

tendency for weeks when the rate of monetary growth deviated from that average to be followed by weeks when its growth rate deviated from the average in the opposite direction. The fact is that there were 27 periods in 1967 when the actual percent change in seasonally adjusted money deviated in the same direction from the annual average for two weeks or more; ten periods, for three weeks or more; and three periods, for four weeks. It is not reasonable that these changes could have occurred without the F.R. finding out soon enough to try to react: Preliminary but quite accurate weekly data are published with a lag of only one week.

Observed deviations from average monetary growth over longer periods than weeks are even more persuasive that the F.R. does not control monetary growth. The average annual rate of increase in money was 2.6 percent from 1957 through 1967. Relative to that historical trend, monetary growth accelerated to a 3.6 percent annual rate from August 1962 through August 1965. This probably made sense, though it could have come earlier. But then as the economy approached capacity utilization, the monetary growth rate, rather than decelerating, accelerated further to 7.6 percent from August 1965 through April 1966. From April through the rest of 1966—during the “credit crunch”—there was no growth at all. As mentioned, monetary growth accelerated to 7.2 percent in 1967. A similar on-again, off-again monetary growth is shown in money broadly defined to include commercial bank time deposits.

The directives of the Federal Open Market Committee to the Manager of the Open Market Account in New York offer the best testimony of what it is that the F.R. tries to do. The directives are usually phrased in terms such as reserve “positions” or “availability” and money market “conditions” or “pressures”. This is measured by net borrowed reserves (negative free reserves)—the arithmetic difference between member bank borrowings from the Federal Reserve and excess reserves.

“Long experience has shown that any departure from a relatively steady ratio between bank credit expansion and the reserves supplied at Federal Reserve initiative sets forces into operation that tend to encourage bank credit expansion when free reserves exist and to restrain bank credit expansion when net borrowed reserves exist.”¹ Net borrowed reserves and market interest rates are correlated; and it is to one or both of these that the Committee usually refers. In the terminology of the Committee, easing conditions are measured by declines in interest rates or net borrowed reserves, while tightening or firming conditions are measured by the comparable increases. Where conditions differ in New York from elsewhere the Manager may indicate that the “feel of the market” is tight, aggregate measures to the contrary.

Statements about money market pressures in the directive have sometimes been made conditional in recent years. The Committee has directed that desired conditions be attained subject to particular developments that might occur between meetings. Shocks related to Treasury financing, bank credit, money, and liquidity developments have been referred to in this way, though it has been unclear what precisely would have to happen to change desired market conditions and by how much. According to the record for the December 12, 1967 Meeting, the Committee directed the Manager to conduct operations for the purpose of “. . . moving slightly beyond the firmer conditions that have developed in money markets partly as a result of the increase in Federal Reserve discount rates, however, that operations shall be modified as needed to moderate any apparent significant deviations of bank credit from current expectations or any unusual liquidity pressures.”²

During the intervening period until the January 9, 1968 meeting, bank credit, estimated by total bank deposits, increased at a 3 percent annual rate but money narrowly defined increased at an 11 percent annual rate. It is presumably not a coincidence that free reserves did decrease as directed and were widely interpreted as an indicator of tightening policy despite the fact that monetary growth had proceeded at such a rapid rate. A similar directive was issued by the Committee at its next meeting. During the following four weeks; free reserves fell further; the rate of bank credit growth was about the same; and monetary growth proceeded at about a 1.5 percent annual rate.

It is clear that the F.R. has not tried to control monetary growth, at least not directly. The proximate targets at which the F.R. has aimed have typically

¹ “The Federal Reserve and the Treasury Answers to Questions From the Commission on Money and Credit,” Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1963, p. 9.

² “Federal Reserve Bulletin,” March 1968, p. 306.