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nizing 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.

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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¹¹¹ Fels, unpublished data.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.

studies inferred recognition of cyclical turns from "policy changes." The results of such a procedure can be misleading. Additional insight into the actions of the monetary authorities is gained by determining the Federal Open Market Committee's ability to recognize cyclical turns independently of its policy decisions. In their studies, Kareken and Solow and Brunner and Meltzer realized that the date of recognition may not be equivalent to the date of policy change. Kareken and Solow thought that "insofar as the Federal Reserve is concerned, troughs signal the need for action, but peaks do not, or may not . . ." ¹¹³ Brunner and Meltzer apparently believed that peaks signal the need for action but that troughs may not. They wrote that "The fact that the lag in changing policy at troughs is longer than the lag at peaks does not necessarily indicate a slower recognition of recoveries. It is doubtful that more rapid movement toward 'restraint' would be desirable from the viewpoint of either the FOMC or the economy." ¹¹⁴ Review of the Committee's actions in the context of its views of past, current, and expected economic conditions (i.e., its recognition pattern) provides new information on the subject.

This section compares the certainty scores, which reflect the Committee's view of economic conditions, with the Brunner-Meltzer scores of policy action reflecting the direction and magnitude of the Committee's policy decisions. The general relationship between the two sets of scores is shown in Table II-3. Brunner and Meltzer scored all the FOMC's policy actions, as given in the "Record of Policy Actions" section of the Federal Reserve Board's Annual Reports. Table II-3 lists all those policy changes and the appropriate Brunner-Meltzer score which were made in the vicinity (minus three to plus six months) of

¹¹³ Kareken and Solow, *Stabilization Policies*, p. 70.

¹¹⁴ Brunner and Meltzer, *The Federal Reserve's Attachment*, p. 46.

Notes to Table II-3

SOURCE: Brunner and Meltzer, *An Alternative Approach to the Monetary Mechanism*, pp. 119-124.

^a The author argues in the text that these scores do not properly reflect the nature of the action taken by the FOMC. Specifically, the action in June 1953 was taken to counteract an anticipated disorderly market; the May 1958 action was again in response to prospective Treasury Financing difficulties; and the actions in July 1958 were taken to absorb reserves which had been previously injected to combat a disorderly market in government securities.

TABLE II-3

FOMC Policy Changes and Certainty Scores in the Vicinity of Postwar Turns

Month of Policy Change	Brunner-Meltzer Score	Certainty Score
<i>November 1948 Peak</i>		
March 1949	+ $\frac{1}{2}$	70
April 1949	+ $\frac{1}{8}$	77.5
May 1949	+ $\frac{1}{2}$	85
<i>October 1949 Trough</i>		
November	- $\frac{1}{2}$	95
March 1950	- $\frac{1}{4}$	100
<i>July 1953 Peak</i>		
June	+1 ^a	45
September	+ $\frac{1}{2}$	70
December	+ $\frac{1}{2}$	85
<i>August 1954 Trough</i>		
December	- $\frac{1}{2}$	95
January 1955	- $\frac{1}{2}$	100
<i>July 1957 Peak</i>		
August	+ $\frac{1}{8}$	40
September	+ $\frac{1}{8}$	45
October	+ $\frac{1}{4}$	55
November	+ $\frac{1}{2}$	85
December	+ $\frac{1}{2}$, + $\frac{1}{4}$	95
January 1958	+ $\frac{1}{4}$	100
<i>April 1958 Trough</i>		
May	- $\frac{1}{8}$ ^a	40
July	- $\frac{1}{4}$, - $\frac{1}{4}$ ^a	80
August	- $\frac{1}{2}$	95
<i>May 1960 Peak</i>		
February	+ $\frac{1}{8}$	30
March	+ $\frac{1}{4}$	35
April	+ $\frac{1}{2}$	40
May	+ $\frac{1}{4}$, + $\frac{1}{2}$	40
June	+ $\frac{1}{2}$	45
August	+ $\frac{1}{4}$	55
September	+ $\frac{1}{8}$	65
October	+ $\frac{1}{8}$	85

peaks and troughs, along with the certainty score for the month in which the policy decision was made.

Although the Committee reversed the direction of policy quicker at peaks than at troughs, it did so at significantly lower certainty scores. The Committee was apparently willing to accept a greater degree of uncertainty when acting in the vicinity of peaks than at troughs. It switched toward easy money before "confirming" that a turn in general business had occurred at each of the four postwar peaks (see Table II-4). The Committee's decision-making process proceeded by successive approximations. At the peaks of 1953, 1957, and 1960, the FOMC made minor adjustments in the degree of restraint even before it was convinced that signs of leveling off and slowing down were indicative of general recession (see Table II-3). This seems prudent. Because of its power to act quickly and to make small adjustments, the Committee can afford to act without waiting to be sure that changing business conditions are auguries of a cyclical peak. In the vicinity of the postwar troughs, the Committee did not switch toward tight money until they were virtually certain that cyclical recovery was actually underway (see Table II-5). Again, this seems prudent. In the vicinity of troughs, the emphasis in monetary policy is on encouraging cyclical expansion. Even if the Committee confirmed troughs with a zero lag, it is doubtful that policy should be changed immediately upon "confirmation." In only one case—the 1958 upswing—did the Committee act before "confirming" the trough. And whether to regard the July decision "to recapture redundant reserves" as a reversal of policy is a marginal decision.¹¹⁵ If the decisive action to tighten in August is assumed to be the date of policy reversal, the pattern of action only after "confirmation" of cyclical revival holds. In either case, the degree of recognition was greater than when policy was changed at any of the peaks. According to Brunner and Meltzer, the Federal Reserve indicated a desire to change policy at peaks after an average lag of a quarter of a month, and twice (in 1953 and 1960) changed policy prior to the approaching peak. Even ignoring the first change in 1953, which was in anticipation of a disorderly market,¹¹⁶ the mean lag is still only a month. The mean certainty score when policy was first changed was about 45 per cent, ranging from 70 to 30. The first major change in policy at peaks, according to Brunner

¹¹⁵ See Chapter 3 above.

¹¹⁶ See Chapter 3 above.

TABLE II-4
Summary of FOMC Policy Changes and Certainty Scores

NBER Reference Cycle Date	Scale of First Indicated Desire to Change Policy ^a	Certainty Score at First Change	Lag ^b (in months)	Score of Major Change in Policy ^a	Certainty Score at Major Change	Lag ^b (in months)
Peaks						
November 1948	+1/2	70	+4	+1/2	70	+4
July 1953 ^c	+1 (+1/2)	45 (70)	-1 (+2)	-1 (+1/2)	45 (70)	-1 (+2)
July 1957	+1/8	40	+1	+1/4	55	+3
May 1960	+1/8	30	-3	+1/4	35	-2
Average for peaks ^c	+7/16 (+5/16)	46.25 (50.25)	+0.25 (+1)	+1/2 (+3/8)	51.25 (57.5)	+1 (+1.75)
Troughs						
October 1949	-1/2	95	+1	-1/2	95	+1
August 1954	-1/2	95	+4	-1/2	95	+4
April 1958	-1/8	40	+1	-1/2	95	+4
Average for troughs	-3/8	76.66	+2	-1/2	95	+3

^a Brunner and Meltzer, *An Alternative Approach to the Monetary Mechanism*, pp. 119-124, and *The Federal Reserve's Attachment to the Free Reserve Concept*, p. 42.

^b Minus means before Peak or Trough, plus after.

^c For this row the score at time of change was made in anticipation of disorderly market. Number in parentheses pertains to change in policy in recognition of cyclical turn.

TABLE II-5
FOMC Average Certainty Scores at Dates of Policy Changes

Peaks			Troughs		
Brunner-Meltzer Score (1)	Number of Policy Changes (2)	Average Certainty Score (3)	Brunner-Meltzer Score (4)	Number of Policy Changes (5)	Average Certainty Score (6)
$\frac{1}{8}$	7	53.9	$-\frac{1}{3}$	1 ^a	40
$\frac{1}{4}$	6	63.3	$-\frac{1}{4}$	3	86.7
$\frac{1}{2}$	8	71.3	$-\frac{1}{2}$	4	96.3
1	1 ^a	45.0	-1	0	—

Source of cols. 1, 2, 4, and 5: Brunner and Meltzer, *An Alternative Approach*, pp. 119-124.

^aThe author argues in the text that these scores were inappropriate and do not properly reflect the Committee's actions.

and Meltzer, averaged about two months after the turns; the average degree of certainty was about 50 and the range was 70 to 35. (See Table II-4.)

For the three troughs studied, there was an average lag of two months before the Federal Reserve first indicated a desire to change the direction of policy. In the months of such changes, the mean certainty score was about 75, ranging from 95 to 40. Major changes in policy were made after an average lag of three months; the certainty score for each major change was 95. (See Table II-4, columns 4, 5, and 6.)

The Committee changed policy in the direction of ease about three times as often as it switched policy toward tightness. There were twenty-two policy actions at peaks, seven of which were minor. There were only eight actions taken at troughs, one of which was minor. (See Table II-5.) For both peaks and troughs, the more decisive the action taken, the greater the mean certainty score. The mean certainty score achieved by the Committee at the time of major changes in the direction of ease was substantially lower than the mean score achieved when changes were made in the direction of tightness. (See Tables II-4 and II-5.)

This general relationship between the Brunner-Meltzer scores and the certainty scores indicates that the Committee changed policy at peaks

on less conclusive evidence than it required at troughs, and that its decision-making process in the vicinity of peaks proceeded by successive approximations. Given that, on the average, decisions to ease are made at lower certainty scores than decisions to tighten, this indicates that signs of a probable peak signal the "need for action" while signs of recovery do not. The Committee switched to tightness only after conclusive evidence was available that cyclical recovery was underway and only after being convinced that its action would not "nip the recovery in the bud." But at peaks, the Committee attempted to stimulate economic activity upon signals indicative of a probable recession, without waiting to be sure that changing business conditions were cyclical in nature.

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Conclusions

Utilizing the Federal Open Market Committee's discussions of business conditions as given in its minutes, this study has assessed the ability of the Committee to anticipate and recognize cyclical peaks and troughs between 1947 and 1960. A scoring system developed by Rendigs Fels for evaluating forecasts was used to quantify the Committee's views of future economic conditions. Beginning three months before the NBER dates of postwar business cycle peaks and troughs and ending six months afterward, the FOMC's forecasts were scored. These scores represent an estimate of the probability of a cyclical turn implicit in the Committee's discussion of business conditions. The scores for this ten-month period are called the recognition pattern and they indicate the Committee's ability to recognize a cyclical turn as it is approached and then passed.

From this pattern of scores, two characteristics have been selected as being particularly useful for evaluating the FOMC's forecasts. The period between the date of a turn and the time when the Committee first indicates that it believes a turn is more likely than not is defined as the recognition lag. The period between the date of the turn and the