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The effects of Federal Reserve action are felt over a long time interval

The processes by which Federal Reserve policy affects the economy are complex and indirect. Nevertheless, there was virtual unanimity in the recent hearings that a steadily growing economy with stable prices was likely to be best assisted by a comparable steady growth of money supply. It would also be natural to expect that the monetary authority would wish to adhere to such policy in the absence of disturbance.

To say that steady growth in the money supply is a necessary condition for the maintenance of general economic stability and growth is, however, not to say that a policy of creating steady growth in the money supply will be sufficient to induce steady growth in the economy.

This critical issue was examined by the Joint Economic Committee in terms not only of rules of conduct for monetary policy, but also in terms of the pattern of changes that could be expected to follow actions by the Federal Reserve System.

Subject to the demands of the Federal Government for support and to the short-term variations in discounting for member banks, the Federal Reserve can make a firm decision on the creation of its own credit. It has therefore good control over the maximum availability of credit for the private sector. The willingness of the commercial banks to lend or of businesses and persons to borrow merely sets the terms on which financial deals are transacted.

The pattern of interest rates, then, is to be regarded as an outcome of a large number of forces of supply and demand to which the open market operations of the Federal Reserve System contribute a very powerful influence.

The strength of these forces and the market responses they set in motion can be estimated in a general and not very accurate way, but cannot be surely forecast. The capacity of the monetary authority to achieve a chosen pattern of interest rates is therefore substantially less than its control over the supply of money or of bank credit. For this reason the committee endorses the recommendation of one witness who regarded interest rates as generally an unsuitable major objective of monetary policy action.

Nevertheless, there are differential impacts on different sectors of the economy resulting from changes in interest rates. It is clear therefore that the monetary authority, in adhering to some policy rule—for example, of steady growth of money supply—cannot wholly ignore the side effects of such a policy on the pattern of interest rates. The monetary authority cannot be indifferent if its policy threatens to create such stringency that the mortgage and municipal bond markets verge on collapse. Nor can it ignore the deterioration of monetary contracts in any important market.