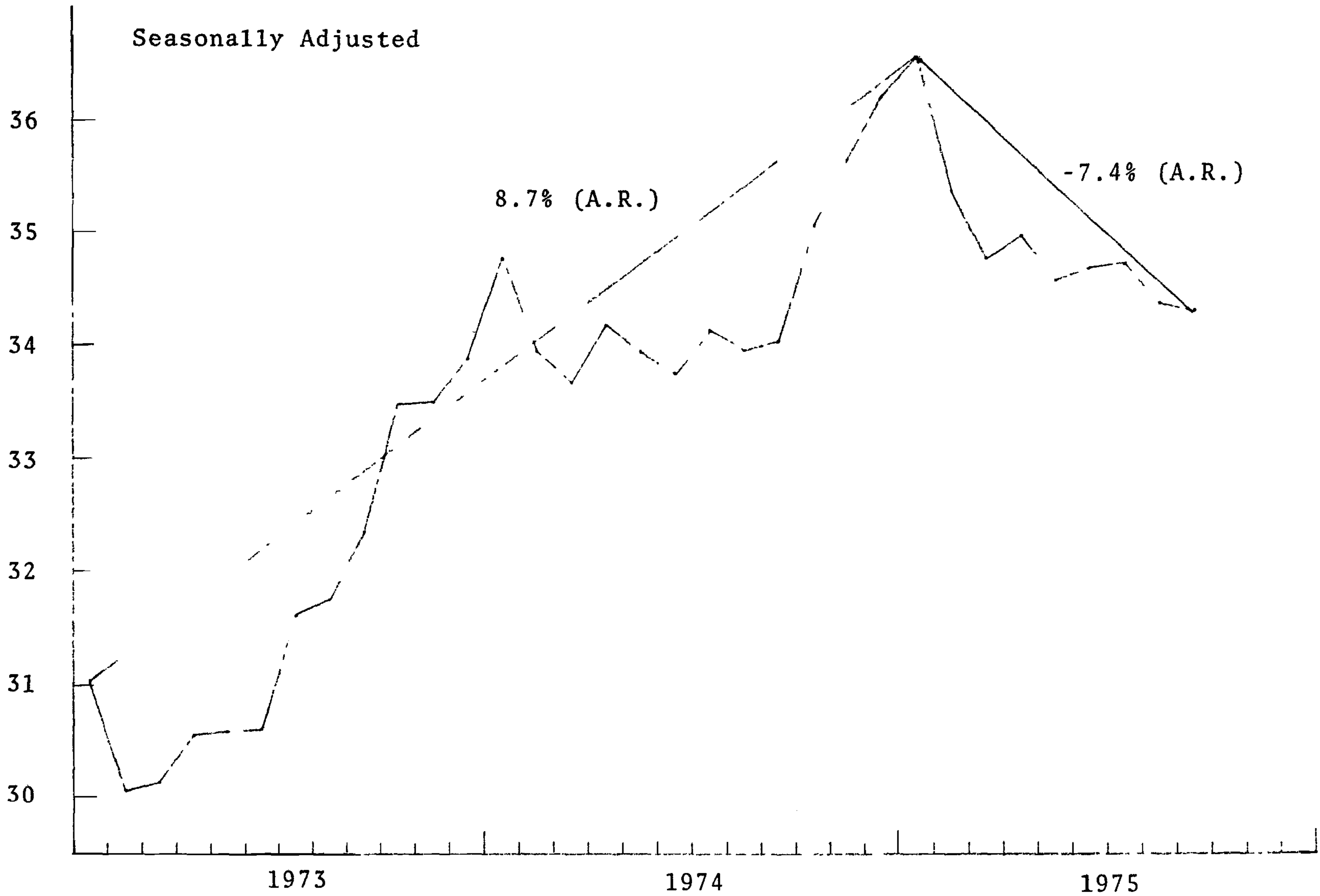
NON-BORROWED RESERVES OF MEMBER BANKS

Billions of Dollars



Source: Federal Reserve Bulletin

ATTACHMENT D

November 18, 1975

Points for FOMC guidance to Manager in implementation of directive		Specifications
A. Desired longer-run growth rate ranges (as agreed, 10/21/75):		
(QIII '75 to QIII '76)	M_1	5 to 7-1/2%
	M_2	7-1/2 to 10-1/2%
	M_3	9 to 12%
	Proxy	6 to 9%
B. Short-run operating constraints (as agreed, 11/18/75):		
1. Range of tolerance for RPD growth rate (November-December average):		4-1/2 to 8-1/2%
2. Ranges of tolerance for monetary aggregates (November-December average):	M_1	6 to 10%
	M_2	7-1/2 to 10-1/2%
3. Range of tolerance for Federal funds rate (daily average in statement weeks between meetings):		4-1/2 to 5-1/2%

4. Federal funds rate to be moved in an orderly way within range of toleration.

5. Other considerations: more than usual 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.