

Federal Open Market Committee Decisions in 1968— A Year of Watchful Waiting

MONETARY policy decisions and actions in 1968 were clouded by uncertainty about the passage of pending fiscal legislation in the first half of the year and by overestimation of the restraining impact of such legislation in the second half. As a result, monetary authorities did not take action to slow the growth of the money stock in the first half of the year when the pace of economic activity was accelerating. Furthermore, they sought to accommodate any tendency toward easing money and short-term credit market conditions in the third quarter, attempting to avoid economic "overkill," the anticipated result of the 10 per cent surtax and \$6 billion cut in planned Federal expenditures passed by Congress in late June. The substantial slowdown in total spending expected by many analysts within and outside the Federal Reserve did not materialize, and it was not until December that the Federal Reserve adopted a policy of restraint.

This article summarizes monetary policy decisions of the Federal Open Market Committee (FOMC) in 1968.¹ The source of information is the record of FOMC policy actions released about 90 days after each meeting and published in the Federal Reserve *Bulletin*.² This record includes the Committee's instruction or current economic policy "directive" to the New York Federal Reserve Bank. The Trading Desk at this bank conducts open market operations for the System. This article will sometimes refer to the directive being sent to the "Desk." The article also compares the policy decisions of the FOMC with the behavior of monetary variables such as market interest rates, and the growth rates of such monetary aggregates as the monetary base, the money stock and bank credit.

These monetary variables frequently appear to give conflicting signs with respect to the direction and degree of the influence of monetary actions on total spending. For example, if market anticipations of future inflation are revised upwards, interest rates may rise. The rise in interest rates, taken alone, might suggest monetary tightness to some observers. How-

ever, the growth of the money stock may be accelerating at the same time, thus indicating monetary ease to others. Similarly, if the money supply increases at a relatively slow rate for several quarters following a period of rapid monetary growth and inflation, interest rates may fall because demands for credit subside as anticipations of future inflation are revised downward. The declining interest rates may indicate "easy money" to some observers, while the lack of growth of the money supply indicates "tight money" to others.

At each meeting the FOMC assesses the current economic situation and reaches a majority opinion regarding the course of monetary actions over the period ahead. Some members of the Committee and staff cite movements in various indicators and the probable influence of fiscal and monetary actions on total spending, prices, interest rates and employment.

Some participants at the Committee meetings do not find any single indicator or group of indicators to be most informative, but rather prefer to "look at everything." The FOMC directives to the New York Federal Reserve Bank reflect this approach. The directives are phrased primarily in terms of "money and short-term credit market conditions," and consequently the Desk devotes most of its attention to interest rates and free reserves.

An alternative approach to economic stabilization policy is provided by consideration of monetary aggregates. One version of this approach emphasizes the money stock, defined as demand deposits plus currency, and will hereafter be referred to as the "monetary view."³ The theory and evidence underlying this approach suggest that the growth rate of the money supply over approximately the current and previous three quarters provides the best indication of the total influence of stabilization actions, both monetary and fiscal, on current economic activity.

³See "An Approach to Monetary and Fiscal Management," a speech given by Darryl R. Francis, President, Federal Reserve Bank of St. Louis, before The Money Marketeters, New York City, October 30, 1968. This speech was reprinted in the November 1968 issue of this *Review*, along with "Monetary and Fiscal Actions: A Test of Their Relative Importance in Economic Stabilization" by Leonall C. Andersen and Jerry L. Jordan. A "Comment" on this article by Frank de Leeuw and John Kalchbrenner and a "Reply" by the authors appear in the April 1969 *Review*. Also see "The Role of Money and Monetary Policy" by Karl Brunner in the July 1968 issue of this *Review*.

¹For a review of economic developments last year, see Norman Bowsher, "1968—A Year of Inflation," in the December 1968 issue of this *Review*.

²The record of FOMC policy actions is also published in the *Annual Report of the Board of Governors of the Federal Reserve System*.

From this analytical approach it is argued that policy-makers could more accurately assess the present state and probable course of the economy by placing greater reliance on the growth of the money supply as an indicator of monetary influence rather than relying on money market conditions and related measures. In this article the directives of the FOMC in 1968 are contrasted with the analysis emanating from the monetary view.

FOMC Directives

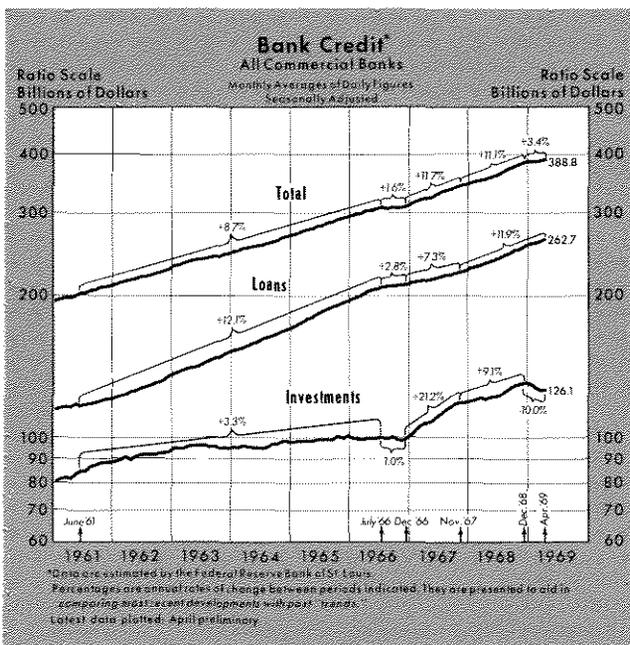
The seven members of the Board of Governors of the Federal Reserve System and five of the twelve Reserve Bank presidents are voting members of the FOMC, while the other Reserve Bank presidents participate in the discussion. Staff members of the Committee contribute analyses and recommendations which provide a basis for the decisions of the Committee. The Chairman of the Board of Governors of the Federal Reserve System is Chairman of the FOMC. The President of the New York Reserve Bank is a permanent voting member and traditionally Vice-Chairman of the FOMC. During the first two months of 1968, the other four voting presidents were from the Reserve Banks of Chicago, Richmond, St. Louis, and San Francisco. For the remainder of the year they were from the banks of Atlanta, Boston, Cleveland, and Minneapolis. Last year the FOMC met every three or four weeks and also on special occasions when circumstances arose which warranted consideration of modification of the directive issued at the previous meeting.

As noted above, the directive issued to the New York Federal Reserve Bank at each meeting is phrased primarily in terms of "money and short-term credit market conditions." The interpretation of these terms by the Desk manager and the demand and supply conditions he faces in the money market are important in determining the effect that implementation of the instruction will have on interest rates and monetary aggregates. The directive contains (1) a summary of general economic conditions; (2) a policy consensus — a statement of the Committee's general policy stance; (3) an operating instruction which indicates the direction in which the Committee feels that money market conditions should move in order to achieve the policy goals, and generally (4) a proviso clause stating that open market operations should be modified if the Desk observes a particular prespecified event, such as a significant deviation of bank credit growth from projections. The exhibit on pages 8 and 9 presents a summary of each of the directives issued in 1968.

The proviso clause tells the manager the conditions under which operations should be modified from the course otherwise specified in the directive. The principal monetary variable employed in the proviso clause during 1968 was bank credit.⁴ For each meeting of the FOMC the Board staff projects the growth of bank credit for the coming month. The proviso clause tells the Desk manager the direction in which he should modify operations if actual bank credit growth is deviating from projections. The manager is not required to alter his operations in such a way as to achieve the projected growth of bank credit. All that is required is that operations be modified somewhat from what they otherwise would have been.

Decisions and Actions in 1968

An examination of the policy directives of the FOMC suggests that 1968 can be divided into three periods. From December 1967 through May 1968 the Desk was instructed to achieve firmer conditions in the money market or to maintain already firm conditions. The second period, from June through November, was one of "accommodating tendencies for short-term interest rates to decline" or "maintaining prevailing conditions in the money market." Firming of money market conditions was allowed in the latter



⁴Bank credit is defined as total loans and investments at all commercial banks. The FOMC often refers to the "credit proxy" — daily average total deposits at all member banks — as a more readily available indicator of the growth of bank credit.

FEDERAL OPEN MARKET COMMITTEE ECONOMIC POLICY DIRECTIVES

Date of FOMC Meeting	Policy Consensus	Operating Instructions	Proviso Clause of Directive
1968 January 9	. . . to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments. Dissents: None	To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the somewhat firmer conditions that have developed in the money market in recent weeks . . .	provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations.
February 6	No change Dissents: None	. . . while taking account of Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm conditions in the money market,	and operations shall be modified to the extent permitted by Treasury financing if bank credit appears to be expanding as rapidly as is currently projected.
March 5	No change Dissents: None	. . . System open market operations until the next meeting of the Committee shall be conducted with a view to attaining somewhat firmer conditions in the money market;	provided, however, that operations shall be further modified if bank credit appears to be expanding more rapidly than is currently projected.
March 14	. . . current policy directive should be modified to permit adaptation of open market operations to the changed circumstances brought about by recent events including the discount rate action. Dissents: None	In light of recent international developments, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm but orderly conditions in the money market, taking into account the effects of increases in Federal Reserve discount rates.	
April 2	. . . to foster financial conditions conducive to resistance of inflationary pressures and attainment of reasonable equilibrium in the country's balance of payments. Dissents: None	. . . System open market operations until the next meeting of the Committee shall be conducted with a view to attaining slightly firmer conditions in the money market;	provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current predictions or if unusual liquidity pressures should develop.
April 19	. . . achieving firmer money market conditions in keeping with the higher discount rate while facilitating orderly market adjustments to the increase in that rate. Dissents: None	System open market operations until the next meeting of the Committee shall be conducted with a view to achieving firmer but maintaining orderly conditions in the money market, while facilitating market adjustments to the increase in the Federal Reserve discount rates.	
April 30	. . . to foster financial conditions conducive to resistance of inflationary pressures and attainment of reasonable equilibrium in the country's balance of payments. Dissents: Mr. Hickman	. . . while taking account of Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the firmer conditions prevailing in the money market;	provided, however, that operations shall be modified to the extent permitted by Treasury financing, if bank credit appears to be deviating significantly from current projections.
May 28	. . . to foster financial conditions conducive to resistance of inflationary pressures and attainment of reasonable equilibrium in the country's balance of payments, while taking account of the potential for severe pressures in financial markets if fiscal restraint is not forthcoming. Dissents: None	. . . System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm conditions in the money market;	provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projection or if unusual pressures should develop in financial markets.

June 18	. . . to foster financial conditions conducive to resistance of inflationary pressures and attainment of reasonable equilibrium in the country's balance of payments, while taking account of the potential impact of developments with respect to fiscal legislation. Dissents: None	. . . System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining generally firm but orderly conditions in the money market;	provided, however, that if the proposed fiscal legislation is enacted, operations shall accommodate tendencies for short-term interest rates to decline in connection with such affirmative congressional action on the pending fiscal legislation so long as bank credit expansion does not exceed current projections.
July 16	. . . to foster financial conditions conducive to sustainable economic growth, continued resistance to inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments. Dissents: None	. . . while taking account of forthcoming Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to accommodating the tendency toward somewhat less firm conditions in the money market that has developed since the preceding meeting of the Committee;	provided, however, that operations shall be modified, to the extent permitted by Treasury financing, if bank credit appears to be deviating significantly from current projections.
August 13	No change Dissents: None	. . . System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining, on balance, about the prevailing conditions in money and short-term credit markets;	provided, however, that operations shall be modified if bank credit appears to be significantly exceeding current projections.
August 19	No change Dissents: None	System open market operations until the next meeting of the Committee shall be conducted with a view to facilitating orderly adjustments in money market conditions to reductions in Federal Reserve discount rates;	provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projections.
September 10	No change Dissents: None	System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the prevailing conditions in money and short-term credit markets;	provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projections.
October 8	No change Dissents: Messrs. Hayes Hickman Kimbrel	System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the prevailing conditions in money and short-term credit markets;	provided, however, that operations shall be modified to the extent permitted by the forthcoming Treasury refunding operation, if bank credit expansion appears to be significantly exceeding current projections.
October 29	No change Dissents: Mr. Hayes	. . . while taking account of the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the prevailing conditions in money and short-term credit markets;	provided, however, that operations shall be modified, to the extent permitted by Treasury financing, if bank credit expansion appears to be exceeding current projections.
November 26	No change Dissents: Messrs. Hayes Hickman Kimbrel Morris	. . . System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the prevailing conditions in money and short-term credit markets;	provided, however, that operations shall be modified if bank credit expansion appears to be exceeding current projections.
December 17	. . . to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments. Dissents: None	. . . System open market purchases until the next meeting of the Committee shall be conducted with a view to attaining firmer conditions in money and short-term credit markets, taking account of the effects of other possible monetary policy action;	provided, however, that operations shall be modified if bank credit expansion appears to be deviating significantly from current projections.

SOURCE: *Federal Open Market Committee Policy Record Entries, Current Economic Policy Directive*

part of this period under authority of the proviso clause, as the growth of bank credit persistently out-paced expectations. The third period started at the final meeting of the year, with an instruction to attain firmer conditions in money and short-term credit markets.

January Through May — Desire For Tightness

Decisions by the FOMC in the first five months of 1968 were all in the direction of firm money market conditions. As 1968 began, inflation and a more serious balance-of-payments deficit were the chief concerns of the FOMC. In January the Committee assessed the thrust of monetary actions to be relatively restrictive because of the high and rising market rates of interest and, therefore, decided not to take further action. Uncertainty about the effects of actions undertaken in late 1967 and concern over disintermediation of commercial bank time deposits (as market interest rates rose relative to Regulation Q ceilings) discouraged further tightening in January.⁵ At the same time, the President's January 1 announcement of a special program to improve the balance of payments, through some special restrictions on lending, investing, and traveling abroad, tended to reduce the urgency of the balance-of-payments considerations as a basis for restrictive monetary actions.

In early February the FOMC viewed the existing economic situation as essentially the same as a month before. Members expressed considerable concern over the inflationary pressures in the economy, noting that the projected growth rate of bank credit was more rapid than they felt desirable. However, the majority of the Committee felt that Treasury financing operations imposed a constraint on monetary policy limiting action to slow the inflation.⁶ The Committee instructed the Desk to maintain firm conditions in the

money markets, and changed the proviso clause in the direction of firmness by stipulating that open market operations should be modified, to the extent permitted by Treasury financing, if bank credit grew as rapidly as was then expected.

In early March the FOMC considered the continuing rapid rise in overall economic activity and prices, and the reduced U.S. trade surplus recorded in recent months. The Committee decided that "greater monetary restraint" was appropriate and directed the Desk to achieve somewhat firmer conditions in the money market. A proviso clause in the direction of firmness indicated that open market operations should "seek still firmer conditions" if bank credit expanded more rapidly than projected.

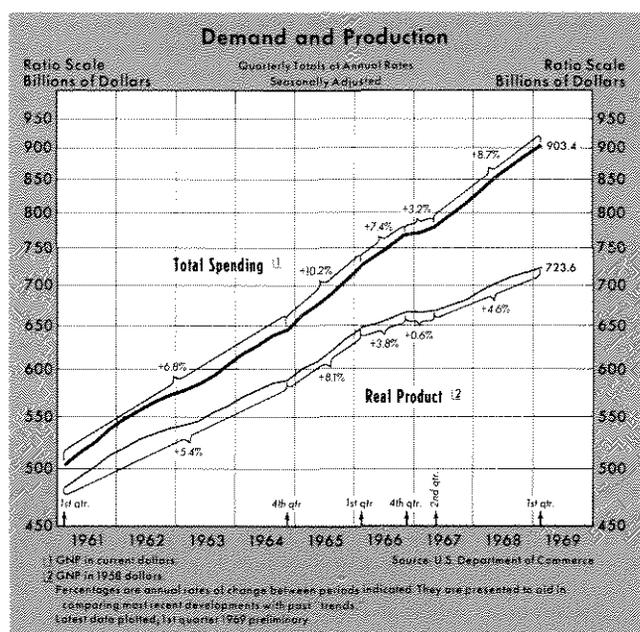
A crisis in the London gold market continued to mount in March, and in the middle of that month the London gold market was closed for two weeks. The Board of Governors approved an increase in the discount rate from 4½ per cent to 5 per cent, and the Committee modified its policy directive. The revised directive instructed the Desk to operate with a view to maintaining firm but orderly conditions in the money market, in light of the gold crisis and the rise in the discount rate.

In early April the Committee again decided that there should be a move toward "attaining slightly firmer conditions in the money market." At the same time, some members of the Committee urged that firming proceed with caution because (1) improved prospects for fiscal legislation led some members to believe that "further firming through open market operations" was not appropriate; (2) "a considerable degree of monetary restraint had already been achieved;" (3) further firming "might have large adverse effects on flows of funds to financial intermediaries," and (4) there was uncertainty about the economic effects of any de-escalation of the Vietnam war. The proviso clause was changed, instructing the Desk to modify operations if unusual liquidity pressures developed or if the growth of bank credit was deviating significantly from projections.

In mid-April the discount rate was raised again. Regulation Q ceilings on the interest rates banks are permitted to pay on large denomination certificates of deposits were also raised to help alleviate the loss of time deposits by commercial banks. Following the change in these administered interest rate ceilings, the Desk was directed to achieve firmer conditions, but also to maintain orderly conditions in the money market.

⁵See Leonall C. Andersen and Michael O. Rigg, "1967 — A Year of Constraints on Monetary Management" in the May 1968 issue of this *Review* for a summary of policy decisions in late 1967. Following the British devaluation in November 1967, the discount rate was raised from 4 to 4½ per cent in an attempt to prevent increased capital flows from contributing more to the balance-of-payments deficit. At the December 1967 meeting of the FOMC, it had been decided to move "slightly beyond the firmer conditions that have developed in money markets partly as a result of the increase in Federal Reserve discount rates." In the last week of December it was announced that a one-half percentage point increase in reserve requirements against demand deposits over \$5 million would take effect in mid-January.

⁶This "even keel" constraint on monetary policy generally means that the Federal Reserve should not change monetary policy when the Treasury is in the market raising new funds or refunding an issue, or the Desk should not allow wide fluctuations in interest rates during Treasury financing.



When the FOMC met in late April, members again made note of the rapid expansion of overall economic activity and the balance-of-payments deficit. Nevertheless, the Committee issued an essentially “no change” operating instruction. Some members favored no change in policy because they felt “a considerable degree of monetary restraint had already been achieved” and because the prospects for fiscal action had improved. Moreover, the impending Treasury refunding seemed to preclude any change in policy at that time.⁷

At the late May meeting of the FOMC, preliminary estimates indicated that the increase in GNP in the second quarter would be about as large as the exceptionally large increase in the first quarter. Therefore, the Committee agreed that “a restrictive monetary policy was appropriate,” and concluded that operations should “maintain the prevailing firm conditions.” The Committee noted that Congress might soon enact the fiscal restraint program and that “a considerable degree of monetary restraint had already been achieved,” as indicated by a slowing in the growth of bank credit and the sharp advances in market interest rates.

The monetary view, emphasizing changes in the money stock, indicates that actions during the first five months of 1968 remained highly stimulative and that monetary conditions remained conducive to con-

tinued inflation. According to this view, inflation accelerates with a lag following monetary stimulus, and as inflation accelerates (and anticipations of future inflation increase), nominal market interest rates rise to compensate lenders for the expected loss of purchasing power of the dollar. Throughout the spring of 1968 interest rates continued to rise as inflation accelerated and the demand for loan funds increased. Many members of the Committee held the view that the rising interest rates and declining growth of bank credit indicated monetary restraint. Yet economic theory (and substantial empirical evidence) suggests that extended periods of rising nominal interest rates are a result of inflation and a strong loan demand, rather than a restraining influence.

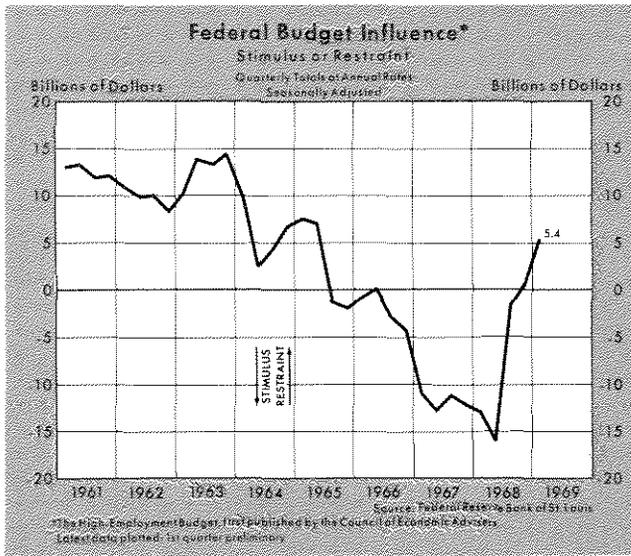
Bank credit was the monetary aggregate most frequently mentioned in the FOMC directives, and this measure did slow in the spring of 1968. However, anyone interpreting this observed slowing should consider that the slowing was a consequence of disintermediation of commercial bank time deposits. As market interest rates rose rapidly in response to the accelerating inflation in the spring of 1968, banks were prevented by Regulation Q ceiling rates from competing effectively for time deposits. As bank deposit growth slowed, the growth of bank credit also slowed, but under such circumstances the slowing of bank credit may not indicate any reduction of total credit or growth of purchasing power in the economy.⁸ Nevertheless, some members of the FOMC interpreted the slowing in bank credit as a sign of monetary restraint. In contrast to the apparent tightening indicated by bank credit and interest rates, the Committee noted that the money stock had increased at a rapid 9 per cent annual rate in April and May and was expected to continue growing at this rapid rate in June, following a 4.7 per cent annual rate of growth from December to March.

*June Through November —
Tendency Towards Monetary Ease*

Decisions by the FOMC during most of the second half of 1968 were strongly influenced by the belief that fiscal action would quickly reduce the rate of increase in total spending. At the meeting in mid-June the Committee expected the 10 per cent surtax and \$6 billion cut in planned Government expenditures to be enacted within a few days. The Board staff estimated that the growth of real GNP would,

⁷Mr. Hickman, President of the Federal Reserve Bank of Cleveland, dissented from the decision, expressing the view that firmer conditions should be sought once the Treasury financing was completed.

⁸See Jerry L. Jordan, “Relations Among Monetary Aggregates,” in the March 1969 issue of this *Review*.



for this and other reasons, slow sharply in both the third and fourth quarters. Therefore, although a rapid pace of total spending continued in the second quarter, the Committee decided against taking restrictive action. They instructed the Desk to maintain firm but orderly conditions in the money market, and to accommodate any tendency for short-term rates to decline if the surtax passed.

The view that the fiscal package would have a substantial restraining impact on total spending soon after passage was widely held in the spring and summer of 1968.⁹ It was argued that moderation in the growth of Government spending, reduced growth of after-tax incomes of individuals and corporations, and a smaller Federal deficit would all add up to substantially slower expansion of total spending after the proposed fiscal package became law. Thus, it was argued that a restrictive monetary policy in the summer of 1968 would be inappropriate and unnecessary, in view of the restraint expected from the fiscal action.

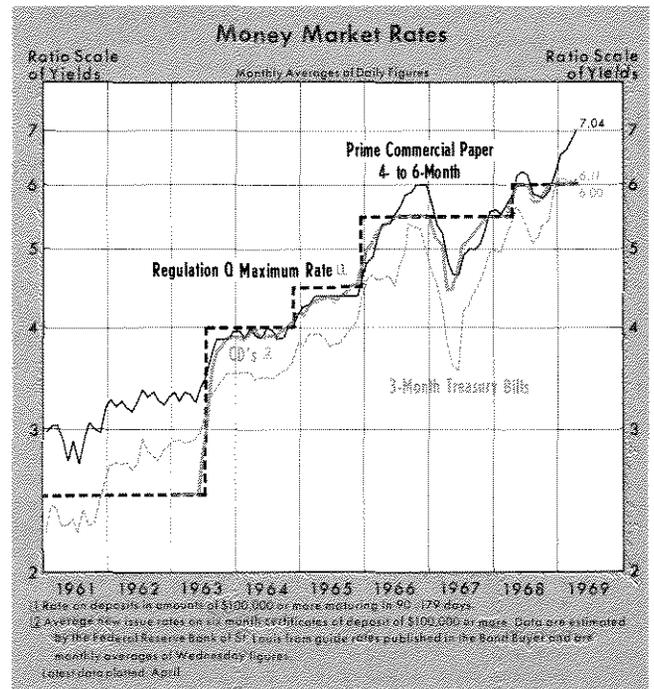
The Revenue and Expenditure Control Act of 1968 was enacted in late June and interest rates continued the decline which had begun in late May, at least partly because the market had anticipated the fiscal action. The Committee pondered the choice between either deferring easing until there was evidence that the fiscal measures were restraining total demand, or accommodating any easing tendencies in the money market. Few members questioned the view that the

⁹For discussion of the fiscal 1969 budget program, see Keith M. Carlson, "A Program of Budget Restraint" in the March 1969 issue of this Review, and "Economic Impact of Fiscal Actions," *Financial Analysts Journal*, Volume XXV, No. 2 (1969), pp. 69-71.

fiscal package would significantly slow the expansion of the economy in the second half of 1968.

At the July 16 meeting, Board of Governors staff projections indicated that the increase in total spending (GNP) in the third quarter would be considerably below the first-half pace. The staff also expected that consumer expenditures would continue to advance at only the moderate second quarter pace, and that the growth of various real magnitudes would soon slow. Given this analysis, the Committee decided that the Desk should accommodate easing tendencies in the money market. Throughout the remainder of the summer and the fall, the decisions of the FOMC continued to reflect the expectation that fiscal actions would significantly slow the pace of economic activity.

At its mid-August meeting the Committee noted that economic activity had been vigorous during the summer. However, some members thought it would be undesirable for the rising interest rates of the preceding few days to be allowed to continue and suggested that a cut in the discount rate might have the effect of moderating further upward pressures on short-term rates. The Board of Governors approved a reduction in the discount rate from 5½ per cent to 5¼ per cent at the Federal Reserve Bank of Minneapolis, and within two weeks the rates at the other District Banks were also lowered. Nevertheless, market rates continued to rise as it became increasingly evident to the business community and others that inflationary pressures were not subsiding.



From August until the December meeting, the operating instructions to the Desk were to maintain about the prevailing conditions in money and short-term credit markets. In fact, however, market interest rates were moving upwards throughout this period. Concern over accelerated growth of bank credit led to a proviso clause in the next few directives, instructing the Desk to modify operations toward tightness if bank credit expansion appeared to be exceeding current projections.

Information presented at the September meeting indicated a slight decrease in the unemployment rate from 3.7 to 3.5 per cent in August, and rapid increases in retail sales and total consumer spending. It appeared likely that very heavy demands for credit would push up short-term interest rates, and the Committee felt that such increases would be consistent with "maintaining prevailing money market conditions." It was deemed appropriate not to accommodate completely the rise in demands for funds because of the observed strength of the economy. A number of members — while not advocating a firming of policy—expressed concern about the rapid rates of bank credit expansion in recent months. On balance, however, "greater restraint" was not considered desirable in view of the continued belief that substantial slowing in overall economic activity would be forthcoming.

At both of the October meetings, Treasury financing operations were a consideration precluding a change in policy. But some members of the Committee felt that the excessive growth of bank credit and persistent inflationary pressures warranted seeking firmer conditions to the extent permitted by Treasury refunding operations. Presidents Hayes (New York), Hickman (Cleveland) and Kimbrel (Atlanta) dissented from the "no change" decision reached at the early October meeting, and President Hayes dissented again in late October. At the late November meeting these three presidents again dissented and were joined by President Morris of the Federal Reserve Bank of Boston. The seven members of the Board of Governors and the remaining voting President, Mr. Galusha of the Minneapolis bank, voted to continue the "no change" policy in November on the grounds that "evidences of slowing in the rate of expansion were likely to become more pronounced in coming months."

The monetary view of the developments from June to November last year suggests that there was about the same degree of inflationary stimulus from monetary growth in the second half of the year as in

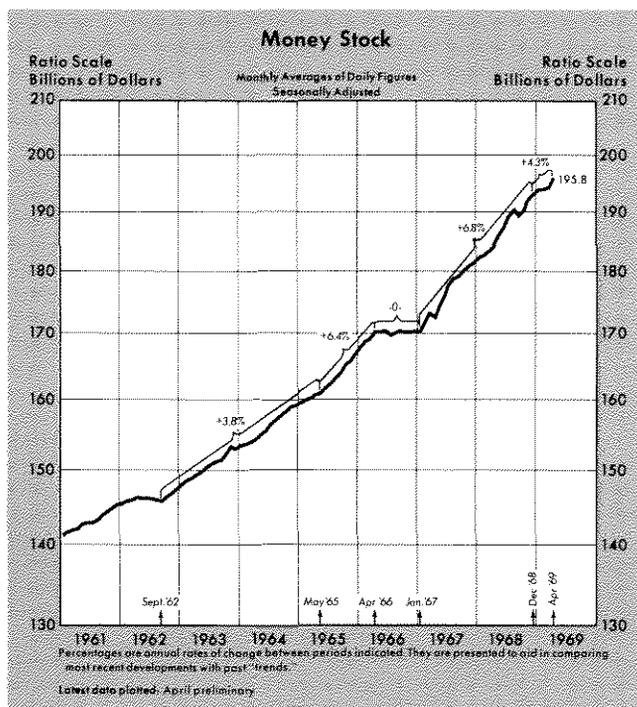
the first half. The monetary base grew at a 7 per cent annual rate from June through November, slightly faster than in the first half of the year. The growth of the money supply (demand deposits plus currency in the hands of the public) slowed from July to October after increasing at a 10 per cent annual rate from March to July. The growth of money in the spring, at rates substantially faster than the growth of the base, is attributable to the decline of Treasury deposits at commercial banks and the disintermediation of time deposits as market interest rates rose sharply relative to Regulation Q ceilings. Conversely, the slowing in the growth of money after midyear was a result of a buildup of Treasury deposits and a rapid increase in time deposits as interest rates fell. Consequently, it can be concluded that monetary influence on the economy remained very stimulative in the second half of the year.

There is considerable evidence that monetary actions influence total spending in the economy with a lag, usually distributed over about four quarters or more. This evidence would indicate that total spending in the third and fourth quarters of 1968 was still under the influence of the rapid growth of money in the first half of the year. Furthermore, the monetary view points out that there is little empirical evidence supporting the view that fiscal actions, in the presence of strong monetary stimulus, have a large and immediate restraining impact on the economy.

December — Effective Move Towards Restraint

The Committee, at the December 17th meeting, decided that restrictive actions should be taken, in view of upward revisions of fourth quarter GNP projections and other signs of strength in the economy. The unemployment rate had declined to 3.3 per cent in December and industrial production and retail sales had risen in November. At the same time, available information showed a third quarter deficit in the U.S. balance of payments. With most commercial banks paying the ceiling rates on large denomination CD's, the Committee expected a larger than usual runoff of CD's, but nevertheless directed that operations be conducted with a view to attaining firmer conditions (allowing interest rates to rise) in money and short-term credit markets. The discount rate was also raised from 5¼ to 5½ per cent on December 18.

The monetary view of the developments following the December 1968 meeting of the FOMC indicates



that a substantial degree of monetary restraint has been achieved, but the ultimate impact of this restraint on total spending will depend on its duration. From December to March 1969 money grew at a 1.9 per cent annual rate, and the monetary base increased at a 3.4 per cent rate. Weekly data show that the level of the money stock jumped sharply in early April, apparently a temporary aberration in the data, but by early May had fallen to the March level. In the period from December to early May, money rose at about a 2 per cent rate. The monetary view indicates that the growth of money in May and June will have a very important bearing on monetary influence on total spending during the second half of this year. If the level of money in May and June averages higher than in April, the growth of money this spring would be sufficiently rapid to offset any restraining influence otherwise emanating from the relatively slow monetary growth from December to March. On the other hand, if the money stock in May and June averages about the same as in March, a substantial slowing in the growth of total spending would likely be observed in the second half of this year.

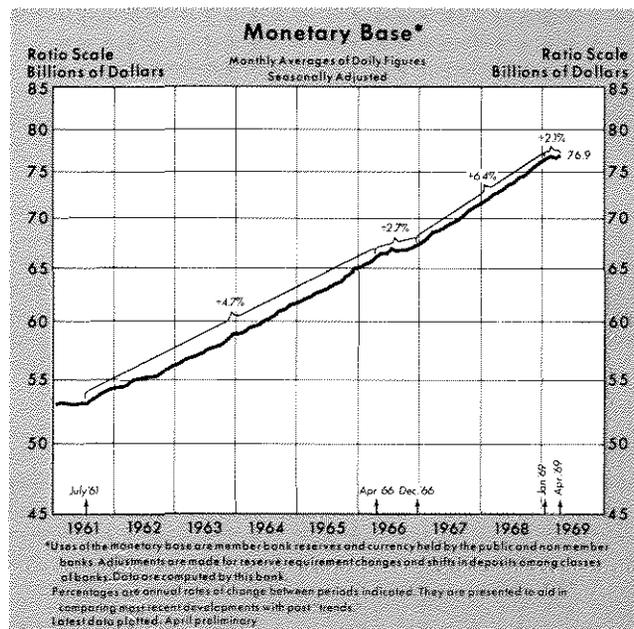
The continued slower growth of the monetary base (at a 3 per cent rate from March to April and a 2.1 per cent rate from January to April) indicates that actions of the Federal Reserve so far this year have not been conducive to rapid monetary growth. Statements of policymakers indicate a desire to main-

tain effective monetary restraint. In this case smaller increases in total spending and lower interest rates can be expected toward the end of this year. Reduction in the rate of inflation will take a longer period of time.

Summary

In the first half of 1968 the operating instructions sent to the Federal Reserve Bank of New York, and implemented by the Desk Manager, indicated that operations should be conducted with a view to maintaining firm conditions or attaining firmer conditions. High and rising short-term market interest rates in early 1968 indicated monetary restraint to some observers, but were probably only the result of rapidly rising demands for loan funds. The growth rates of the money stock and the monetary base on balance were very rapid throughout the first half of last year, indicating stimulative monetary actions. The growth of total bank deposits and bank credit slowed substantially in the spring of 1968 as market interest rates rose sharply relative to the ceiling rates banks were permitted to pay on time deposits, and banks were unable to compete effectively for time deposits. The majority of the FOMC interpreted the slowing of bank credit growth, coupled with rising market interest rates, as a sign of significant monetary restraint. Therefore, direct actions to slow the growth of Federal Reserve credit, the monetary base and the money stock were not taken.

Beginning with the first meeting after the passage of the fiscal package at midyear, the FOMC in-



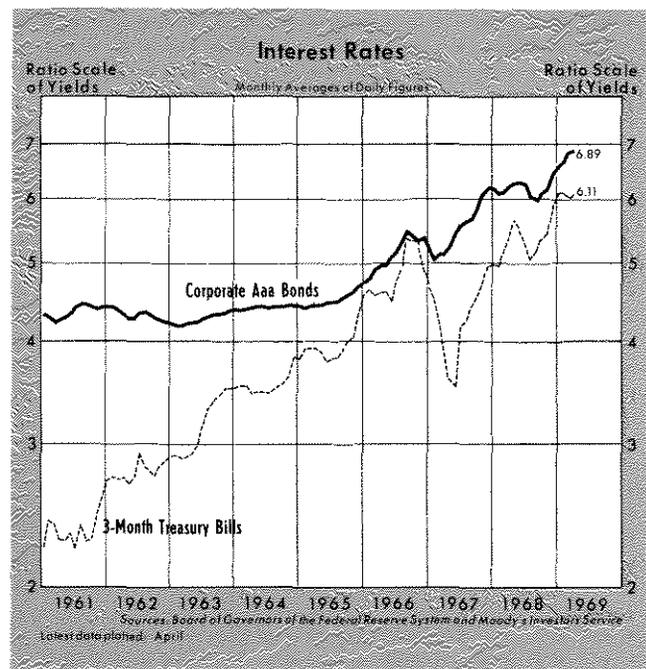
structed the Desk manager to accommodate less firm conditions or to maintain prevailing conditions in the money markets. Until the final meeting of the year in mid-December, the majority of the Committee remained convinced that substantial restraining influence was forthcoming from the fiscal package, and concluded that monetary restraint was inappropriate.

There was considerable support for the majority opinion of the FOMC throughout the economics profession. Business and financial periodicals in the summer and early fall cited the majority of economic analysts as concluding that the fiscal package would soon have a substantial restraining impact on the economy. The Wharton School forecasting model indicated that the immediate impact of the fiscal package would slow the growth of GNP to \$8.7 billion in the third quarter of 1968, less than half the actual result for that quarter. Similarly, most other forecasting models indicated there would be immediate slowing of economic activity and that by the first quarter of 1969 there was a strong possibility of a recession or "fiscal overkill."

The easing of market rates of interest from June into August last year may be attributed to the widely held expectation that substantial slowing of the economy, smaller price increases, and lower interest rates were soon to be forthcoming. However, as the second half of 1968 progressed it became increasingly evident that the immediate restraining impact of the fiscal action had been considerably overestimated and that rapid price increases and high market rates of interest would continue into 1969.¹⁰

¹⁰The Council of Economic Advisers held firmly to the view that the economy would slow as a result of the fiscal action. In early November, Arthur Okun, the Chairman of the CEA, announced that the nation had "turned the corner toward price stability." He observed that "it should be emphasized that our over-all price performance is still far from satisfactory. But improvement is a fact—and no longer just a forecast."

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Analysis based on the growth of money, on balance, does not indicate monetary restraint in early 1968. Furthermore, monetary growth during the period from June to November was about as stimulative as during the first part of the year. According to the monetary view, these actions were so expansive as to offset any restraint which might have developed from the more restrictive Federal budget.

If a tighter monetary policy was warranted in December, as it surely was, then it would also have been appropriate during the summer when total spending and expectations of price rises were also increasing rapidly. The decision to slow monetary growth probably would have been made if the FOMC and other analysts had not overestimated the restraining effects of the fiscal action and ignored the probable expansionary impact of the rapid growth of the money supply.

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