TECHNICIAN'S PERSPECTIVE

By John W. Schulz

New Broom

FIVE TIMES in the last two decades investors took a shellacking from the effects of tight-money policies carried out, in the interest of combating inflationary trends, by the Federal Reserve Board under the chairmanship of William McChesney Martin. Mr. Martin's era has now come to an end, and today Arthur F. Burns takes over his post at the Fed. Mr. Burns probably is, in principle, no less conservative than his predecessor. But there are reasons to believe that under his leadership the techniques whereby the Federal Reserve executes monetary policy may, before too long, take a radical new departure.

In recent years, more and more economists have come round to the view that the way in which the Fed has gone about implementing policy has had unduly destabilizing consequences for the economy, because it tended to promote rather than avoid excessively inflationary growth of the money supply, which then had to be squeezed out by perhaps unnecessarily painful deflationary strategies. The trouble stems from the fact that the central bank has been carrying out policy decisions mainly by trying to influence money-market conditions through the manipulation of short-term interest rates and control of reserve availability for commercial banks. Studies indicate that techniques designed to manage money-market conditions cannot also effectively control changes in the money supply, in fact that such techniques risk a downright loss of control over the rate of money growth. There is, the monetarists suggest, some hope of managing either interest rates or the money stock, but not both; and since interest rates are an unreliable indicator of monetary policy anyway, the Fed would do better to concentrate on trying to control the money supply and related monetary aggregates directly, while letting interest rates find their own level in an otherwise free money market.

Two governors of the Federal Reserve Board, Messrs. Maisel and Mitchell, are on record as favoring just such a change in money management technique, and the new board chairman reportedly is inclined to agree. One more convert would give the monetarist school of thought a sympathetic majority on the Federal Reserve's seven-man board. Since the chairman's opinion may carry extra weight, this may now be more a probability than a possibility.

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Benefiting Stock Prices

A prospect that the Fed will focus on managing the monetary aggregates and let short-term interest rates "float" has some interesting implications for investors. For one thing, it should mean that the official "line" would de-emphasize the importance of interest rates as indicators of policy. For another, because the next policy shift almo . certainly will be toward less severe restraint, short-term rates could be expected to fall more sharply in a free money market than they would if the hitherto prevailing technique of manipulating money-market conditions remained in effect. This could scarcely help benefiting common stock prices. Longer range, unpegged short-term rates could add a new price risk to media, such as Treasury bills and commercial paper, in which investors traditionally have sought shelter from the threat of a falling stock market; the result could be a greater degree of stability for stock prices as investors thought twice about moving from equities into short-term debt instruments.

No less important, if the monetary aggregates replace interest rates as "official" policy indicators, the fact that some of them rose in last year's fourth quarter from extreme-restraint lows in October could take on new significance. As this column suggested two weeks ago, business statistics appearing this quarter are likely to furnish the money managers with enough no-growth evidence to warrant some relaxation of the monetary stringency. Since major aggregates are already well above their tight-money lows of three or four months ago, no great shift toward ease in new techniques of managing the money supply directly would be needed to make a trend of revived money growth clearly visible to all. Reassurance on this score might do more than anything else to bolster stock-market confidence. ■