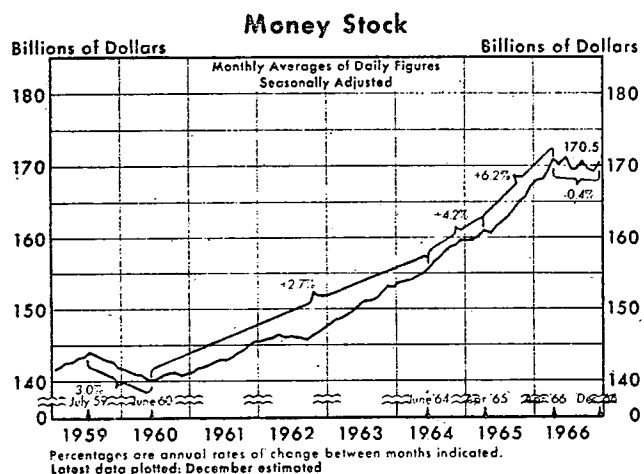


volving a net decline in the money supply, compared with an average earlier performance of 3 or 4 per cent a year growth. Evidently this sharp departure in monetary policy can be interpreted as the factor causing the choking off of expansion since last summer. Indeed, it is difficult to find anything other than monetary policy to which to attribute this.



We observe that as measured by the behavior of the money supply monetary policy has remained severely restrictive down to the present. The latest data show the money supply still varying erratically at a level slightly below that of last June. Monetary policy, then, has not eased. The prevailing policy remains very restrictive. The monetary policy that transformed the economy from extreme buoyancy to its present ambiguous position remains in operation. It seems reasonable to believe that the monetary policy that brought the economy to the brink of recession will suffice to push it over the brink. If the Federal Reserve does not change course very soon, it seems reasonable to expect a recession by summer.

The declines in interest rates since late last year, then, obviously do not reflect the injection of new money into the economy at an accelerated rate, since this has not happened. Rather, they seem to reflect mainly the indirect effects of monetary policy on interest rates, which soon if not immediately generally overpower its direct effects. The lack of monetary growth after last spring caused a reduction in the rate of growth of total demand, which involved a reduction in demands for credit and thus led to reductions in interest rates. The decline in interest rates reflects not the direct effects of an expansive monetary policy but rather the indirect effects of a contractive monetary policy.

Measured in terms of the behavior of the money supply, monetary policy has been scarcely less erratic than fiscal policy, but on some crucial occasions it moved in the right direction. Thus, it contributed to both the acceleration of growth in total demand in 1963 and the deceleration in 1965, both of which were constructive and both of which were opposed by fiscal policy. This striking fact illustrates a more general conclusion, that in this interpretation monetary policy stands forth as a surprisingly powerful influence upon total demand. There does not seem to have been any substantial change in the rate of growth of the money supply that was not followed by a responsive change in total demand. If such is the case, the approach of using monetary policy in an effort to bring about a politically attractive interest rate with its effect upon total demand offset by fiscal policy may bring a result quite different from the one expected by its proponents.

A distinctive feature of the Council Report is its emphasis upon interest rates as an objective of policy, its prescription that interest rates should be reduced in this country and abroad. In the interpretation just reviewed, the Council's position on interest rates is basically erroneous. It interprets interest rates as determined by monetary policy, and therefore as a measure of monetary policy. The dependence of interest rates upon demands for credit, which in turn are