

Federal Reserve policies are the only factor influencing the money stock. It is equally mistaken to assume that policy actions do not extend beyond the money stock to affect growth rates of other financial assets, expectations of market participants, and the terms on which borrowers in a variety of different credit markets find funds available to finance spending plans. Failure to appreciate the potentially disturbing effects of policy actions on aspects of the monetary and credit environment other than the money stock could easily lead to serious mistakes in monetary management.

We must, and do, guide Federal Reserve policies with a careful assessment of the effects those policies have on the money stock. But in interpreting movements in the money stock over time it is essential to recall that they movements are the result of the interaction of many forces: The behavior of the nonbank public, acting in response to its desire to hold money and other financial assets; the behavior of Federal Reserve in supplying bank reserves, and in setting discount rates, reserve requirements, and ceiling rates that banks may pay on time deposits; the behavior of the commercial banks in using the reserves supplied to them by the Federal Reserve; the behavior of all financial institutions in bidding for the savings of the public. It is erroneous to interpret changes in the money stock as though they represented exclusively the result of the operation of a guidance system for the economy administered by the central bank. Variations in money holdings over any period represent the supply behavior of the central bank acting together with the demand factors existing in the private sector of the economy.

A meaningful interpretation of changes in the growth rate of the money stock must try to take into account, therefore, the factors underlying the public's demand for money and its ability to substitute between money balances and other financial assets. It is particularly important to assess properly what is happening to growth rates of other financial assets that are likely to be close substitutes for money in the public's financial asset portfolio. Our monetary history, as I read it, does not indicate that there is any unique financial asset, or combination of financial assets, which satisfies the public's liquidity preference.

Indeed, over the past decade—and especially in the past 5 or 6 years—there have been significant changes in the public's preference for various types of liquid assets. For example, in the late 1950's we observed that the growth rate of time deposits of commercial banks was beginning to respond to changes in monetary conditions. Monetary policies that limited the overall supply of bank reserves and bank credit tended to raise rates of interest on market securities. Because rates paid on time deposits by commercial banks were generally less flexible, these deposits became less attractive to the public, relative to market securities, and their growth rate slowed. Expansive monetary policies, contrariwise, tended to accelerate time deposit growth.

Manifestly, a given dollar increment to bank credit associated with a rise in time deposits need not be any the less expansive, in terms of its effects on spending, than if the increase in bank credit were supported by a rise in demand deposits—and hence by a growth in the stock of money. Indeed, it might be more expensive, since banks might channel funds received through time deposit growth into types