

a less active role in moderating short term shocks to the financial system than is true in the U.S. In Australia, where I was visiting economist to the Reserve Bank of Australia last year, there are relatively wide spreads between the buying and selling prices of the monetary authority. It takes a larger change in money market conditions to induce an open market operation. The market is free to determine interest rates on short term instruments over a much wider range of values than is true in the U.S. And there is substantially more variability in rates of interest in the short term money market in Australia than in the U.S., though it is importantly limited by speculation and international capital flows where rate changes are expected to be temporary.<sup>8</sup>

There was a strong seasonal in interest rates in the U.S. before the establishment of the F.R. This has since been moderated by F.R. actions. There was no apparent seasonal in interest rate variation from month to month during that period of the 1930's when the F.R. did not make any open market transactions for a few years; but there were substantial month-to-month changes in interest rates, presumably reflecting non-policy factors. Finally there is the testimony of the F.R. officials who repeatedly have reported that there are large changes in uncontrolled factors in the short run that would cause sharp changes in market interest rates and money market conditions in absence of cushioning operations.

I am willing to conclude that there would be increased short term variability in market interest rates if the F.R. tried to moderate variation in monetary growth rates.

#### IV. WOULD LIMITING VARIATION IN THE RATE OF MONETARY GROWTH INCREASE INTEREST RATE VARIABILITY OVER THE BUSINESS CYCLE AND SECULARLY?

Limiting variation in monetary growth would likely decrease interest rate variability. This is stated with full knowledge that it is an affront to conventional wisdom.

Monetary growth in the postwar period has been lowest around cyclical peaks. It has accelerated subsequently and then, during expansions, has sometimes accelerated further and sometimes decelerated. It is reasonable to infer that interest rates would have been lower and would have fallen faster around cyclical peaks if monetary growth had proceeded at its long period average. Similarly a steadier rate of monetary growth would have held interest rates higher than the actual lows at cyclical troughs since these periods often coincided with high points in rates of monetary growth.

There are separate short term and long term forces that affect the relationship between monetary policy and interest rates. The argument that is most familiar involves the short run where increases in monetary growth could be expected to decrease interest rates and decreases in monetary growth could be expected to increase interest rates. The point is that policies that expand the money supply provide banks and others with the wherewithal to increase the demand for investments, the effect of which is to bid up their prices, or equivalently to reduce interest rates. This argument depends on the presence of relatively sticky prices and wages, and by implication, less than capacity utilization of resources. When these conditions hold, it is possible for declining interest rates to stimulate demand without causing offsetting price and wage increases. A similar argument can be made for a decrease in monetary growth.

Though one cannot be sure, it is reasonable that cyclical interest rate variability of this variety would be reduced by policies that limit variation in rates of monetary growth. The present cyclical interest rate pattern mainly follows the business cycle with peaks and troughs roughly coinciding with peaks and troughs in economic activity. To the extent that steady monetary growth would represent an acceleration (deceleration) relative to observed growth around cyclical peaks (troughs), moderating variation in monetary growth would tend to damp interest rate variability at the extremes. And it could also be expected to force interest rates to decline earlier and to precede cycle peaks in economic activity. The argument is that around cyclical peaks when monetary growth has been slowest, a relative increase in monetary growth would tend to decrease interest rates. The implication is that the timing of interest rates changes, the effects of which are inevitably lagged, would be reset to start their stimulative effects earlier than under the present policies. These policies have deliberately taken actions to make high interest rates or tight money market conditions

<sup>8</sup> William G. Dewald. "The Short Term Money Market in Australia." the English, Scottish and Australian Bank Limited Research Lecture, 1967, Brisbane: University of Queensland Press, 1967.