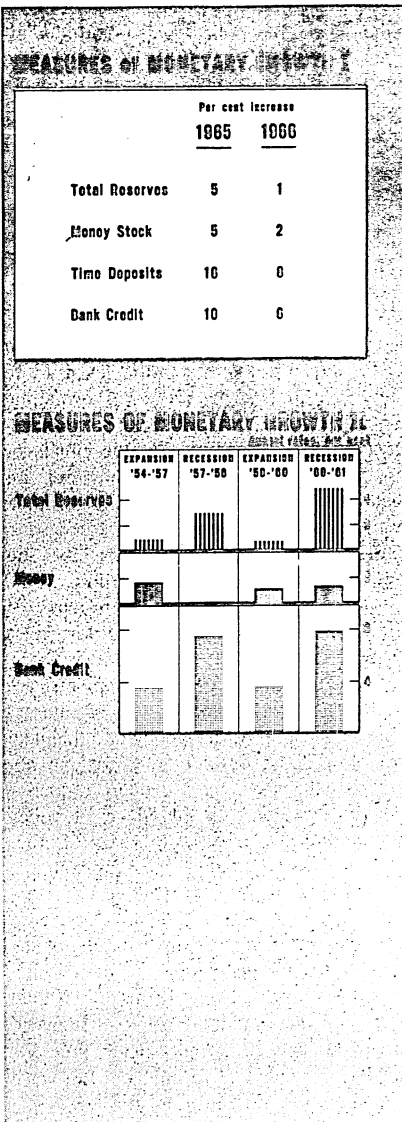




common thread that links the financial markets, their behavior is vital in any assessment of monetary policy.

Because of the difficulties in interpreting interest rate movements, some economists advocate judging the posture of monetary policy by one or more measures of monetary growth. There are times when a variety of quantity measures display parallel movements, as those shown here did between 1965 and 1966. Then, the direction of policy, at least, is clear, although the degree of restraint or ease may not be.

The more serious problems arise when there is a need for finer judgments on the course and intensity of policy. Here, for example, we show the annual rates of change in total bank reserves over recent periods of expansion and recession (as defined by the National Bureau of Economic Research). It appears from the total reserve measure that Federal Reserve policy was contracyclical: reserves rose more rapidly during recessions than during expansions.

But growth of the money stock during these periods suggests a different conclusion: the money stock has sometimes risen more rapidly during expansions than in intervening periods of recession. It is perhaps tempting to interpret this as evidence of misguided policy action. But the money stock is determined by the public's demand for money interacting with monetary policy; this demand is influenced by income, interest rates, expectations, and other factors. Thus, changes in the money stock must be interpreted in light of changes in other financial and nonfinancial variables that accompany them.

In contrast to the changes in money, growth in bank credit over these economic cycles was contracyclical: largest during recessions and smallest in periods of expan-