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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 time when the Committee first indicates that it is virtually certain that a turn has occurred is defined as the confirmation lag.

Using these three concepts—the recognition pattern, the recognition lag, and the confirmation lag, the FOMC's forecasts were compared with those of the eight business analysts studied by Fels. Next, the Committee's policy decisions were related to its recognition pattern to determine the relationship between the Committee's views of economic conditions and its policy decisions.

This attempt to quantify the Committee's forecasts, to assess its ability to recognize cyclical turns, to compare its performance with that of other forecasters, and to relate its recognition pattern to its policy actions revealed the following:

1. The beginning date of the Committee's recognition pattern varied from one to nine months before the cyclical turn. The pattern at the four peaks (1948, 1953, 1957, 1960) generally began before that at the three troughs (1949, 1954, 1958). The two peaks (1953 and 1957) for which the pattern began earliest are those which both the Committee and the business publications found easiest to recognize. On the other hand, the ending of the recognition pattern varied from one to seven months after the turn, and the pattern for troughs ended before that of peaks. With the exception of the 1948 peak, the Committee was certain of the occurrence of a turning point within six months after the NBER date of the turn. At the date of the turn, the estimated probability was generally below 50; it reached the vicinity of 50 about two months after the turn.

2. The Committee's comments on the business outlook in the vicinity of cyclical turns exhibit the same general pattern as that found by Fels for the business publications: "As time goes by, analysts become increasingly aware of first the possibility, then the probability, and finally the certainty of a turning point." [117]

The over-all performance of the Committee in recognizing postwar turns is not particularly impressive when compared with that of other forecasters.[118] Its performance was about the same as the average performance of the eight business analysts. The Committee and the other forecasters had mean certainty scores in the vicinity of peaks which were strikingly similar. At troughs, however, the business analysts

[117] See Part I, p. 47.

[118] See, however, p. xvi above.

"recognized" turning points earlier than the Committee but "confirmed" their occurrence later.

3. The Committee has systematically been quicker to reverse the direction of policy at peaks than at troughs, but it did so at substantially lower certainty scores. At peaks, action was taken soon after the Committee became aware of the probability of a recession. At troughs, changes in policy were made only after the FOMC was virtually certain that cyclical recovery was underway.

4. The Committee's actions in the vicinity of peaks indicate the difficulties involved in the concept of an inside lag or recognition lag measured by a single number. The recognition of cyclical turns is a gradual process and monetary policy, being a highly flexible tool, can be slightly modified as the Committee's assessment of the outlook slowly changes. For example, in 1957 the Committee made slight adjustments in policy during both August and September (the peak occurred in July). Neither change was made primarily because of concern about an anticipated peak, yet the Committee was aware of changing business conditions and this awareness was probably a factor contributing to its decisions. A similar case occurred in 1953. In June, a month before the peak, the FOMC injected reserves into the market primarily because of an anticipated disorderly market in government securities. However, concern about the future direction of economic activity may have influenced the Committee's decision. Again, in 1960 the Committee began to change policy in the direction of ease three months before the NBER date of the peak and continued easing almost continuously for the next several months. What is more, the decision in February was made because the Committee recognized the deceleration in economic activity. However, the minutes show that the members were not anticipating the approaching downturn nor did they think a peak probable.

5. At both peaks and troughs, the more confident the Committee was that changing business conditions were cyclical in nature, the more decisive its action.