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the number of months before the NBER date of the turn by which the Committee was judged to have begun recognizing an approaching turn. In three cases the pattern began more than three months before the turn, but for only two (1953 and 1957) did it begin substantially before that time. In each of these cases, the year previous to the peak year had been a period in which the Committee exhibited considerable concern about the possibility of a turn (see the above discussion of "false alarms"). As a rule of thumb, three months prior to a turn seems to be a reasonable date for the beginning of recognition, and comparisons of the FOMC's recognition pattern with that of the business forecasters is made on this basis.

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The FOMC's Recognition Pattern: A Chronological Review

To give the reader more insight into the forecasting ability of the Committee than is provided by the certainty scores alone, this section describes its recognition pattern for each of the seven postwar turns covered in this study and compares its performance in recognizing and confirming these with the performances of the forecasters in Fels' sample of eight.

When policy actions are referred to, the author adopted the language of the Committee in characterizing them. For example, the "policy of neutrality" is the Committee's terminology, not the author's. Consequently, the references to "easy," "tight," "neutral," etc., money policies do not necessarily represent the author's opinion as to what monetary policy was being pursued, but represent the Committee's intentions as indicated in its minutes. Such references are merely descriptive and, as noted above, the scoring of the FOMC's forecasts is independent of the actions taken.

1. The 1948 Peak

With the expiration of wartime price controls in the second half of 1946, an inflation began that dominated the economy from 1946 to late 1948. Throughout 1947 and 1948 monetary policy was designed to keep pressure on member bank reserves and to restrain the further expansion of bank credit. However, because of the wartime growth of the public debt and because of its responsibility for maintaining an orderly market for government securities at low interest rates, the Federal Reserve was unable to restrain credit expansion to the desired extent and acted as a "permissive parent" of the inflation.

Inflationary pressures paused twice over the three-year period of expansion: once in the second quarter of 1947 when businesses began disinvesting in inventories, and again in early 1948 when commodity prices broke sharply downward. The Committee indicated little concern that the first lull in the pace of inflation might be the beginning or forewarning of recession. It viewed the pause as temporary relief from persistent inflationary pressures.[22] In contrast, Fels found that the lull "was widely misinterpreted as the beginning of recession" by many analysts.[23] During the second pause, the Committee took a "wait and see" attitude as to whether the decline in commodity prices was the signal of a major adjustment or simply a needed correction of a particular situation. The consensus was that, despite the price break, the basic inflationary forces were still at work.[24] Again some business commentators "raised the question of recession prematurely." [25]

The downturn began in the fourth quarter of 1948. The NBER's business cycle peak is November. At its October meeting, the Committee appraised the situation as inflationary and recommended a continuing anti-inflationary program.[26] Their comments show that the Committee members had little premonition that a cyclical peak was imminent. During November the FOMC recognized a hesitation in business ac-

[22] *Minutes,* June 5, 1947, pp. 102ff.
[23] Part I of this volume, p. 26.
[24] *Minutes,* February 26 and 27, 1948, pp. 24–49.
[25] Part I, p. 26.
[26] *Minutes,* October 4, 1948, pp. 165–72. John H. Williams, a staff member, expressed the very perceptive opinion, as summarized in the minutes, that "inflation was in the process of wearing itself out, that the prospect was for moving sidewise or even downward, that a serious downturn was unlikely." (*Ibid.,* p. 166.)

tivity but viewed the weakness as temporary and felt that the basic expansionary forces continued unchanged.[27] Over the next three months, there was a gradual drift toward pessimism about the future direction of the economy. By March 1949, the Committee regarded the economic situation as a "healthy readjustment" which would be helpful in bringing greater stability to the economy. Its feeling was that a moderate adjustment could prevent a precipitous downward spiral in the future. It wished to encourage what was viewed as a helpful development, and changed from a policy of restraint to one of "neutrality." [28] The Committee felt "it should replace the existing policy of exercising restraint on credit expansion with a policy which would relax such restraint without following an aggressive easy money policy." [29]

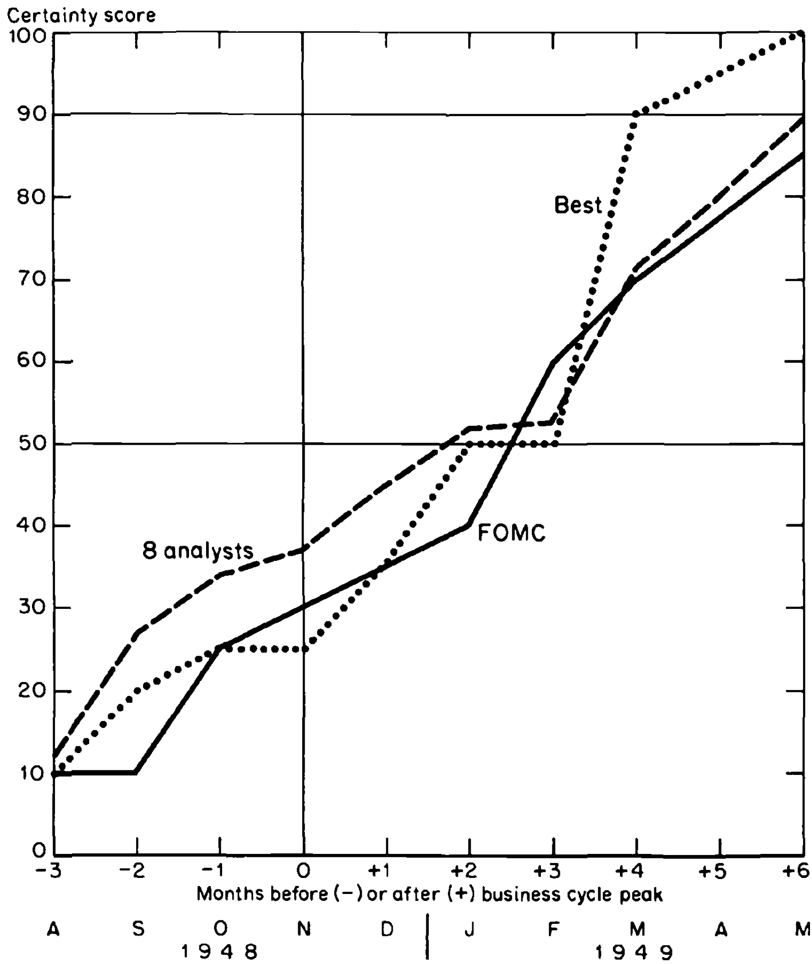
During April and May the FOMC continued to adjust policy in the direction of ease as it became increasingly confident that the "healthy readjustment" was turning into cyclical recession. But it was not until June that the Committee confirmed that the economy was actually in the midst of a recession. They agreed that "declines in business in recent months had gone faster than had been considered likely at the beginning of the year, [and] that further declines appeared probable. . . . Now the time has come for an affirmative credit policy in the light of the developing business situation, which would have significance to the market, the banking system, and ourselves." [30]

Relative to the NBER business cycle peak date of November, 1948, this means that the lag in confirming the occurrence of the downturn was some seven months—the Committee's poorest performance during the period studied. The recognition patterns of the FOMC and other business analysts were quite similar (Chart II-1). For the Committee, the scores for this peak were the lowest for any of the seven turns; for the business analysts, scores for recognition were lower than for any other turn except 1960. The business forecasters did not "recognize" (i.e., did not receive a score greater than 50) until two months after the NBER date of the peak; the Committee received such a score only three months afterwards. Neither group had "confirmed" (i.e., received a score of 90 or better) by the end of six months. For the Committee this was the only turn that was not confirmed within a six-month period.

[27] *Minutes,* November 15, 1948, pp. 180–183.
[28] *Ibid.,* March 1, 1949, pp. 44–50.
[29] *Annual Report of the Board of Governors of the Federal Reserve System, 1949,* p. 111.
[30] *Minutes,* June 28, 1949, pp. 82–83.

CHART II-1

Certainty Scores for the November 1948 Peak



SOURCE: Part I of this study and other original data made available to the author.

Although the recognition performance of the "best" forecasting publication was inferior to that of the average of the eight in the immediate vicinity of the peak, it is interesting to note that it confirmed the occurrence of the turn in March—the month of policy change by the Committee. Was it, perhaps, strongly influenced by the FOMC's decision to ease?

What accounts for the relatively poor performances in recognizing the cyclical changes taking place in 1948? Fels hypothesized that forecasters (1) did not realize the extent to which the structure of the economic system had changed as a result of the depression and the war, (2) became cautious after misinterpreting the lull in 1947 as the beginning of recession and repeated the error in early 1948, (3) wondered if the decline might be followed by another bout of inflation, and (4) thought in terms of deep depression and rapid inflation rather than business cycles with mild contractions.[31]

Most of these factors influenced the Committee. The recession that occurred was not the expected depression. Although the widely held expectation of a severe contraction following the war proved groundless, the FOMC felt that continued inflation would only make the ultimate adjustments more severe. Twice before, the economy had halted its inflationary expansion, and these postponements of the contraction could only make the inevitable downswing deeper. The decline that did occur was so mild relative to expectations that it was considered a "healthy readjustment" which would reduce the inevitable reaction following three years of almost continuous inflation. The Committee was aware that government expenditures were to increase sharply. This, in combination with the tax cut in the spring of 1948 and the newly adopted role of the government in attempting to stabilize economic activity, led to expectations of continued expansion over the near term.

In addition, however, the FOMC was particularly concerned about inflation because of its inability to restrict credit to the desired extent. Its responsibility for pegging interest rates on government securities left the Committee with little room to maneuver against inflationary pressures and made its members acutely aware of their inability to restrain credit expansion. They were increasingly conscious of inflationary developments after experiencing almost three years of frustration in trying to slow down the expansion of credit. The Committee's concern with the problem of halting inflation led it to neglect the developing recession.

2. *The 1949 Trough*

The eleven-month contraction was very mild. In constant (1958) dollars, GNP declined from a peak of $328.7 billion in the fourth quarter

[31] See Part I of this volume.

of 1948 to a low of $323.3 billion in the fourth quarter of 1949. The trough was double-bottomed. A recovery began in July only to be interrupted by the coal and steel strikes in September and early October, but the lull was short and expansion resumed when the strikes ended. The second trough in October is the one selected by the NBER as the business cycle date.

At its August meeting, the Committee agreed that "as long as the condition of declining economic activity continued the System should see to it that conditions of monetary ease and low money rates were maintained as a means of encouraging business activity." [32] In September the Committee "recognized" the cyclical turn and a score of 60 was assigned to the forecasts. It felt that the expansion of business activity during July and August probably indicated that the end of recession was near but decided that nascent recovery was too precarious to warrant a change in the direction of policy. Indicative comments were:

> If the signs of developing business recovery which were apparent during July and August had begun to accelerate and give indication of an end of the present period of adjustment, there might be some reason for re-examining the policies adopted by the System in June, but . . . it had become clear that the recovery was rather precarious and . . . an adjustment still had to take place in the price structure.[33]
>
> In view of the recent and continuing recovery in business activity, the present did not seem . . . to be an appropriate time to make the reduction in discount rates.[34]

The Executive Committee of the FOMC "confirmed" the revival in business conditions at their November meeting and advocated a shift in policy toward restraint. Allan Sproul stated that "it appeared to be the consensus of the System economists that present business conditions would continue at about existing high levels through the first half of 1950, . . . and the high levels of business activity were re-introducing an inflationary bias in the economy. . . ." [35] Marriner Eccles' opinion was that "the System should give some indication through a firming of short-term rates that it had recognized the change in conditions that had taken place in recent months." [36] The Committee agreed that continued

[32] *Minutes,* August 5, 1949, pp. 112–113.
[33] *Ibid.,* September 21, 1949, p. 145.
[34] *Ibid.,* p. 148.
[35] *Ibid.,* November 18, 1949, p. 156.
[36] *Ibid.,* pp. 156–157.

expansion was expected and that a more restrictive credit policy should be followed.

Of all turns, the average certainty score for the 1949 trough is the highest. If the NBER business cycle date is used as the criterion, the Committee "confirmed" the reversal only one month after it occurred and "recognized" the turn one month before it occurred. However, it is clear that the Committee felt that the cyclical turn occurred in July. The coal and steel strike which interrupted the revival in October was not viewed as a sufficient force to break the economy's continued upward movement. If the alternative date of the trough (July) is used, then the confirmation lag is four months and the recognition lag two months. In either case, the FOMC was much more prompt in correctly assessing the situation than were the business analysts (see Chart II-2). Fels found that "among troughs, the scores for 1949 are lowest, though the difference from 1958 is slight. The scores might have been even lower for 1949 had the trough not been double-bottomed." [37] Indeed, it was not until April 1950, that the business analysts reached an average score of 90 per cent (i.e., "confirmed" the occurrence of the trough), some five months after the FOMC. Although the "best" forecasting publication did significantly better than the average of the eight, it did not match the FOMC in confirming the turn. In light of the performance of others for recognizing and confirming the 1949 trough, the Committee's performance was remarkable. The discounting of the deflationary impact of the strikes undoubtedly accounts for most of the superiority of the FOMC over the other forecasters.

3. The 1953 Peak

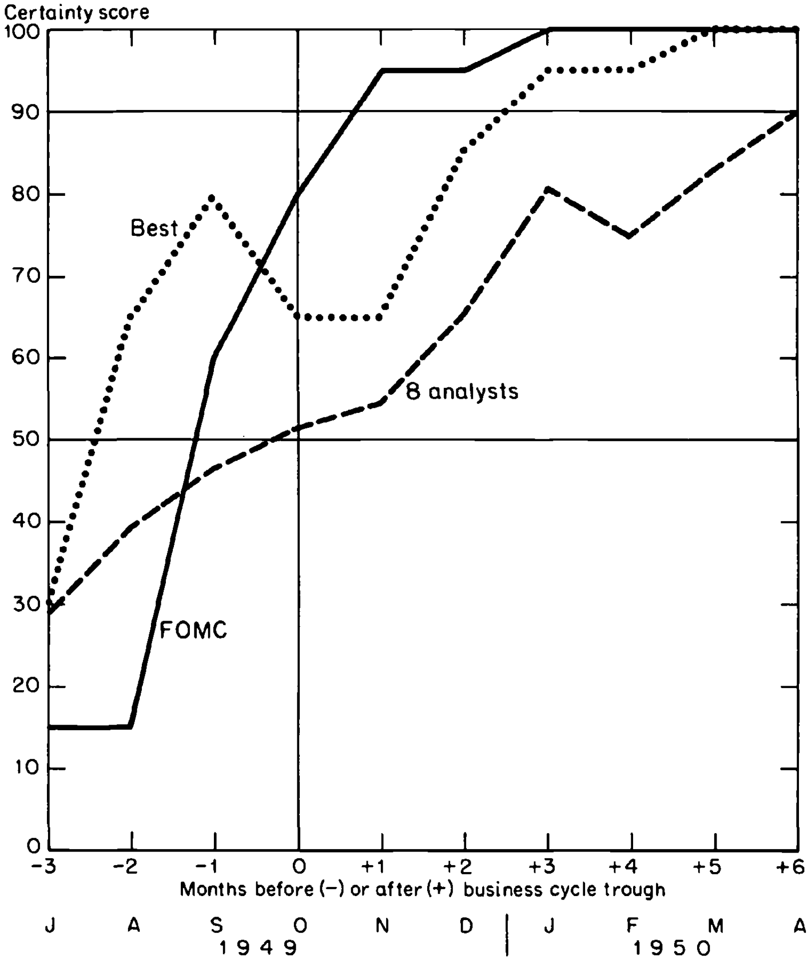
Following the 1949 trough, the economy began an expansion, dominated by developments associated with the Korean war, which carried GNP to a record level of $367.5 billion in the second quarter of 1953. During all of 1950 and through the first half of 1951 the Federal Reserve continued and intensified its policy of credit restraint. However, as 1951 progressed, the inflationary pressures slackened and the outlook became one of approximate balance at a high level of activity. Beginning in June, the Committee changed to a policy of "neutrality."

As the economy continued expanding through 1952 and into 1953,

[37] See Part I, pp. 26–27.

CHART II-2

Certainty Scores for the October 1949 Trough



SOURCE: Part I of this study and other original data made available to the author.

and its need for money and credit grew with increasing activity, the policy of neutrality gradually became a policy of restraint. A gradual shift in the viewpoint of the Committee occurred during the first quarter of 1953: there was a growing concern that the expansion might develop into an unsustainable boom which would eventually result in downward adjustments. The Committee unanimously agreed that open market operations should be conducted so as not to encourage ease.[38]

Pessimism about the future course of business activity increased during April and May; there was a change of emphasis in open market operations, from a policy designed "not to encourage ease" to one intending "to keep the market tight but to keep it from getting any tighter." [39] The comment which typified the Committee's view was that:

> The Open Market Committee's policy of credit neutrality gradually became a policy of credit restraint and, with a further lag, has become a tight money policy . . .
>
> The necessitous borrowing of the Treasury will press further on bank reserves, and put further pressure on the money market if we do nothing to offset it. It would be appropriate to buy government securities to prevent this Treasury borrowing from introducing new pressures upon bank reserves.[40]

The Committee decided that, in light of the existing tightness and the needs of the Treasury, some reserves should be injected into the market in order to keep it from becoming too tight.[41]

At its June meeting, the FOMC agreed that there should be a further increase in reserves in the near future. The Committee injected reserves into the market primarily because of the existing tightness and the anticipated disorderly market in government securities, and only secondarily because of some concern about the near-term condition of business activity.

At the June meeting the Committee's staff review stated that economic conditions were "characterized by a moderately higher level of economic activity and generally stable prices. While the economic situation has continued strong, financial markets have been unsettled at times and throughout the period there has been an undertone of concern about potential declines in economic activity." [42] After an extended discussion of "disorderly markets," the Committee members agreed that reserves should be injected into the market on a sharply rising basis in order to keep the situation from getting tighter.[43] Although their discus-

[38] *Minutes,* March 24, 1953, p. 106.
[39] *Ibid.,* May 26, 1953, p. 191.
[40] *Ibid.,* May 6, 1953, p. 147.
[41] *Ibid.,* pp. 147–158.
[42] *Ibid.,* June 11, 1953, pp. 199–200.
[43] *Ibid.,* pp. 240–244.

sion indicates that they were aware of the changing business conditions, they did not view the situation as the beginning of cyclical contraction. We assigned a certainty score of 45.

During July and August, after the Treasury financing program was out of the way, the FOMC decided that only token purchases should be made for the System's account. This is further evidence that the possibility of a peak was only a marginal factor in the decision to inject reserves during June. The staff review in August typifies the viewpoint of the Committee concerning the future outlook:

> Record levels of aggregate output and employment attained in the second quarter of 1953 have generally been maintained thus far in the current quarter; . . . the situation continued to be characterized by over-all stability in prices and activity and by considerable selectivity in developments in particular lines; and . . . whether this is a period of formation of forces for further uptrend or for some downward readjustment can not yet be clearly read from current business indicators.[44]

The Committee members viewed the near-term outlook as one of continued horizontal movement at high levels and they were trying to keep the balance between inflationary and deflationary developments. In light of their discussion, we assigned a score of 50 to the August meeting.

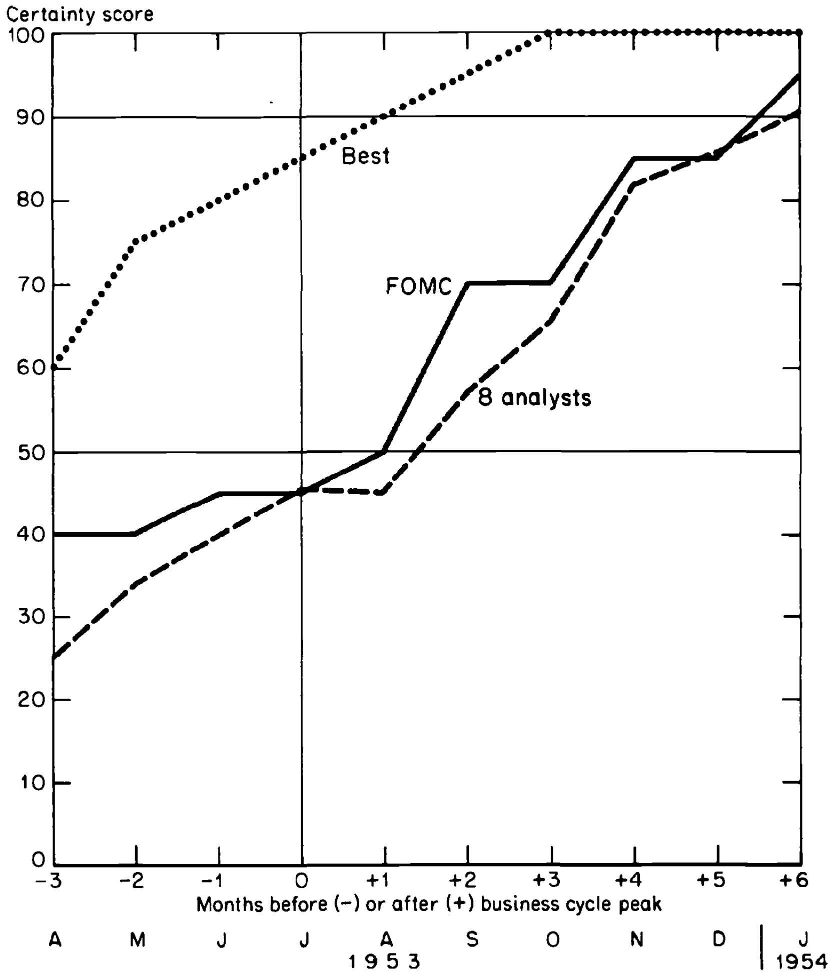
At the September meeting, a policy of active ease was begun. The Committee was not yet convinced that recession was underway but considered the probability of renewed inflation to be small. From a balance between inflationary and deflationary forces, the Committee's outlook changed to a balance between stability and deflationary forces. Although the initiation of such a policy makes it apparent that the Committee recognized the probability of deflationary forces gaining the upper hand (the certainty score was 70), it was not until January 1954 that the July peak was actually confirmed as the beginning of a recession in business activity.

Among the four peaks, the FOMC's performance in recognizing the 1953 turn was the best. The same is true for the business analysts and for the "best" forecaster of the eight.[45] Although the recognition patterns of the average of the forecasters and the Committee were quite similar, the "best" forecaster did significantly better (see Chart II-3). Several months before the peak both groups evidenced concern about the level

[44] *Ibid.*, August 25, 1953, p. 318.
[45] Part I, p. 28, and other original data made available to the author.

CHART II-3

Certainty Scores for the July 1953 Peak



SOURCE: Part I of this study and other original data made available to the author.

of activity during the second half of 1953.[46] In anticipating changing business conditions, the Committee did well. However, as the peak approached and passed, definite realization that recession was, in fact, occurring increased only slowly, as Chart II-3 indicates. Several reasons could account for such a pattern of recognition.

The downswing was relatively easy to anticipate. The end of the Korean war was not difficult to foresee and the reduction in defense expenditures was anticipated. Such expenditures had been a mainstay through most of the expansion. This time there were no accumulated private demands as a result of war shortages and no accumulated liquid assets to fill the gap. Indeed, in several areas (i.e., consumer durables, plant and equipment, and housing) private demands had been stable or declining since early 1951. Consequently no good reason existed to expect continued expansion once defense expenditures were cut.

In addition, the FOMC had already taken action to ease pressure in the money market before the peak occurred. In June, a month before the NBER business cycle peak, the Committee injected substantial amounts of reserves into the market to avoid further tightening. The members realized that their policy of neutrality had gradually become a policy of restraint and then of undue tightness as the economy continued to expand. The fear of failure of the Treasury debt issue and the uncertainty of the business outlook led them to ease credit conditions. Consequently, since action had already been taken, the Committee was under no real pressure to confirm the "slippage" in economic activity as nascent recession and to reverse the direction of policy. In addition, the recession was so mild that euphemisms such as "horizontal movement at a high level," and "slippage" were not unfounded.

Whatever the reasons for the slow confirmation, the Committee must be given credit for a good early warning of the peak. The FOMC took appropriate action, however gratuitous, prior to the turn in business activity and probably modified the severity of the subsequent recession.

[46] Two members of the Committee made excellent forecasts as early as the fall of 1952. In October, C. R. Youngdahl, a staff member, described the outlook as "one in which we are looking toward a period of downward adjustment next spring or after mid-1953, while rather strong business activity is indicated for the period immediately ahead." (*Minutes*, October 22, 1952, p. 194.) And in November, C. S. Young said: "While a good level of business activity was anticipated through the first quarter of 1953 . . . there was considerable sentiment that some decline would occur after that, partly because it was anticipated that defense expenditures would decline." (*Ibid.*, November 5, 1952, p. 202.)

4. The 1954 Trough

The contraction lasted thirteen months—from July 1953 until August 1954. During the first half of 1954, consumer expenditures became an expansionary force. One of the primary factors supporting the rise in consumption was the increase in disposable income as a result of the January 1954 tax cut. The revival of consumer expenditures, the continued expansion of state and local government spending, and the stability of fixed investment soon brought the contraction to a halt and the economy moved sidewise through most of the second and third quarters of 1954. The recovery began in September.

As the recession continued into 1954 with little evidence of either an upswing or a leveling off, the Committee continued its policy of active ease through the first quarter of 1954. In April there was a slight drift toward optimism as the recession seemed to be slowing down, and by May the consensus was that the economy was beginning to level off. Indicative comments were:

> Unless the downward drift was reinforced by fresh contractive factors, activity might be approaching a balanced position at current moderately reduced levels. While the foundations of revival might be taking shape, the sources of revival impetus were not yet clear.[47]
>
> The decline had begun to level off but whether it is a U or V bottom, or just a ledge in a downward drift, we can not yet know.[48]
>
> The current decline in economic activity had about leveled off. . . .[49]

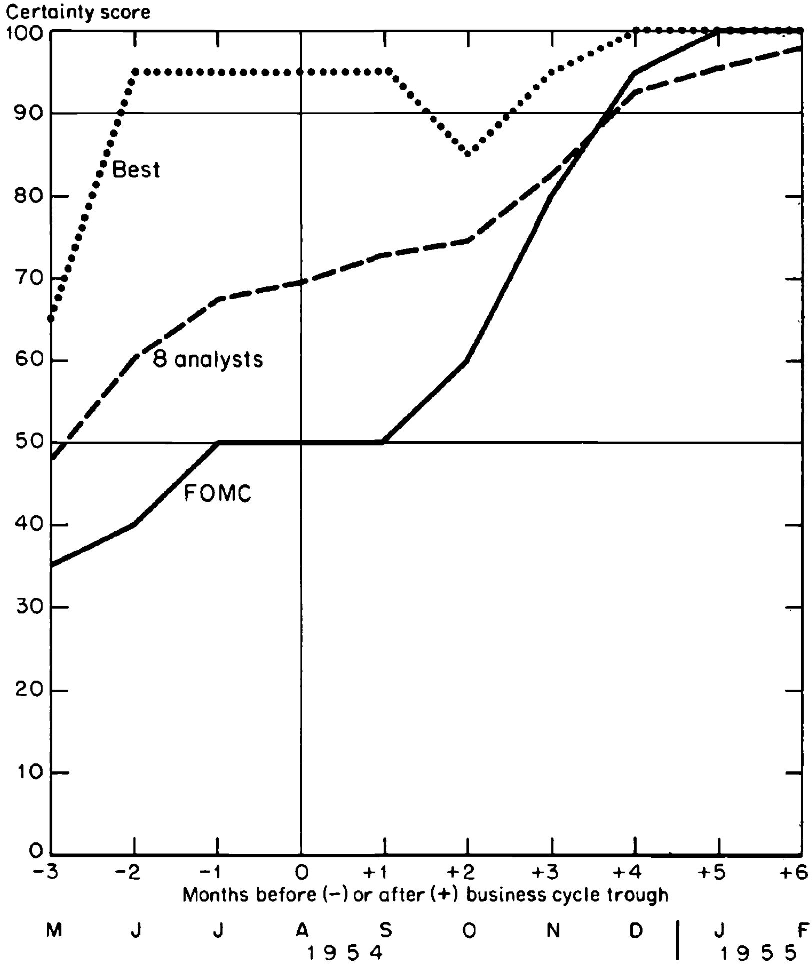
In June it was apparent that the rate of decline in activity had slowed and the "leveling off" thesis was maintained by the Committee with little increase in confidence as to the future outlook. The active ease policy was continued through the entire second quarter.

The outlook had improved somewhat by the beginning of the third quarter and the Committee was assigned a score of 50 (see Chart II-4). The drift toward optimism began in July. The typical view was expressed by staff member Frank R. Garfield when he said, as summarized in the minutes, "during June economic developments continued to show mixed trends with further indications that recessionary tendencies were abating but no clear evidence that an upturn was under

[47] *Minutes,* May 11, 1954, pp. 147–148.
[48] *Ibid.,* p. 150.
[49] *Ibid.,* May 26, 1954, p. 159.

CHART II-4

Certainty Scores for the August 1954 Trough



SOURCE: Part I of this study and other original data made available to the author.

way." [50] During August, the NBER trough date, the Committee stuck to its view that the economy was leveling off but saw some signs of improvement. The common view was that "the economy appears to be moving sidewise with some signs of improvement. . . . There is nothing

[50] *Ibid.*, July 7, 1954, pp. 208–209.

at present, however, to indicate a strong upsurge and modest seasonal increases this fall is the most likely outcome." [51] Again there was no change in the policy of active ease.

Although in September the economy started its upswing from the plateau on which it had been for the past several months, the Committee's view was much the same as before. Allan Sproul stated the typical view:

> We appear to have been on an economic plateau for the past three or four months following upon the decline in economic activity which began in the summer of 1953.
>
> I believe that a generally sidewise movement of the economy is more likely during the next few months than a pronounced and cumulative movement either up or down.[52]

The Committee members agreed that continued sidewise movement was the most likely prospect over the near term and decided to continue the existing policy of ease.

The Committee's outlook changed little by the October meetings. It agreed with R. A. Young's characterization of the situation as one of "high level doldrums." There were too few encouraging signs to indicate general revival and few signs of renewed recession. But increasing optimism concerning future economic activity was indicated at the November meeting, along with some concern about nascent speculation, and the certainty score increased to 80 (see Chart II-4). The Committee recognized the strengthening in the situation and doubted that the upward trend would be reversed. However, the members were not entirely convinced that cyclical expansion was already underway and did not change the policy of active ease.

At its December meetings, the Committee was virtually certain that a cyclical turn in business conditions had occurred and that revival was underway. Most of the Committee expressed agreement with Allan Sproul's assessment of the outlook:

> The economy seems definitely to have turned upward. . . . The danger in continuing to pursue the first course [aggressive ease] is that it might now encourage speculative forces in the economy which could lead to a brief burst of activity and another relapse.
>
> We are just coming into a recovery phase of economic activity, in which

[51] *Ibid.*, August 24, 1954, p. 245.
[52] *Ibid.*, September 22, 1954, pp. 277–278.

we want to avoid a false speculative upturn, but in which we also want to avoid nipping the bud of real recovery.[53]

R. A. Young pointed out that "data becoming available made it clear that a vigorous economic recovery was now visible and tangible." [54] And Chairman Martin thought that "recovery had a full head of steam." He doubted if the Federal Reserve was likely to do anything which could "nip the recovery in the bud." [55]

For the 1954 trough, the FOMC's certainty scores were the second highest of any turn—second only to scores in the vicinity of the 1949 trough. For the business analysts and the "best" of the eight, the certainty scores for this turn were the highest among any of the postwar turns.[56] Although both groups confirmed the occurrence of the trough in December, the business forecasters were substantially more optimistic through the second and third quarters when the Committee characterized the economy as moving sidewise. The performance of the "best" analyst is so good that it suggests an "optimistic" bias. For a comparison of these three performances see Chart II-4.

Flat or U-shaped turns in the direction of economic activity are inherently more difficult to recognize than sharp or V-shaped turns. The 1954 trough was flat bottomed which makes precise dating of the turn difficult and somewhat tenuous. If the present National Bureau business cycle date of August is taken as the date of the trough, the recognition performance of all forecasters studied is quite good. If recent revisions in data influence the NBER to move the trough to a period earlier in the year, perhaps May, June, or July, the performances will not look as good.[57]

As Chart II-4 shows, the certainty scores of the Committee are substantially below those of other forecasters for the months in the immediate vicinity of the trough. Perhaps this is a case where policy responsibility dampened the FOMC's optimism. As early as April, the Com-

[53] *Ibid.*, December 7, 1954, pp. 366–368.

[54] *Ibid.*, December 28, 1954, pp. 395–396.

[55] *Ibid.*, p. 403.

[56] See Part I, p. 29, and other original data made available to the author.

[57] For discussion of the NBER and alternative dates of cyclical turns, see: Lorman C. Trueblood, "The Dating of Postwar Business Cycles," *Proceedings of the Business and Economics Section of the American Statistical Association*, Washington, D. C., 1961; George W. Cloos, "How Good Are the National Bureau's Reference Cycle Dates?" *Journal of Business*, January 1963; and Victor Zarnowitz, "On the Dating of Business Cycles," *Journal of Business*, April 1963.

mittee was aware of the slackening in the pace of recessionary tendencies and correctly diagnosed the "leveling off" which occurred. However, there was not a significant increase in its certainty score until November, and cyclical expansion was not confirmed until December. It is apparent that the FOMC was wary of nipping possible recovery in the bud and this concern influenced its views during the extended period of sidewise movement.

5. The 1957 Peak

The recovery gained vigor in the early part of 1955 and the expansion proved to be one of the most exuberant on record. From the trough in GNP during the second quarter of 1954, the economy grew over the next thirty-five months to a peak GNP of $446.3 billion during the third quarter of 1957—an increase of over 20 per cent. The economy teetered on the brink of contraction throughout 1956. However, the boom in fixed investment by business and the revival of government expenditures helped to prevent cyclical contraction. The expansion resumed in the fourth quarter of 1956, sparked by the recovery from the steel strike, the increase in automobile production resulting from the introduction of new models, an increase in federal government expenditures, and a sharp increase in exports as a result of the Suez Crisis. However, the economy was unable to maintain the momentum, and the peak of the expansion came in July 1957 (with August a close runner-up).

Upon recognizing the revival in economic activity, the FOMC began tightening credit and continued to put pressure on the reserve position of member banks throughout 1955. Even though the Committee fluctuated between optimism and pessimism as to the rate of economic activity during 1956, at no time did it foresee a probability of deflationary forces gaining sufficient strength to carry the economy into recession.

At the beginning of 1957, the Committee characterized the economic situation as strong and still inflationary. The economy continued to operate at close to peak levels but seemed to be losing some of its momentum. During February there was increasing discussion of the possibility of a downturn sometime during the year, but the Committee felt that the evidence of weaknesses was not yet sufficient to justify a change in the policy of restraint. Its view was that the economy might be entering a period of sidewise movement at high levels.

No change in policy was made at the March or April meetings although the Committee noted that evidence of slackening continued to mount. The economic situation was pictured as one of activity on a "high plateau." The tenor of reports at the May meetings was little changed. The outlook continued uncertain; some economic indicators were edging up while others were drifting down. The Committee decided that the prudent course of action was to maintain the status quo and to wait until the outlook was clear before taking any policy action.

In its midyear outlook, the Committee judged that the economy continued to operate at high levels although moving sidewise, perhaps with a slight upward tilt. The majority of the FOMC felt that the most probable direction of activity was an upturn in the fall, with a concomitant increase in inflationary pressures. The Committee's August forecast was essentially the same. Although the discount rate was raised from 3 to 3.5 per cent between the July and August meetings, no change was made in open market policy or in the degree of restraint to be maintained in either month. The minutes summarized Chairman Martin's statement of the consensus as follows:

> With the seasonal demand coming on he would tend toward a \$500–\$400 million level of net borrowed reserves rather than risk getting up to \$600 million or higher. . . . The discussion today made it clear in his opinion that there should be no change in the Committee's directive and no change in policy, and he subscribed to that point of view completely.[58]

The certainty score for August (40) reflects the view that the Committee did not think a peak probable and its discussion of policy indicated no desire to change the degree of restraint.

The FOMC detected little change in the trend of economic activity at its September meeting. Its view was that activity continued at high levels with offsetting adjustments. The members foresaw neither the formation of deflationary forces sufficient to cause a downturn nor a combination of forces which would lead to an upsurge of general demand pressures and greater inflationary pressures. Its minutes indicate that the Committee did not visualize a change in policy from continued restraint and that it had not "recognized" the peak. However, several

[58] *Minutes,* August 20, 1957, pp. 530–531.

members indicated that, because of the increased pessimism in the business and financial communities, the same degree of tightness could be achieved with a lower level of negative free reserves.[59] Chairman Martin's position, as summarized in the minutes, was that:

it was always necessary to resolve doubt one way or the other in carrying out Committee policy, and for the immediate future [until the current Treasury financing was completed] he would resolve these doubts on the side of ease rather than tightness.[60]

In October, there was a decided increase in pessimism. The staff stated that recent developments called for a thorough review of the economic situation, and that:

the economy as a whole showed basic strength but there was uncertainty as to what combination of demands would prevent recession in activity or, better, make for advance in total output and employment at present price levels.[61]

Other representative comments were:

Doubts as to the business outlook have been very considerably strengthened by developments since we met three weeks ago.

Statistical data for September and early October suggest that the business plateau which we have recognized for many months is beginning to tilt downward.[62]

Now that the marked upturn in fall business activity has not materialized, the time has come for adapting Federal Reserve System credit policy to an economic situation which indicates that general activity may be falling from its long heralded high plateau.[63]

However, not all members of the Committee shared the more pessimistic outlook. As Vice-Chairman Hayes summed it up:

There was a fairly even division between those who appraised the outlook with the view that statistics and developments that had been observed held a considerable threat of recession and those who felt that basically such a possibility was still to be demonstrated and that recent developments were largely psychological with the basic factors remaining strong.[64]

[59] *Ibid.*, September 10, 1957, pp. 547–557.
[60] *Ibid.*, pp. 570–572.
[61] *Ibid.*, October 22, 1957, pp. 615–618.
[62] *Ibid.*, pp. 619–622.
[63] *Ibid.*, pp. 630–631.
[64] *Ibid.*, p. 650.

These divergent views resulted in a decision to make no overt change in policy direction. The Committee's decision was that:

there was no immediate occasion to reverse its policy of restraint on credit expansion or to make a change in the policy directive. While it was clear that the Committee at this juncture did not wish to make any move which would signal a change in policy, it wished to supply seasonal needs reasonably freely. It did wish to increase restraint from what it had been. There was some feeling that the Committee should actually diminish restraint a little, but more of the members believed that the Committee should resolve doubts on the side of ease.[65]

At the November meeting, although all the members recognized that the economy was no longer on the "high plateau," not all of them were willing to call the downward trend the beginning of a cyclical contraction. Comments indicative of the two views were:

The most recently available data confirm that moderate downward adjustment has, in fact, been occurring. Indeed, the composite showing that cyclical downturn has now set in is fairly impressive.[66]

These changes had been desirable and in the direction that the Committee had been aiming for some time past in trying to bring the inflationary forces under control. There was still a strong possibility of a resurgence of upward pressures . . . and any overt move toward ease, any positive change in the direction of policy, would seem . . . to be a mistake at this time.[67]

There was no longer a question of forecasting a change in the economy; it was a question of recognizing what was on us.[68]

The policy consensus reached by the Committee was to moderate the pressure on bank reserves. It changed its directive for the first time since March 1957, and instructed the account manager to conduct operations with a view to "fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves."[69] The *Minutes* clearly indicate that this was the first overt action taken in the direction of ease as a result of anticipated economic trends. Prior to this action, policy changes had been slight modifications within the continuing policy of restraint. In November the policy of restraint itself was abandoned. Such a decisive change was in keeping with the

[65] *Annual Report of the Board of Governors of the Federal Reserve System, 1957*, p. 54.

[66] *Minutes*, November 12, 1957, pp. 660–662.

[67] *Ibid.*, pp. 690–691.

[68] *Ibid.*, pp. 671–674.

[69] *Annual Report of the Board of Governors of the Federal Reserve System, 1957*, pp. 54–55.

rise in the certainty score from 55 to 85. The minor adjustments in policy made in the previous three months reflect the FOMC's response to a slowly changing assessment of the outlook.

Despite the policy change that occurred in November, it was not until the December meetings that the Committee was definitely convinced that a cyclical downturn had occurred and that the economy was in a recession. R. A. Young's statement typifies the Committee's outlook:

> In recent reports to the Committee, I have used the words "downsettling" to characterize the drift in over-all activity. In the light of recent information, general economic recession now appears to be the most appropriate description.[70]

Thus it was some five months after the July peak before the FOMC "confirmed" the contraction as a cyclical one.

Among peaks, the FOMC's certainty scores for 1957 are second only to those for 1953. The same is true for the business analysts. The recognition patterns of the two groups are strikingly similar, although the Committee was somewhat more pessimistic during the period of sidewise movement. Both groups indicated significant increases in the degree of recognition in November, after the President's comment that the economy was taking a breather. To account for the business forecasters' poorer performance in recognizing the 1957 peak relative to the 1953 peak, Fels suggested that "inaccurate information" and the "persistence of inflation, in the form of rising consumer prices, after the cyclical peak was passed" were contributing factors.[71] These influenced the forecasts of the Committee as well, particularly the continued rise in the consumer price index. (See Chart II-5.)

Both the Committee and the average of the business analysts performed better than the "best" business forecaster. In this case, the latter's "optimistic bias" worked against it. Even four months after the peak, the publication did not view a recession as probable.

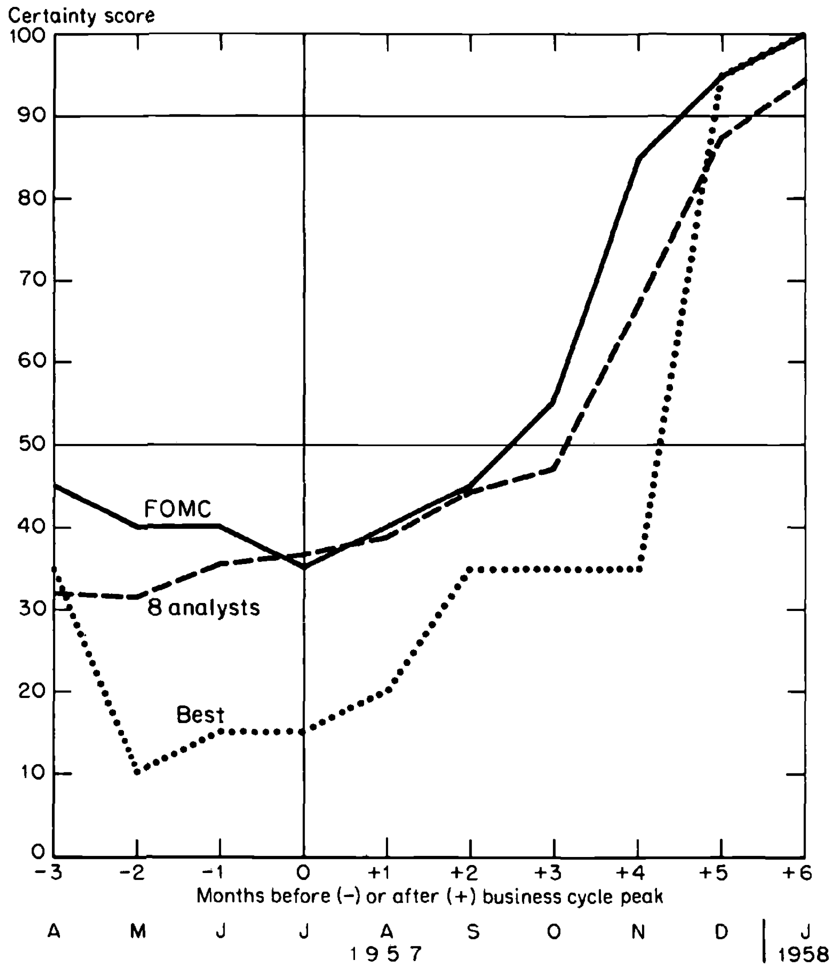
6. The 1958 Trough

The cyclical peak occurred during the third quarter of 1957. The recession that followed was the shortest but the most severe of the postwar

[70] *Minutes,* December 12, 1957, p. 770.
[71] See Part I, pp. 30–31.

CHART II-5

Certainty Scores for the July 1957 Peak



SOURCE: Part I of this study and other original data made available to the author.

period. Indeed, it was one of the shortest on record, lasting only nine months—from July 1957 to April 1958. Though brief, the contraction was sharp. GNP declined from $446.3 in 1957-III to $434.7 in 1958-I. Despite the decline in business activity, price levels generally continued rising during the contraction, so that in real terms the recession was even more severe. Unemployment rose from 3 per cent of the labor force at the peak of the expansion to a postwar high of 7.4 per cent a year later. The upturn came quickly. Early in 1958, the deflationary factors abated in strength and expansionary factors gained in force. According to the NBER chronology the trough occurred in April.

The Committee continued to ease credit during the first quarter of 1958. It had recognized the recession and was concerned about its length and depth. Virtually all economic indicators were continuing their downward trend and the outlook was for further contraction in activity. The comment characterizing the view of the majority in early March was that:

> the most recent facts clearly suggest that the 1957–58 recession has a better than even chance of being less moderate in extent and duration than either the 1948–49 recession or the 1953–54 recession.[72]

In mid-April, the outlook was for continued decline in output and employment, but the Committee did see faint signs of some slowing down in the rate of decline and perhaps even some leveling off. The majority of the Committee felt that:

> most recent data on recession are suggestive of some slowing down in the pace of decline for total output and employment, some leveling out in trade, and some developments of an expansive character in finance.
>
> At the same time, the over-all drift is still plainly downward. Indeed, current figures offer only slight basis for hope that the saucering-out phase of recession is at hand, and very little, if any encouragement for hope that revival will be setting in within a score of weeks.[73]

A few members were substantially more optimistic than this statement indicates. For example, Governor Robertson stated that "he had a very definite feeling that the economy was getting ready to start upward." [74] To ease the market, the Committee, on balance, favored a reduction of the discount rate and a reduction in reserve requirements in lieu of open market purchases. These actions were taken.

The Committee became more optimistic during its meetings in May. The talk of a leveling-off and a recovery increased. Many of the economic indicators suggested that the recession might be "saucering out" but

[72] *Minutes,* March 4, 1958, pp. 170–173.
[73] *Ibid.,* April 15, 1958, pp. 269–270.
[74] *Ibid.,* p. 298.

there was no clear evidence of a general upswing. The majority opinion was that:

a bottom to decline in economic activity appears to be in the making.

But it is a long jump from the conclusion that recession may be bottoming out to the conclusion that recovery is shortly to begin.

On balance, it seems best to view the period which the economy is now entering as one of test of recession bottom.[75]

Governor Robertson again differed with the view of the majority. He advocated a policy formulated on the basis of a recovery rather than a leveling-off.[76] The Committee decided that there was no need for a change in policy or in the degree of ease.

By June the Committee was convinced that the recession was bottoming-out, but was undecided as to the length of the bottom and the timing of the recovery. The comment most representative of the FOMC's view was that:

Bottoming-out of recession is in fact occurring. It is the better part of wisdom *not* to conclude as yet that a recovery pattern has definitely taken form.[77]

Governor Robertson persisted in his optimism. To him "The economic report indicated very clearly a leveling out or possibly an upward movement." [78] Again the Committee made no change in the existing degree of ease to be maintained. Although there was no change in policy, their discussion of the outlook indicates that the Committee members thought the probability of cyclical recovery in June to be about 50-50 (see Chart II-6).

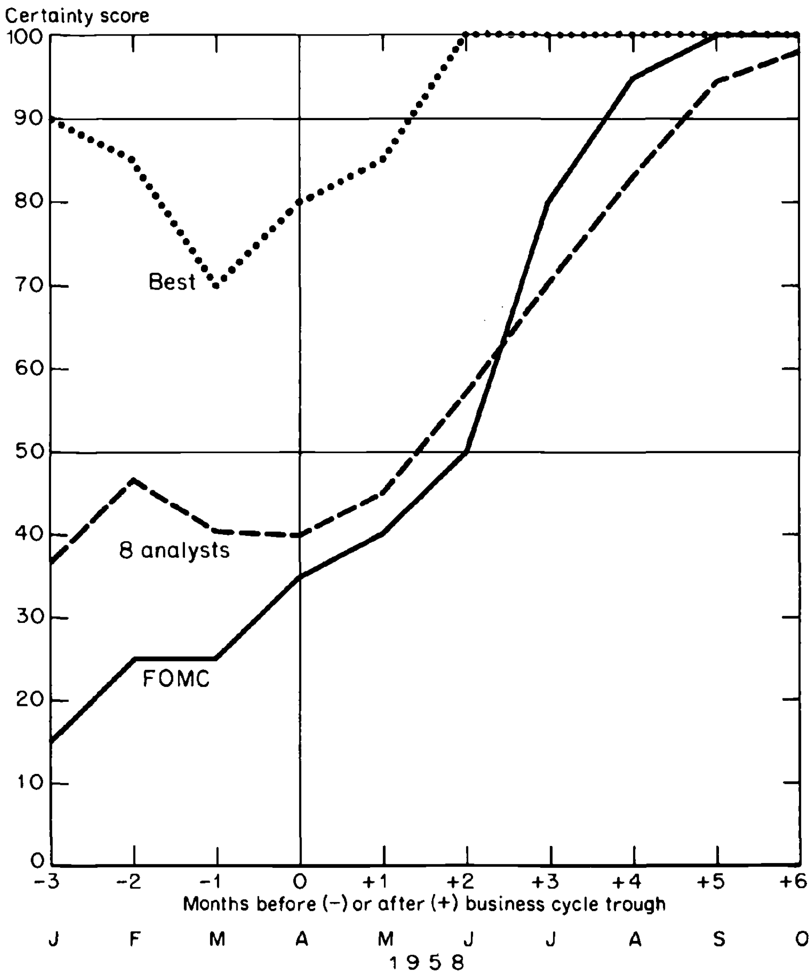
As July progressed, the Committee shifted its views of the situation from leveling-off to doubts about the nature of the recovery: temporary or permanent. Comments indicative of the doubtful nature of the rebound were:

Whether an abrupt turnabout of activity is taking place or *whether* evident improvement merely reflects a temporary rebound of production too far below consumption is yet to be determined.[79]

[75] *Ibid.,* May 27, 1958, pp. 377–379.
[76] *Ibid.,* p. 298.
[77] *Ibid.,* June 17, 1958, pp. 429–430.
[78] *Ibid.,* p. 434.
[79] *Ibid.,* July 8, 1958, pp. 472–473.

CHART II-6

Certainty Scores for the April 1958 Trough



SOURCE: Part I of this study and other original data made available to the author.

The country was not yet in a vigorous recovery and there was still a possibility that the economy might be experiencing sort of a false bottom.[80]

By its last meeting in July, the evidence of business improvement was sufficient to cause the FOMC to change the direction of policy, although

[80] *Ibid.*, p. 501.

it was not completely confident that a cyclical upswing had indeed occurred and that the recovery was more than temporary. All the members' comments were hedged with such phrases as "looks as if," "increasingly clear," and "no conclusive evidence." For example, Young, in his staff review, pinpointed the turning point date but hedged just a bit: "domestically, springback of economic activity has been impressive, so much so that it now looks as if April will mark the recession trough and May the first month of revival." [81] Most of the other statements by Committee members were hedged with qualifications. In view of the evident improvement in business conditions, the Committee decided that the appropriate policy was to reduce the existing degree of ease by recapturing redundant reserves which had been injected into the market in early July to combat a "disorderly condition."

It was not until August that the Committee confirmed that the contraction was over and decided to move decisively in the direction of tightness. Only then was the policy directive changed to provide for open market operations with a view "to fostering conditions in the money market conducive to balanced economic recovery." [82] The Committee agreed that cyclical revival was underway and concurred with R. A. Young's statement that:

> we no longer need to be tentative about the fact of domestic economic recovery. The unfolding data are abundantly clear. They show vigorous revival—one of the more robust on record following one of history's shorter and milder contraction periods.[83]

Among troughs, the Committee's certainty scores in the vicinity of the 1958 turn were the lowest. The same is true for the average score of the eight business analysts. Although the Committee recognized a change in the situation as early as April, and perceived the recovery in early July, it was not until August that it was confident that the recession was over. After experiencing two recessions which had rather flat bottoms, undoubtedly the Committee members were again expecting a "saucering out" rather than a sharp turn upward. Such an expectation would account for their reluctance to confirm that the recovery recognized in July was the cyclical trough.

Much the same pattern of recognition was followed by other fore-

[81] *Ibid.,* July 29, 1958, p. 590.

[82] *Annual Report of the Board of Governors of the Federal Reserve System, 1958,* p. 59.

[83] *Minutes,* August 19, 1958, p. 692.

casters (see Chart II-6). Again the performance of the "best" forecaster was remarkable, especially in comparison with the FOMC and the average of the eight analysts. One again suspects a strong optimistic bias.

7. The 1960 Peak

The expansion which followed the 1957–58 contraction was the shortest of the postwar expansions—twenty-five months. GNP in current dollars increased from its low of $434.7 billion in the first quarter of 1958 to a peak of $504.7 billion during the second quarter of 1960, a rise of some 15 per cent. In spite of the expansion, the economy never really approached full employment at any time during the recovery. The unemployment rate, which had risen above 7.5 per cent during the recession, never fell below 5 per cent during the upswing.

After August 1958 the FOMC tightened the pressure on reserves of member banks quickly and vigorously. By the end of the year free reserves had dropped from about $500 million to a negative $150 million. From a 1.75 per cent discount rate in mid-1958, the rate was moved up steadily until, at the beginning of 1960, it stood at a postwar high of 4 per cent. With but little variation the FOMC viewed the economy as expanding throughout 1959, and expected inflation to occur at almost any moment.

At its first meeting in 1960 the FOMC expressed confidence in the future outlook. The majority opinion was that "the customary measures of current activity are almost all up, and further increases seem as certain for the near term as anything can be." [84] The Committee's consensus was to continue the existing policy and it instructed the account manager to maintain the status quo.

[84] *Minutes,* January 12, 1960, pp. 6–7. Governor A. L. Mills was consistently less sanguine than the majority through the first quarter of the year. He dissented from the optimistic view and argued that:

> The opening of the year 1960 reveals the national economy badly overextended creditwise and finds the System's Open Market Committee faced with the necessity of conducting a monetary and credit policy that will prevent tautness in the credit markets from reaching the breaking point and still allow enough credit headroom to support stable and sustainable economic growth. The rationale of such policy argues that deflation is a more imminent danger than inflation, and that if a severe deflation is to be avoided economic momentum must be maintained through the invigorating impulse of a reasonable flow of newly created commercial bank credit into the economy. (*Ibid.,* pp. 31–32.)

By its second meeting in January, sufficient evidence had accumulated to indicate that the expected vigorous boom with accompanying inflationary pressures had not developed. The failure of the economy to meet these expectations introduced some uneasiness. While the Committee still felt that forces were on the side of expansion, some members expressed tentative doubts about the future level of activity. The consensus of the meeting was that an "even keel" should be maintained and that no change in the policy directive was called for.

The Committee continued to discount the poor performance of the economy at the February meeting. Its feeling was that the performance was bad only in relation to exuberant expectations. The majority opinion was expressed by Guy Noyes and Alfred Hayes. Noyes said, "The prospects for avoiding an inflationary boom are certainly brighter—and as is inevitably the case, the possibility that we may be confronted with a major readjustment is similarly enhanced." [85] Hayes also recognized the moderating tendency but stated, "I believe it would be a mistake, however, to over-emphasize these moderate tendencies, since the basic outlook for production, employment, and spending is strong, and the possibility of an inflationary boom cannot be dismissed completely while the year is yet so young." [86] The Committee's decision was that open market operations should be directed toward a "slight but not visible" easing.[87] The certainty score assigned was 30 (see Chart II-7).

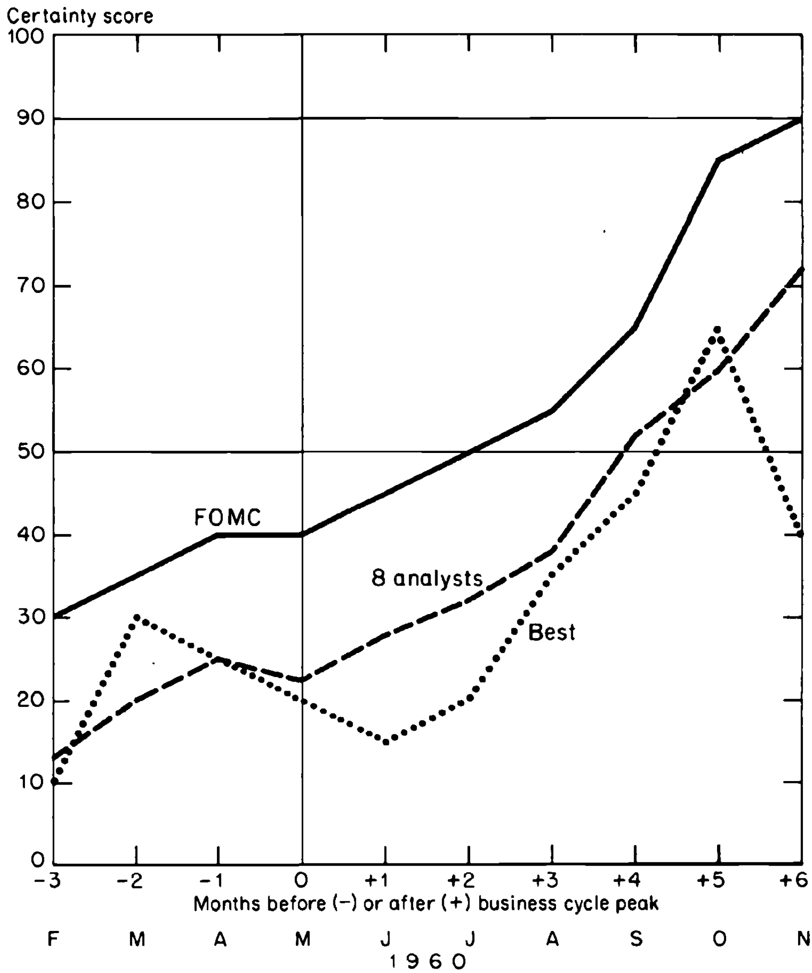
At its meetings in March, the Committee expressed increasing concern about the future course of business activity, primarily because of the failure of new expansionary forces to appear. Typical statements describing the situation were:

> On balance, the current business lull appears likely to represent a period of hesitation in a strong or expanding economy, rather than the beginning of a cumulative downward movement.[88]
>
> The upward trend of activity seemed definitely to have slowed somewhat, but there were no signs of serious weakness.[89]
>
> The country was in the midst of a lull before an outbreak of expansionary forces in the near future.[90]

[85] *Ibid.*, February 9, 1960, pp. 114–115.
[86] *Ibid.*, pp. 120–122.
[87] *Ibid.*, p. 168.
[88] *Ibid.*, March 22, 1960, pp. 267–268.
[89] *Ibid.*, pp. 276–277.
[90] *Ibid.*, p. 280.

CHART II-7

Certainty Scores for the May 1960 Peak



SOURCE: Part I of this study and other original data made available to the author.

The Committee agreed that its policy in the immediate future should be one of moderately less restraint and that open market operations should be conducted with a view "to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion." [91] The statements cited above indicate that the FOMC was fully aware of a slowing down in activity but did not anticipate the beginning of a cyclical contraction.

The April economic outlook was still uncertain, but fears of a cyclical downturn were not expressed. The statement that most closely characterized the Committee's position came from Governor Balderston, who stated that "the situation at the moment seemed to be one that might be described as 'rolling prosperity.' Whether it was rolling uphill, on the level, or downhill, he did not know . . ." [92] The meeting resulted in a consensus to move in the direction of slightly more ease but with great care that this not be done in an overt way so that no one would get the impression that the Committee was more concerned about the future outlook than it really was. The minutes made it clear that the Committee was fully cognizant of the deteriorating economic condition but that it was not convinced that the deflationary forces were cyclical in nature. The certainty score assigned was 40.

During May, the NBER peak month, the Committee members voted to move toward zero free reserves—another move in the direction of ease. They characterized this action as "leaning against the wind" when, as they viewed the situation, there was no deflationary or inflationary wind to lean against. A zero level of free reserves was considered to be a neutral policy which was appropriate to a view that the economy was undergoing a moderate expansion with no evidence of inflation. Comments indicative of this view were:

> Although economic activity is at a relatively high level and will probably continue its expanding trend, the expansion is likely to be moderate . . .[93]
>
> The most recent business information indicates the probability of a moderate expansion in business activity.[94]
>
> The chances were greater that the economy would move upward than it would move downward.[95]

This outlook was shared with varying degrees of confidence by most of the Committee members. The minutes show that the policy change was not taken in anticipation of a cyclical contraction.

The Committee's outlook was a little less optimistic in June. The

[91] *Ibid.*, March 1, 1960, pp. 252–253.
[92] *Ibid.*, April 12, 1960, pp. 357–359.
[93] *Ibid.*, May 3, 1960, pp. 389–392.
[94] *Ibid.*, pp. 394–395.
[95] *Ibid.*, pp. 404–406.

typical comment was that "although some of the business data that have become available during the last three weeks have been disappointing, they do not alter the prospects of further moderate business expansion in the second half of the year." [96] In general, the Committee agreed that the immediate outlook was for little change from the current situation; the economy was moving sidewise, perhaps with a slight upward tilt. The consensus of the Committee was to "mark time" until the outlook was clearer and that errors, if any, should be on the side of ease. Again it is clear that the FOMC did not yet view a recession as probable, and the certainty score assigned was 45.

By July there was a decided shift toward pessimism. For the first time, the Committee viewed the most probable outcome as something other than modest expansion—either continued sidewise movement or a downswing. Some sample comments by members indicated the range of opinion within the Committee. Karl Bopp expressed the view that "on balance there was less danger of a renewed burst of inflation than of continuation of the current lull or a turn downward." [97] Watrous Irons said that the economy was moving along sideways at a high level while J. A. Erickson felt that the situation could be described as "coasting uphill." [98] Governor Balderston was less sanguine than the majority and correctly interpreted the indications of cyclical decline. He was persuaded that a turn had occurred, and said that "in his view the decline that one might expect at this phase of the cycle was now evident and should be countered actively . . ." [99] The members agreed with Chairman Martin's statement that "it appeared that the Committee unanimously wanted to trend toward an easier reserve position. . . ." [100]

Even at their August meeting, a majority of the Committee felt the economy was still operating on a high plateau. While some members were more pessimistic than the following statement indicates, it is characteristic of the majority opinion:

> The picture [was] one of fairly level activity with no widely divergent offsetting trends. There were some divergent trends, it was true, but in general the economy was moving at a good level.[101]

[96] *Ibid.*, June 14, 1960, pp. 503–505.
[97] *Ibid.*, July 26, 1960, p. 606.
[98] *Ibid.*, p. 622.
[99] *Ibid.*, pp. 627–628.
[100] *Ibid.*, p. 630.
[101] *Ibid.*, August 16, 1960, p. 672.

The directive was changed, with four members objecting, to provide that open market operations should be conducted with a view "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment." [102] Although the directive was changed, policy was only slightly modified (if at all). The consensus was stated by Governor Balderston (acting chairman) and summarized in the minutes:

> a continuance of the current policy, giving to the Account Manager more than the usual freedom to follow the feel of the market because of the changes in reserve requirements that were to occur in the near future.[103]

The four members who objected to the directive change felt "that the consensus did not contemplate a sufficient modification in the course and objectives of open market operations to necessitate a change in the directive." [104]

There was a substantial increase in pessimism by September. The Committee was fully aware that adjustments had been and were taking place, but seemed to be about evenly divided between thinking that sufficient grounds had been laid for renewed expansion and believing that more adjustments and deterioration were still ahead. On balance the Committee felt that:

> The economy has already made a number of important adjustments that are ordinarily associated with a moderate recession in business activity, and . . . with the benefit of hindsight we may find 1960 was a year of moderate recession, and that 1961 will be one of recovery.[105]

The policy decision was to maintain an "even keel" with doubts resolved on the side of ease. The certainty score of 65 reflects the Committee's judgment that some downward drift in activity was the most probable direction of business.

Despite the evidence that had accumulated by October that economic activity was slowing down, not all members of the Committee were convinced that the economy was in the midst of a recession. But the doubters constituted a small minority and even they thought that the economy was on the verge of a decline. The attitude of the members is

[102] *Ibid.*, p. 689.
[103] *Ibid.*, p. 686.
[104] *Annual Report of the Board of Governors of the Federal Reserve System, 1960*, p. 63.
[105] *Ibid.*, September 13, 1960, pp. 697–699.

indicated by the following short phrases from their appraisals of the outlook: "depth and duration of the recession," "there was little evidence to support anything other than a pessimistic view," "little cheerful news," "recessionary economic influences," "signs of further weakening," and "sliding-off of activity." Perhaps Chairman Martin's statement best characterizes the Committee's view of the situation:

> There was a declining business picture, whether it be called a recession or a rolling adjustment, but the economy was not going over a precipice by any means. There was no sign as yet that the decline had burgeoned into a major depression. There had been recessionary tendencies since March . . .[106]

Its discussion makes it evident that the Committee wished to continue the easy money policy.

In November, the Committee confirmed the existence of recession. Guy Noyes, in summarizing the staff report, stated:

> For what it is worth, the evidence of future plans suggests that the further declines will be less precipitous than any other postwar downturn.
>
> Certainly, the downward drift in the economy so far is not the sort of decline that has generally been associated with a recession in business cycle analysis. It has led to a profusion of new and refurbished descriptive phrases—and I can see no harm in offering still another. I would like to suggest that this might be termed a "moderated recession." [107]

The Committee agreed with the staff's analysis of the situation and the policy pursued was continued ease. Thus the "confirmation lag" at the 1960 peak was six months.

For the Committee, certainty scores in the vicinity of the 1960 peak were the second lowest among all turns. For the average of the eight business analysts and for the "best" analyst, the performance was the poorest among all turns, peaks or troughs. Although their recognition patterns are quite similar, the Committee "recognized" and "confirmed" the peak well before the other forecasters (see Chart II-7). Perhaps some of the FOMC's superiority can be accounted for by quicker access to the relevant economic data. However, here the Committee simply seems to have been the best forecaster.

A number of factors account for the relatively poor performances in recognizing the cyclical nature of the deterioration in business condi-

[106] *Ibid.*, October 25, 1960, p. 837.
[107] *Ibid.*, November 22, 1960, pp. 859–861.

tions. Because of the extreme mildness of the decline in GNP (from $504.7 billion in 1960-II to $503.3 billion in 1960-IV), it is little wonder that the Committee hesitated to confirm the existence of recession. Characterizing the situation as "idling in neutral," "sidewise at a high level," etc., was not wholly inappropriate. An additional factor working against early "recognition" and "confirmation" may have been the decision to ease prior to the turn. As early as February, policy was changed to a "slight but not visible" easing and the degree of ease was continually increased through the next several months. Consequently the Committee was not under real pressure to recognize the peak and reverse the direction of policy.

8. Summary

OVER-ALL PERFORMANCE

A useful way to evaluate the Committee's performance in forecasting and recognizing cyclical changes in business conditions is to compare its recognition pattern with that of other forecasters. The recognition patterns of the FOMC and the mean patterns of the eight business analysts analyzed by Fels are quite similar. At only two turns, the 1949 trough and the 1960 peak, did the recognition and confirmation lags of the two groups differ significantly. In the case of the 1949 trough, the recession was double-bottomed and the Committee recognized the first turn as the true bottom. In 1960, the FOMC seems to have had a greater appreciation of the deflationary forces at work and, consequently, made better forecasts than the business publications.

For the most part, the cyclical turns which the Committee and the business analysts found easy or difficult to recognize were the same (see Table II-2). For both groups the troughs of 1949 and 1954 were the most readily recognized of all turns; the peaks of 1948 and 1960 the most difficult. There is a striking similarity in the rankings of the average certainty score for each turn between the two groups. This similarity holds if each turn is ranked among all turns and if the peaks and troughs are ranked separately.

Both the Committee and the business analysts consistently recognized and confirmed the occurrence of troughs more promptly than peaks (see Charts II-8, II-9, and II-10). At the four peaks studied, the FOMC achieved a mean certainty score of over 50 after a lag of two

TABLE II-2

Comparison of Recognition and Confirmation Lags Between the FOMC and Business Analysts

NBER Business Cycle Date	Rank of Average Certainty Score (high to low) [a]			Recognition Lag (months)			Confirmation Lag (months)		
	FOMC	Eight Business Analysts	Best Over-All	FOMC	Eight Business Analysts	Best Over-All	FOMC	Eight Business Analysts	Best Over-All
Peaks									
November 1948	7 (4)	6 (3)	5 (2)	+3	+2	+4	[b]	[b]	+4
July 1953	3 (1)	4 (1)	3 (1)	+2	+2	−3	+6	+6	+1
July 1957	4 (2)	5 (2)	6 (3)	+3	+4	+5	+5	+6	+5
May 1960	6 (3)	7 (4)	7 (4)	+3	+4	+5	+6	[b]	[b]
Troughs									
October 1949	1 (1)	2 (2)	4 (3)	−1	0	−2	+1	+6	+3
August 1954	2 (2)	1 (1)	1 (1)	+2	−2	−3	+4	+4	−2
April 1958	5 (3)	3 (3)	2 (2)	+3	+2	−3	+4	+5	+2

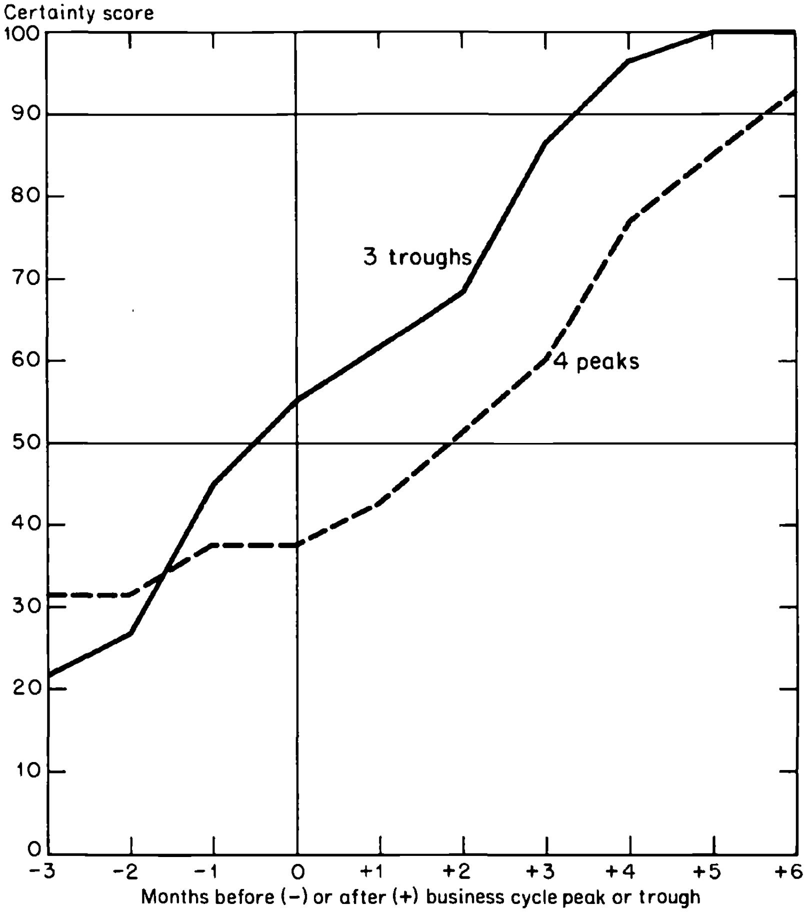
SOURCE: Rendigs Fels, Part I of this volume, and other original data made available to the author. Note that for the recognition lag of the "best over-all" forecaster there are three entries of − three months. Since Fels' scores only start at − three months, the author read the "best" forecaster's comments in earlier months to check if its recognition lag was shorter. For the 1953 peak, a − three-month lag is appropriate. However, for both the 1954 trough and the 1958 trough, the date of recognition was at − four months.

[a] Rank in parentheses is the rank (from high to low) of that turn among only the peaks or only the troughs. The prior ranking is among all turns.

[b] The turn was not confirmed within six months of the NBER reference cycle date.

CHART II-8

FOMC Certainty Scores for Postwar Peaks and Troughs

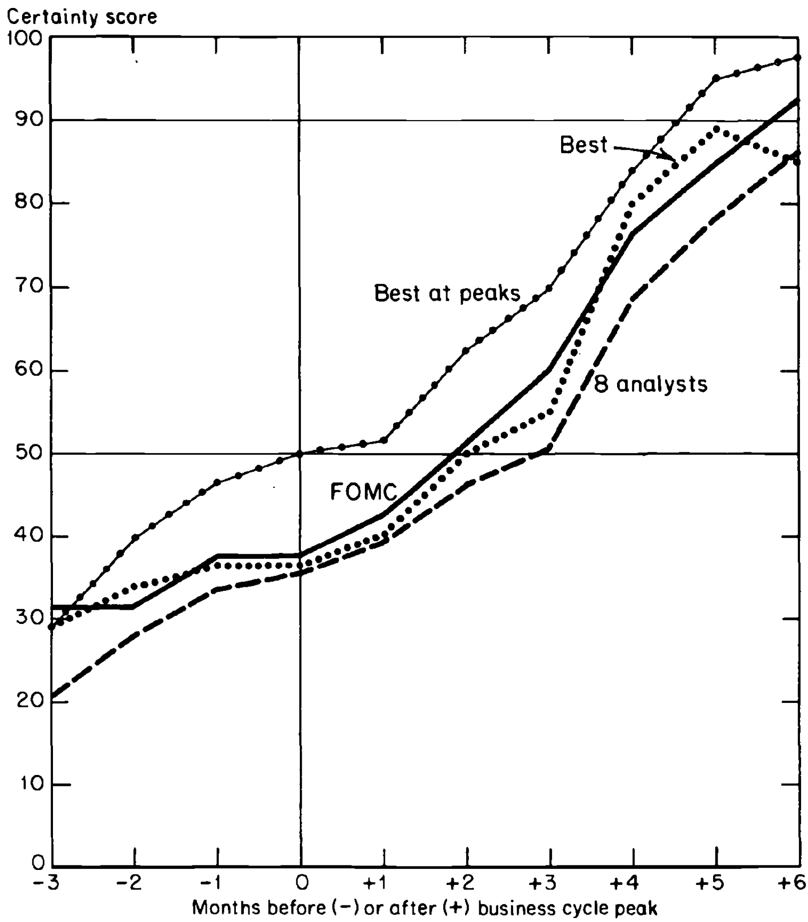


SOURCE: Part I of this study and other original data made available to the author.

months; a mean score of 90 or better after a lag of six months. The eight business analysts, taken as an average, exceeded a mean score of 50 three months after the peaks; a mean score of 90 was not achieved even after the lapse of six months (see Chart II-9). At the three troughs studied, the FOMC achieved a mean certainty score of 55 with a zero lag; a mean score of 90 or better after a four-month lag. The eight

CHART II-9

FOMC and Business Analysts Certainty Scores for Four Postwar Peaks



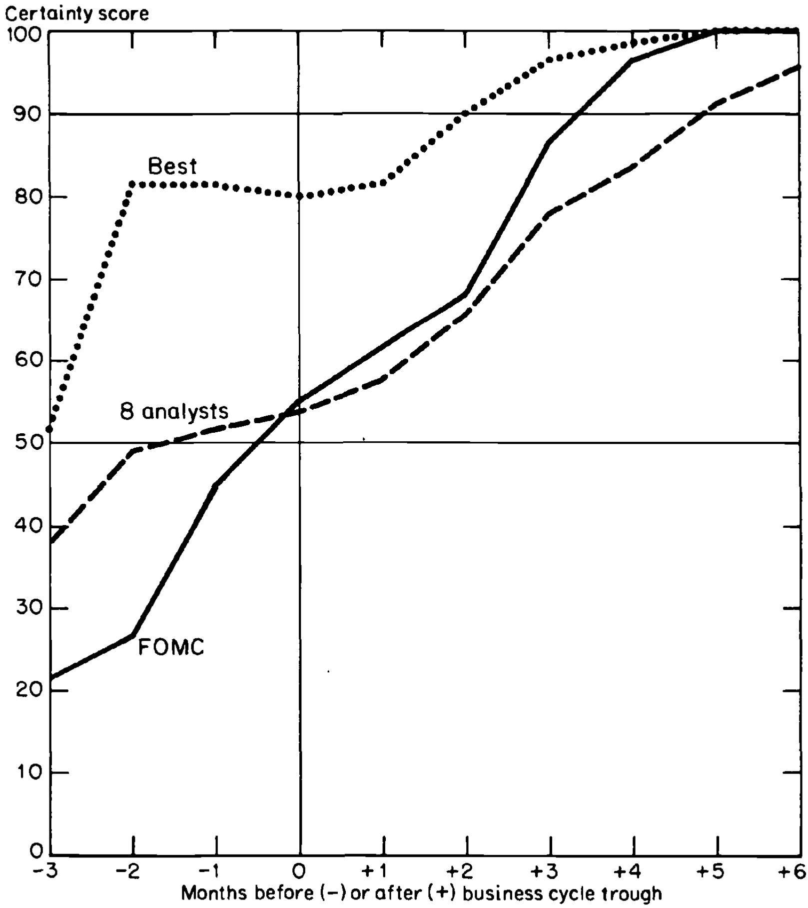
SOURCE: Part I of this study and other original data made available to the author.

business publications exceeded a mean score of 50 one month prior to the troughs; a mean score of 90 or better after a five-month lag (Chart II-10).

Taking the seven peaks and troughs together, a procedure that tends to compensate for any optimistic or pessimistic bias, the FOMC achieved an average certainty score of 27 per cent three months before the

CHART II-10

FOMC and Business Analysts Certainty Scores for Three Postwar Troughs



SOURCE: Part I of this study and other original data made available to the author.

turn, 45 per cent at the turn, 71 per cent three months after the turn, and 96 per cent six months after the turn. The corresponding average figures for the eight business publications are nearly the same, namely: 28 per cent, 43 per cent, 63 per cent, and 90 per cent.

What accounts for the systematic difference in the recognition patterns for peaks and troughs? In the case of the FOMC, a contributing factor may have been that, until the Accord in 1951, its hands were virtually tied when it came to fighting inflation. The minutes indicate that during 1947–50 the Committee was more concerned with halting inflation, current and expected, than with insuring growth and full employment. It was during this period that the FOMC turned in its worst performance for recognizing a peak and its best performance for recognizing a trough. Its striving to disentangle itself from the responsibility for supporting government security prices impressed upon the FOMC the difficulties of combating inflation.

The dominant reason, however, seems to be that postwar peaks were inherently more difficult to recognize than troughs. In addition, historically, expansions have been more variable in length than have contractions. Since this is well known and expected by forecasters, they are continually on the lookout for the end of contractions but not for expansions.[108] As Fels suggested, forecasters were continually optimistic about the depth and duration of postwar recessions:

> Despite the forebodings of an occasional prophet of doom, forecasters have generally expected each contraction to be short and mild. Although they were not able to pinpoint when the trough would come, they were basically right.[109]

This optimism is particularly evident in the recognition pattern of the "best" forecaster (compare Charts II-11, II-12, and II-13). The FOMC may also have been optimistically "biased." As Guy Noyes, of the Committee's staff, suggests, "Perhaps this line of thinking proves only that Americans are incurable optimists, but there is some historical precedent for 'sidewise movements' that are fully recognized as 'recessions' only in retrospect." [110] Whatever the reason(s), there was a systematic difference in recognition patterns between peaks and troughs.

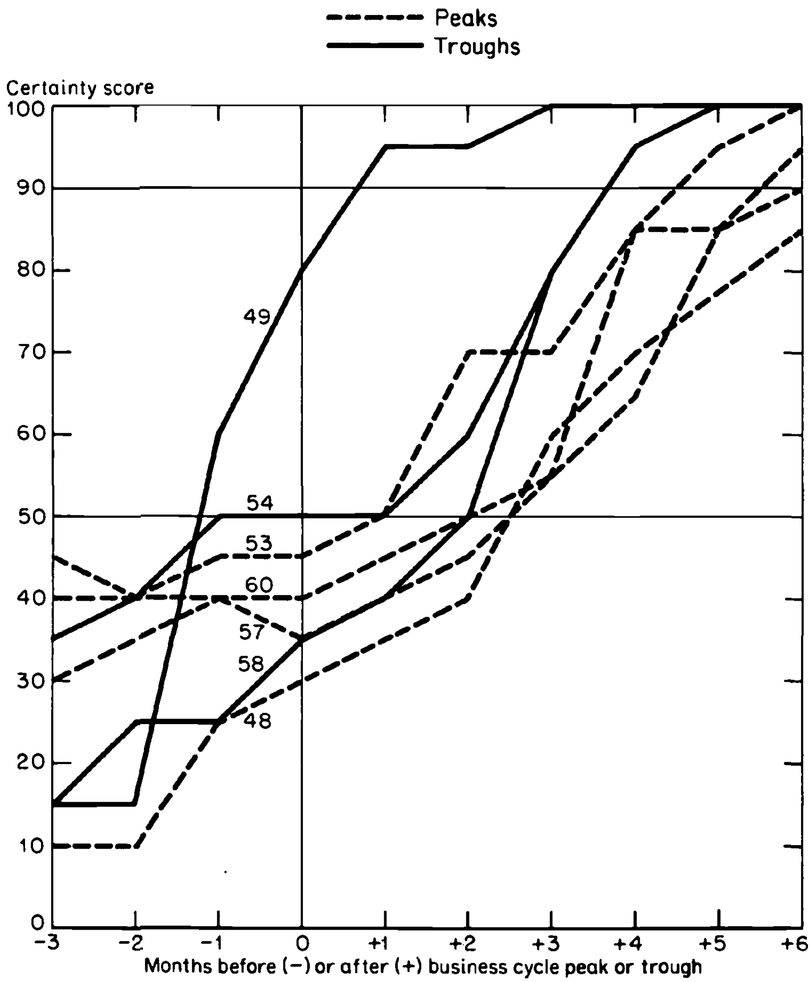
PERFORMANCE AT PEAKS

The Committee reached a mean certainty score of at least 50 two months after the NBER dates of the peaks; a mean score of 90 or better six months afterwards. The business publications exceeded a mean score of 50 three months after the peaks; a mean score of 90 was not reached within six months afterwards.

[108] I am indebted to Phillip Cagan of the National Bureau for this point.
[109] See Part I, p. 47.
[110] *Minutes*, September 13, 1960, p. 699.

CHART II-11

Certainty Scores at Seven Business Cycle Turns: FOMC

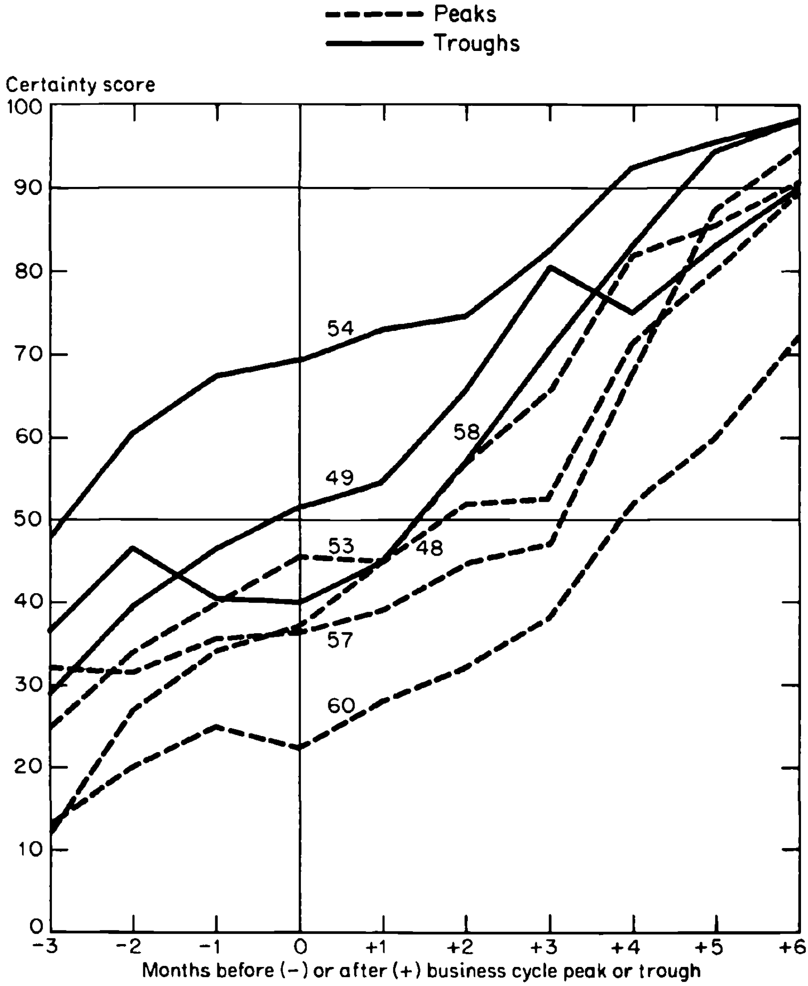


SOURCE: Part I of this study and other original data made available to the author.

If the certainty scores in the vicinity of the four peaks are averaged, there is little difference between the Committee's performance and that of the eight publications (see Chart II-9). Over-all, the Committee did little if any better than the average of the eight. Despite this similarity

CHART II-12

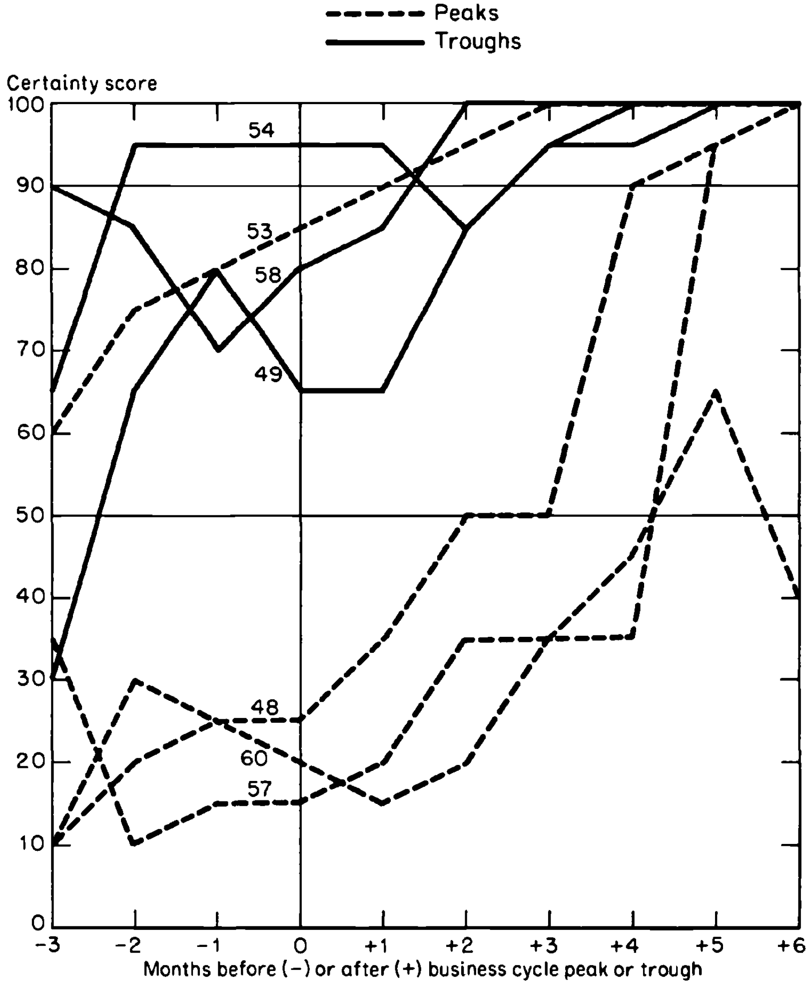
Certainty Scores at Seven Business Cycle Turns: Mean of Eight Analysts



SOURCE: Part I of this study and other original data made available to the author.

CHART II-13

Certainty Scores at Seven Business Cycle Turns:
"Best" of Eight Analysts



SOURCE: Part I of this study and other original data made available to the author.

in mean performances, there were substantial differences at each of the four peaks (see Charts II-1, II-3, II-5, and II-7). If the performances at peaks are reviewed individually, the Committee has generally succeeded in "recognizing" and "confirming" the turns prior to other forecasters (see Table II-2). However, only in the vicinity of the 1960 peak was the FOMC's recognition performance unambiguously superior to the business analysts'.

The forecaster with the highest mean certainty score for all turns taken together was not substantially better than the average of the eight together (Chart II-9). Actually there is little to choose in the over-all performances at peaks between the Committee and the average of the eight business analysts. Although the mean recognition pattern of the publication with the best record of recognizing peaks was quite similar to that of the FOMC, it succeeded in "recognizing" and "confirming" the turns one month before the Committee (Chart II-9).

PERFORMANCE AT TROUGHS

The FOMC's mean recognition performance in the vicinity of the three troughs is more difficult to evaluate. It achieved a mean score of over 50 with a zero lag; a mean score of 90 or better after a four-month lag. The eight business analysts taken together exceeded a mean score of 50 one month prior to the troughs; a mean score of 90 or better after a five-month lag. The average degree of certainty achieved by the eight analysts was substantially higher than the Committee's before the troughs, about the same from the troughs to about two months afterwards, and then lower (see Chart II-10). In essence, the business forecasters, on the average, "recognized" troughs prior to the FOMC but "confirmed" their occurrence after the Committee.

Again, the mean performances hide individual differences between the two groups in recognizing the three troughs (see Charts II-2, II-4, and II-6). However, only in the vicinity of the 1949 trough was the recognition performance of the Committee clearly the better. At the other troughs, the differences in recognition patterns are similar to those exhibited by their mean patterns.

In the case of troughs, the "best" forecaster was significantly better in its over-all performance than both the eight analysts and the FOMC. Its average recognition lag was – three months, its average confirmation lag, + two months (see Chart II-10). Indeed, its performance in recognizing troughs was so good that it is doubtful that forecasting ability accounts for it. The "best" forecaster is the publication with the highest mean recognition score for peaks and troughs taken together. Since it was only the fourth best performer at peaks, its performance at troughs primarily accounts for the high over-all certainty score. In fact, it had the highest mean certainty score at each of the three troughs.[111] Because of the difference in its performance at peaks and at troughs, one suspects a strong optimistic bias.

SUMMARY

In summary, both the Committee and the business analysts consistently recognized and confirmed the occurrence of troughs more promptly than peaks. The over-all recognition patterns of the FOMC and the other forecasters, taken as a group, are quite similar. At peaks there is little difference between the recognition patterns of the Committee and the average of the eight; at troughs, the business forecasters were better in giving early warning but the Committee was better in confirming their occurrence. All in all, the Committee's ability to forecast and recognize postwar cyclical turning points "can only be regarded as splendid," [112] if one assumes the same is true for other forecasters.

4

The FOMC's Recognition Pattern and Policy Decisions

The two previous studies of the Federal Reserve Board's ability to recognize and act on cyclical turns disagreed on conclusions. This was due to their widely different estimates of the Board's ability to recognize peaks; their results at troughs were of the same general nature. Both

[111] Fels, unpublished data.

[112] Brunner and Meltzer, *The Federal Reserve's Attachment to the Free Reserve Concept*, p. 50.