

credit, and the holders of demand deposits passively absorb whatever deposits are generated.

In actual fact, demand deposits are only one among a variety of financial claims, and holders of deposits, determine through a rational allocation of their resources the size of their demand deposits and, therefore, the size of the money supply. If fiscal and monetary policies are successful in maintaining an orderly rate of economic growth, the money supply will grow in some easily predictable relationship to the growth in the economy. But the process runs from economic growth to a need for more money rather than from monetary growth to economic advance.

A money supply guideline employing a broader definition of money to include commercial bank time deposits is even less meaningful. In the eyes of the saver, except as risk considerations may enter in, and in economic significance there is no difference between savings at commercial banks or savings and loan associations, mutual savings banks, credit unions, et cetera.

In the eyes of the investor and in economic significance there is no difference between investing in bank certificates of deposit or Treasury bills, finance paper, Government agency obligations, et cetera.

To select commercial bank liabilities as the critical variable in developing a policy target is not only irrelevant, it runs the risk of having policy respond to what is nothing more than normal period-to-period adjustments in the relative competitiveness of various saving or investing media.

Probably the most useful guideline for Federal Reserve policy would be in terms of net credit raised by the private nonfinancial sector of the economy.

As indicated earlier, the existence of unusually large Government credit demands will ordinarily require some limitation upon private credit, stopping short of restraint that would damage the economy. Unusually large Government surpluses leading to debt retirement would ordinarily call for some effort to encourage private credit usage.

With this marginal adjustment to the demands of the public sector, however, it should ordinarily be feasible to construct estimates of the amounts and types of credit that would be required to support the desired rate of economic growth. Targets so derived would be strategic since it is through alterations in credit flows that the Fed has its immediate effect upon the economy, and they would be operational since the Fed is able to have direct influence upon credit flows.

None of this is intended to suggest that there is anything like an invariable relationship between rate of economic growth and net private demands for credit. There is a close relationship between residential construction and demand for mortgage credit and between sales of durable consumer goods and the demand for installment credit.

In the case of business credit demand, however, variations in internal cash flow, shifting tax dates, and so forth, influence the amount of external credit required to support any given rate of growth-in-business activity. These influences are broadly predictable within a flow of funds model, however, and may be allowed for in setting targets.

Credit is used only because it is needed to cover expenditures. The availability of credit and the rate of credit growth, therefore, are immediately relevant for the total of final purchases in the economy.