

creases in the money stock cause interest rates on financial assets and credit instruments to fall. But this effect is ephemeral. It is short-lived precisely because lower interest rates impel increases in investment and consumption spending. For as employment and economic activity expand, product prices and the dollar returns to capital, that is present and expected profits, also rise. Product prices rise directly because of the increases in spending. Profits rise because capital resources are used more intensively and the goods produced with these resources sell at higher prices. (If this troubles you think of what happens to land rents in the wake of population increases.) In turn, because of the rise in prices and profits it now pays to sell financial assets and buy consumer and capital goods. In the final analysis, as a consequence there is a tendency for interest rates on financial assets and credit instruments to rise with monetary growth and economic expansion. As Milton Friedman has put it, "monetary growth will also make for higher interest rates, as changed price expectations overcome the liquidity effects of rapid monetary growth."

This is an extremely important point. It can't be overemphasized. It means we cannot judge the thrust of monetary policy by looking at interest rate trends. On the one hand, increases in interest rates may mean that money is "tight"; for the initial impact of a policy of monetary restraint on interest rates is to raise them. On the other, increases in interest rates may mean that we are in the midst of a boom with product prices and yields on real capital rising because of feedback from monetary expansion and the public, accordingly, selling financial assets and credit instruments (and hereby bidding up their yields) so they can obtain funds to buy the higher-price consumer goods and higher-yield capital goods. Thus interest rate trends are an unreliable indicator of the thrust of monetary policy.

We can however, without any hesitation or doubt whatever, judge the thrust of monetary policy by what is happening to the money stock. If it is rising rapidly policy is expansionary, no ifs, ands or buts. More on this in a moment.

Now, let's look at the behavior of our money stock. The facts show that the nation's money stock has expanded very rapidly recently whether defined inclusive or exclusive of time deposits in commercial banks. I prefer to use the narrow conventional definition which equates money with circulating media, that is, the usage that defines money as a social good. Back in February, 1961 the public's holdings of currency and demand deposits (seasonally adjusted) added up to \$141.6 billion. In January, 1963 the total was \$148.0 billion. The money stock had increased at annual rate of 1.6 per cent in these twenty-three months. In January, 1965 the quantity of money was \$160.0 billion. Between 1963 and 1965 it had increased at an annual rate of 4.0 per cent. In January, 1966 the money stock was \$168.4 billion; it had risen by 5.2 per cent in 1965. In January, 1967 the money stock was \$169.6 billion; it had increased only 0.7 per cent from a year earlier and in fact had fallen after June, 1966. In January, 1968 the quantity of money was \$182.4 billion: It had risen by 7.5 per cent in 1967. For the record, in the second half of 1967 the annual rate of increase was only 5.1 per cent and so far this year the money stock has risen at an annual rate of 5.5 per cent reaching \$184.1 billion in mid-April.

Manifestly, money supply policy was strongly expansionary in 1967 and there is at most scant evidence that it is now being moderated. Recalling the theoretical link between money supply and consumption and investment spending it is difficult not to conclude, and totally reasonable to conclude, that a major underlying cause or root of the current inflation is monetary policy as specified by growth of money stock.

We have come full circle, back to our original and central question. What should the Fed now do to slow, if not halt, the current burgeoning inflation? Hopefully, the answer is now self-evident. To be succinct, the answer is: Moderate the growth of the conventionally defined money stock. To elaborate upon this dictum: This, then is the essence of a judicious monetary policy, if not for all seasons at least for this one. First, the Fed must stop trying to dampen spending via intervention of higher interest rates, which is its traditional operating procedure in inflation. It must stop using this tactic because we cannot readily distinguish between interest rate increases that result from its policy actions and those that feedback from increases in economic activity and in present and expected prices and profits. In periods of economic expansion, interest rates, as we have seen, tend to be pulled up by rising prices and profits, and hence in such periods the Fed can be fooled into thinking it is tightening money when in fact it is doing nothing, if its target is higher interests. The