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Monetary Policy in 1969

NOTHING HELD THE ATTENTION of forecasters in 1969 more than Federal Reserve policy and the behavior of money and credit markets. And perhaps nothing surprised forecasters more than the behavior of the monetary and credit aggregates last year. It may be useful to review the formulation of Federal Reserve policy during 1969 against the background of the money and credit conditions that developed from it.

The Modus Operandi of 1969

Open market policy is decided by the Federal Open Market Committee, or FOMC, which has twelve voting members: the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the presidents of the other eleven Reserve Banks.[1] But open market policy, whatever it may be, is executed by the FOMC's agent, the Manager of the System Open Market Account. He does the actual buying and selling of Treasury securities. The

1. Some of the presidents of the other eleven Reserve Banks (for example, the presidents of the Boston and Chicago Banks) serve as voting members every other year and some (for example, the presidents of the Minneapolis and Kansas City Banks) serve every third year. Since 1954, all twelve presidents, whether or not they were serving as voting members, have attended each meeting of the FOMC and participated in policy deliberations.

manager must therefore be told what committee policy is, and this the FOMC does—formally at least—once every three or four weeks. At each meeting it adopts by majority vote a statement of policy, or a directive, the second paragraph of which tells the manager how to conduct open market operations over the interval until the next meeting.

During 1969, the FOMC used one or the other of two key phrases in its directives. In the twelve months December 1968 through November 1969, fourteen directives were adopted; in each the phrase "conditions in money and short-term credit markets" appears. In December 1969 one directive was adopted; it contains the phrase "conditions in the money market." For the record, then, what the FOMC has been telling the manager to do is to achieve either certain conditions in money and short-term credit markets or, less often, certain conditions in the money market. In its directive of December 17, 1968, it told him to attain firmer conditions in money and short-term credit markets; and in its directive of December 16, 1969, to maintain prevailing firm conditions in the money market.

To most economists inside and outside government, "conditions in the money market" suggests three variables: the federal funds rate, free reserves, and member bank borrowings from the Federal Reserve System. When the manager is instructed to achieve certain money market conditions, he presumably is given appropriate target values or ranges of values for these three variables. And when instructed to achieve certain "conditions in money and short-term credit markets," he presumably is given target values for four variables—the three so-called money market variables and the rate on three-month Treasury bills.

The manager cannot be sure, however, of simultaneously hitting targets for several variables. Economic relationships—including those that determine the federal funds rate and the Treasury bill rate—are in some degree erratic. And as a practical matter the manager has only one instrument, the System's portfolio of Treasury securities; essentially, he operates by altering the System's portfolio, which is to say by buying and selling Treasury securities. In deciding what type of securities to buy or sell, and when, he may be able to influence the spread between the funds rate and the bill rate. But his ability to influence this spread—or, more generally, the relationships between the variables used in specifying money and short-term credit market conditions—would seem to be slight. It is difficult to imagine the manager keeping the funds and bill rates within their respective ranges when, for no apparent reason, the funds rate is threatening to fall below

the lower end of its range and the bill rate is threatening to rise above the upper end of its range.

Judging by what happened in 1969, the problem of inconsistent targets is real enough. It is one of the lessons of last year that the funds rate and the bill rate often move in opposite directions. Free reserves do not always decrease when the funds rate rises or increase when it falls; nor do borrowings always increase and decrease with the funds rate. It may be that banks do not all behave alike and that the distribution of deposits is highly variable (and unpredictable as well). But whatever the explanation for "unexpected" changes in the variables used in specifying conditions in money and short-term credit markets, the fact is that there were quite a few in 1969. From mid-December 1968 through the end of December 1969, there were fifteen FOMC meetings. In the intervals after six of them the funds rate and free reserves both either increased or decreased (see Table 1). What is more, in the interval after eight of these meetings either the funds rate increased and borrowings decreased or the funds rate decreased and borrowings increased. Finally, in the interval after seven of these meetings, the funds rate and the bill rate moved in opposite directions.

Of course, when specified target values or ranges turn out to be inconsistent, the manager cannot simply stop the world and get off. To do nothing is, for him, to do something. He must therefore have ways of combining or averaging target values. Whether always or only from time to time, he may give priority to a single variable; he may, for example, hit his funds rate target and miss the others. But when given inconsistent targets, the manager may strike a compromise; hitting none of the targets exactly, he may achieve an average for all variables that, as best he can judge, approximates the degree of restraint desired by the FOMC.

Directives and Conditions in 1969

How the FOMC directives of the period from mid-December 1968 on were in fact implemented is shown in Table 1. In the directive of December 17, 1968, the manager was told to attain firmer conditions in money and short-term credit markets. Clearly, this he did. The bill rate and the funds rate rose significantly in the interval after the meeting; so did member bank borrowings, and free reserves declined.

Table 1. Directives of the Federal Open Market Committee and Changes in Selected Monetary Variables, December 1968 through December 1969

Meeting date	Phrase employed in directive	Interval between meetings	Change in average value[a]: 3-month Treasury bill rate (basis points)	Change in average value[a]: Federal funds rate (basis points)	Change in average value[a]: Free reserves (millions of dollars)	Change in average value[a]: Member bank borrowings (millions of dollars)
1968						
December 17	attain firmer conditions	12/19/68– 1/15/69	42	38	−188	327
1969						
January 14	maintain prevailing firm conditions	1/16/69– 2/ 5/69	−3	13	172	−35
February 4	maintain prevailing firm conditions	2/ 6/69– 3/ 5/69	−2	22	−11	27
March 4	maintain about prevailing firm conditions	3/ 6/69– 4/ 2/69	−12	21	−140	118
April 1	maintain firm conditions[b]	4/ 3/69– 4/30/69	12	71	−108	39
April 29	maintain prevailing firm conditions	5/ 1/69– 5/28/69	−8	110	−283	369
May 27	maintain prevailing pressure	5/29/69– 6/25/69	41	21	38	−3
June 24	maintain firm conditions currently prevailing	6/26/69– 7/16/69	31	30	34	−46
July 15	maintain currently prevailing firm conditions	7/17/69– 8/13/69	30	−27	61	−48
August 12	maintain prevailing firm conditions	8/14/69– 9/10/69	−6	11	148	−162
September 9	maintain prevailing firm conditions	9/11/69–10/ 8/69	8	37	−98	31
October 7	maintain prevailing firm conditions	10/ 9/69–10/29/69	−9	−39	−95	51
October 28	maintain prevailing firm conditions	10/30/69–11/26/69	20	−4	52	31
November 25	maintain prevailing firm conditions	11/27/69–12/17/69	54	5	30	−68
December 16	maintain prevailing firm conditions	12/18/69–12/31/69	19	2	238	−46

Sources: Board of Governors of the Federal Reserve System, *Fifty-Fifth Annual Report, 1968; Federal Reserve Bulletin* (various issues).

a. The change is the difference between the average values for the given and the preceding interval.

b. The directive goes on, however, with this qualification: "taking account of the effects of other possible monetary policy action."

In the directive of April 1, 1969, the manager was told to maintain firm conditions while "taking account of the effects of other possible monetary policy action." During the next week, all twelve Federal Reserve Banks raised their discount rates from 5½ to 6 percent. In light of this, it is reasonable to interpret the directive as a conditional instruction to the manager to attain firmer money and short-term credit market conditions in the event of a rise in discount rates. And again there is no ambiguity in the subsequent changes in target variables. The funds rate rose. Borrowings from the System and the bill rate increased also. And free reserves decreased. Unambiguously, firmer conditions were achieved.

In all of the other directives of the period under consideration, however, the manager seems to have been told (if not always in exactly these words) to maintain prevailing conditions in money and short-term credit markets. Conditions in these markets might, therefore, be expected to have remained essentially unchanged in intervals after all the FOMC meetings except those of December 17, 1968 and April 1, 1969.

For the interval following the January 14 meeting, this expectation seems to have been roughly fulfilled. The bill rate hardly changed; and although the funds rate rose modestly, free reserves also increased and member bank borrowings decreased. The only substantial change in any of the four target variables is the $172 million increase in free reserves. It may be that the manager does not give this variable much weight, for he surely could have prevented it from increasing so sharply. In any event, it seems a reasonable conclusion that FOMC intent, as expressed in the January 14 directive, was realized.

The interval following the meeting of February 4, 1969 presents no problem of interpretation. Nor does it throw much light on the trade-offs used by the manager. Again, the four target variables show rather insignificant changes. It might fairly be judged that conditions in money and short-term credit markets did remain essentially unchanged during this interval. But if not, then a firming occurred. The funds rate and borrowings increased. Free reserves decreased. And a decline of 2 basis points in the bill rate can hardly be regarded as an offset.

The interval following the March 4 meeting does, however, present a problem of interpretation. All three of the money market indicators moved toward firmness by substantial amounts, while the bill rate fell 12 basis points. Should it be concluded that the manager really was giving a lot of weight to the Treasury bill rate, and therefore regarded the subjectively

weighted average change of all four variables as roughly zero? If this weighted average change was not zero, the explanation can hardly be that the increase in bank credit was threatening to exceed expectations. The bank credit proxy averaged less in March than in February.[2]

And what of the interval following the April 29 meeting? Conditions in the money market became sharply firmer; and the Treasury bill rate declined a modest 8 basis points. To conclude that conditions in money and short-term credit markets were unchanged, the bill rate has to be given great weight. Perhaps this is what the manager did. But he cannot have done so consistently. In the interval after the May 27 meeting there was an increase of 41 basis points in the bill rate. Money market variables showed little change, however, and the manager was told at the May 27 meeting to maintain prevailing pressure on money and short-term credit markets. If the bill rate was being given great weight, conditions in the money market should have become considerably easier.

Conditions in money and credit markets should probably be regarded then as having become firmer after the April 29 meeting, even though at this meeting the manager was told to maintain prevailing conditions. The seeming frustration of FOMC intent may be explained by a threatened greater-than-expected increase in bank credit. Total deposits averaged less in May than in April; and total deposits plus Eurodollar borrowings averaged the same in the two months. The FOMC seems to have been expecting a slight decrease in the latter total. But quite possibly it would have increased had there been no firming of conditions in money and short-term credit markets.

There has, however, been no public acknowledgment by the System that the manager invoked the proviso clause after the April 29 meeting. This may mean nothing. But it is possible to point to other times when the margin between expected and actual changes in bank credit was as great as (or greater than) those in the interval after the April 29 meeting and when conditions did not change as they should have.

2. The so-called proviso clause appears in one or another of its several forms in all of the directives of the period December 1968 through December 1969. Thus, in the directives of March 4 and April 29 the manager was told to modify open market operations, or change the target values for the money market variables and the bill rate, "if bank credit appears to be deviating *significantly* from current projections" (emphasis added). When the manager does change the target values, as on occasion he apparently has, he is said to invoke the proviso clause.

If the proviso clause was not invoked after the meeting of April 29, then twice during the first half of 1969—after the March 4 meeting and after the April 29 meeting—an unintended or inadvertent firming of conditions took place in money and short-term credit markets. It may simply be that the manager, unable directly to control any of the target variables, cannot hit his targets exactly or even approximately. And he may not try to compensate immediately for wide misses, or discrepancies between actual and target values; he may simply try to get back onto a reasonable track. It is also possible, however, that what the FOMC says in its directive does not always adequately characterize its intent.

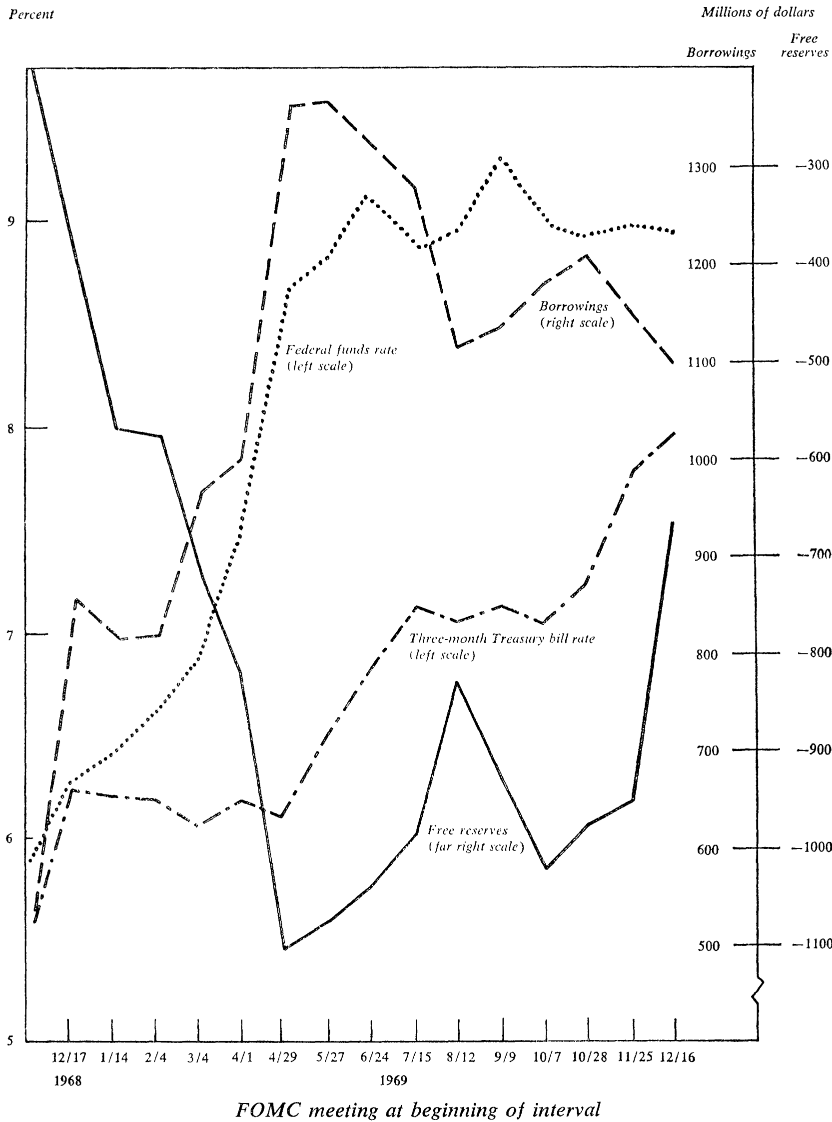
One might expect that, if conditions did become inadvertently firmer after, say, the April 29 meeting, the FOMC might have been inclined to go back to the status quo ante. The manager was not told to do so in the directive of May 27. But there is a ready explanation for this. The FOMC believed that any easing of conditions in money and short-term credit markets, however slight, would revive or reinforce inflationary expectations. And it was determined to demonstrate that it would persist in providing sufficient monetary restraint to curb inflation.

The second half of 1969 presents few, if any, problems of interpretation. In all but one of the FOMC meeting intervals of that period, conditions in money and short-term credit markets can reasonably be said to have remained unchanged. In the interval following the September 9 meeting, conditions did become unambiguously—if only slightly—firmer.

It is interesting (and perhaps not without implications for the behavior of the money stock) that in each of the intervals after the last three FOMC meetings in 1969 the bill rate increased smartly, while conditions in the money market became, if anything, less firm. This development is, however, more easily noted than explained.

The averages of the three money market variables and the bill rates in the FOMC meeting intervals are plotted in sequence in Figure 1. As will be clear, the entire period from mid-December 1968 on divides neatly into two subperiods: the first, which includes six FOMC meeting intervals, from mid-December 1968 to the end of May 1969, and the second, which includes nine meeting intervals, from the beginning of June to the end of 1969. Through the first subperiod, conditions in the money market became firmer: Free reserves decreased, the funds rate increased, and so did borrowings. Since the bill rate was pretty much unchanged, conditions in money and short-term credit markets also became firmer. In the second

Figure 1. Average of Rates on Federal Funds and on Three-month Treasury Bills, and of Free Reserves and Borrowings from the Federal Reserve System, in the Intervals between Meetings of the Federal Open Market Committee, December 1968–December 1969



Source: See Table 1.

subperiod, the bill rate increased. On balance, however, conditions in the money market seem to have eased slightly, so it is far from obvious that conditions in money and short-term credit markets became firmer. Indeed, on this evidence, FOMC policy may be interpreted as more restrictive in the first of the subperiods than in the second.

An Interesting Contrast

One gets a strikingly different impression of FOMC policy in 1969 by looking at the behavior of bank credit and money. The adjusted bank credit proxy and total time deposits, as well as the money stock, increased less during the second half of 1969 than during the first half, with total time deposits actually decreasing (see Table 2). Bank credit expanded only modestly from the fourth quarter of 1968 to the second quarter of 1969. But it did expand. And over the second half of the year it actually decreased. Total time deposits decreased in the second quarter, but the third and fourth quarter decreases were much more pronounced. The money stock held virtually steady in the second half of 1969; and between the fourth quarter of 1968 and the second quarter of 1969 it rose at a 5 percent annual rate. Using the percent change in bank credit or the money stock, one must then conclude that FOMC policy was more restric-

Table 2. Adjusted Bank Credit Proxy, Time Deposits, and Money Stock, Quarterly Averages and Percent Changes, Fourth Quarter 1968 through Fourth Quarter 1969

Dollar amounts in billions

Year and quarter		*Adjusted bank credit proxy*[a]		*Total time deposits*		*Money stock*	
		Amount	*Percent change*	*Amount*	*Percent change*	*Amount*	*Percent change*
1968	4	$302.3	—	$202.1	—	$193.4	—
1969	1	305.6	1.1%	202.6	0.2%	196.3	1.5%
	2	307.5	0.6	201.6	−0.5	198.5	1.1
	3	304.9	−0.8	195.4	−3.1	199.1	0.3
	4	304.8	0	193.7	−0.9	199.3	0.1

Source: *Federal Reserve Bulletin*, various issues.

a. Includes total time deposits, Eurodollar borrowings, and other nondeposit liabilities.

tive in the second half of 1969 than in the first half. But based on the percent change in conditions in money and short-term credit markets, the conclusion would have to be just the opposite.

Not that it matters how, when looking back, FOMC policy is defined or measured. But it is perhaps significant that the important monetary aggregates and conditions in money and short-term credit markets can change at markedly different rates. The implication would seem to be that the economy may take one course if the FOMC uses the bill rate and money market variables in specifying policy, as it did in 1969, and another if it uses one or more of the monetary aggregates.

Would the money stock have increased as it actually did quarter by quarter in 1969 if the FOMC had employed this variable in specifying policy? Would bank credit have done so? One can reasonably wonder, especially since in the directive adopted at the meeting on January 13, 1970 the manager was told to maintain firm money market conditions but at the same time to take account of "the Committee's desire to see a modest growth in money and bank credit." Why was this desire mentioned? Were a majority of FOMC members unhappy with what happened to money and bank credit in 1969? If the FOMC had been using the money stock or even bank credit, in specifying policy, it would perhaps have set target values different from the actual values for 1969.

Discussion

SEVERAL PARTICIPANTS POINTED TO FACTORS that might help to reconcile the intentions of the Federal Open Market Committee and the behavior of the indicators of conditions in the money and short-term credit markets during 1969. William Brainard suggested that the policy directive was only a small component of the information transmitted by the Federal Open Market Committee to the manager; the rest of this information might throw light on his behavior. For example, the manager was in constant communication with the Board, even to regularly scheduled daily telephone calls. He had the opportunity to check back if he ran into difficulties in his attempt to hit a number of targets all at once.

William Poole suggested that the results, in some instances, may depend upon the choice of averages of the rates and reserves for the intervals between meetings. He wondered whether "prevailing conditions" might

sometimes be better approximated by the state just prior to the meeting rather than the average of the three or four prior weeks. Daniel Brill agreed with the need for this qualification.

Poole also suggested that the Federal Reserve may have paid considerably more attention to the provisos in the directives about the growth of bank credit than was allowed for in Kareken's analysis. He suggested that this fact might have accounted for the apparently more restrictive action on the credit and money market indicators during the spring than the policy instruction seemed to call for, since bank credit and money did spurt during the month of April. Poole also noted another way in which the monetary aggregates might have influenced policy decisions in 1969; the revision of the money supply series during the summer revealed that money had grown considerably more during the first half of the year than had been initially recognized.

William Fellner and others referred to several statements made by Federal Reserve officials last summer and fall that seemed to point to a resumed growth of money and bank credit that did not subsequently occur. Holding the line on the money and credit market variables was accompanied by virtually no growth in the stock of these key liquid assets, and that was apparently not anticipated at the time. Yet it was agreed that the Federal Reserve had the opportunity to expand the aggregates if it had chosen to do so. Samuelson commented: "One cannot believe that the Fed can continue to be surprised in one three-week interval after another. Yet it might work out in the following way. In advance they might feel that it would be disastrous to have no growth in the money supply from May to November. But then, when there actually is no growth for a month or two and they see that no disaster occurs and indeed that inflation remains stubborn, they are willing to maintain that situation in order to achieve the contribution to the fight against inflation that they really want to have."

Fellner noted that the issues being discussed fitted neatly into the analytical framework of a "decision tree." Developments occur that may be unforeseen in the sense that they are contrary to the best estimates of economists, but are foreseeable as contingencies—as possibilities rather than probabilities. In that sense, the decision maker can formulate a strategy to deal with the surprises. Samuelson noted that one way decision makers sometimes handle this problem is to decide to pick their route when they reach the fork in the road—which, in the case of monetary policy, might be a reasonably efficient strategy.