

mainly on the basis of the growth rate of the Nation's money stock, is that monetary policy became excessively stimulative shortly after the middle of 1965, and remained so until the late spring or early summer of 1966. The high rate of growth of money balances during this period, it is contended, was a principal source of the inflationary pressures we suffered in 1966. Also, it is alleged that monetary policy became excessively restrictive in the late spring or early summer of 1966, and remained so until late in the year—as the monetary authorities characteristically overreacted, it is said, to their earlier mistake of excessive ease. This criticism goes on to argue that monetary policy once again swung too far in 1967, producing an unusually high rate of expansion in the money stock that set the stage for a revival of inflationary forces late in 1967 and on into the current year.

There is an alternative interpretation of monetary policy during this period, derived from a more careful and comprehensive view of developments in the real economy and in financial markets from late 1965 to date, that accords more closely with the unfolding facts of the situation. As this committee knows well, the problems of excess demand, economic instability and inflation that have plagued us for nearly 3 years first made their appearance in the summer and early fall months of 1965. Our defense effort in Vietnam had just begun to be enlarged, and defense orders were pouring out in volume. At the same time, growth in the stock of money accelerated from a rate of about 3 percent in the first half of 1965 to about 6 percent in the final 6 months of that year.

Whatever one's views on the relative importance of the defense buildup, as opposed to the rise in the monetary growth rate, as factors in the ensuing increase in the growth rate of aggregate demand, hindsight points clearly to the view that prompter and more vigorous efforts should have been taken to counter the inflationary head of steam that was developing in the latter half of 1965. By imposing measures of fiscal restraint then, and adapting monetary policies to the altered environment, we might have preserved the balanced, orderly growth that we had been enjoying over the previous 4 years. We did not, largely because the magnitude of the defense effort that was getting underway then, and the reverberations it was having in virtually every corner of the economy, were not fully recognized until late in 1965. Given the knowledge that we have presently—which was not then available—the course of monetary and fiscal policies in the latter half of 1965 looks inappropriate.

Once a program of monetary restriction was initiated in December of 1965, however, we moved to a posture of restraint much more quickly and decisively than the figures on the money stock alone would indicate. The accompanying chart shows the percentage changes, at annual rates, of the money stock, money plus time deposits at commercial banks, and savings accounts at a major nonbank thrift institutions. (These percentage changes are calculated from 3-month averages to smooth out some of the erratic monthly movements in these series.) The chart indicates some rather critical differences in the timing of these three series in the period from mid-1965 to mid-1966. Thus, though the money stock continued to rise briskly over the early months of 1966, the growth of money and time deposits together began to decline in the late fall months of 1965. And the growth rate of nonbank