A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, May 2, 1967, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Brimmer
Mr. Daane
Mr. Francis
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Sherrill
Mr. Swan
Mr. Ellis, Alternate for Mr. Wayne
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Hickman and Galusha, Alternate Members of the Federal Open Market Committee

Messrs. Bopp and Clay, Presidents of the Federal Reserve Banks of Philadelphia and Kansas City, respectively

Mr. Holland, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Molony, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Brill, Economist
Messrs. Baughman, Craven, Garvy, Hersey, Jones, Koch, Partee, Ratchford, and Solomon, Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Fauver, Assistant to the Board of Governors
Mr. O'Connell, Assistant General Counsel, Legal Division, Board of Governors

Mr. Reynolds, Adviser, Division of International Finance, Board of Governors
Mr. Bernard, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors
Miss McWhirter, Analyst, Office of the Secretary, Board of Governors

Messrs. Kimbrel and Coldwell, First Vice Presidents of the Federal Reserve Banks of Atlanta and Dallas, respectively
Messrs. Eisenmenger, Eastburn, Mann, Taylor, Tow, and Green, Vice Presidents of the Federal Reserve Banks of Boston, Philadelphia, Cleveland, Atlanta, Kansas City, and Dallas, respectively
Mr. Deming, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Kareken, Consultant, Federal Reserve Bank of Minneapolis

Chairman Martin welcomed Mr. William W. Sherrill, recently appointed to the Board of Governors, to his first meeting of the Federal Open Market Committee. The Chairman noted that Mr. Sherrill had executed his oath of office as a member of the Committee prior to today's meeting.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on April 4, 1967, were approved.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period April 4 through April 26, 1967, and a supplemental report for April 27 through May 1, 1967. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs said that the Treasury gold stock would remain unchanged again this week. Since the Stabilization Fund had more than $100 million of gold on hand, he would assume that no reduction in the gold stock would be required for at least several weeks to come.

Mr. Coombs commented that the London gold market had been very badly shaken by the publicity given to recent statements on U.S. gold policy contained in a publication of the Chase Manhattan Bank and in a speech by the president of the Bank of America. It was likely that those statements had brought about a permanent change in market thinking, and they had probably lifted the underlying demand for gold to a new high level. As a result of the statements, the gold pool lost about $25 million during April. Since the pool might well have been in surplus during April if the statements had not been made, their true cost probably was closer to $50 million, and that was likely to represent only the first instalment. The one factor that had kept the market from a major crisis had been the continued abnormally high flow of South African gold; the running down of South African gold reserves had increased the flow by nearly 40 per cent above normal in recent months. As soon as South Africa halted the present reserve drain and sought to rebuild its gold reserves, as it had after each previous period of drain, the supply of gold reaching London would drop sharply below current levels, perhaps by more than 50 per cent, and the gold pool would be exposed to the full brunt of speculative buying. As of the moment the pool's resources were only $85 million. The prospective deterioration in the U.S. balance of payments during 1967, together with the escalation of the war in Vietnam, seemed likely to aggravate the gold market situation still further, and it was entirely possible that before the summer was out there could be a major crisis in the London market.

On the foreign exchange markets, Mr. Coombs continued, sterling had had another good month during April. He expected that the British Government announcement, to be made this morning, would indicate that their reserve increase had been in excess of $100 million. At least part of the inflow to the U.K. probably reflected the comparative advantage which the British were continuing to maintain by keeping credit conditions in London relatively tight and rates relatively high compared to other centers. If the Bank of England had followed the discount rate cuts by the Federal Reserve and the German Federal Bank, it was likely that that would have triggered off sympathetic moves by central banks of the Netherlands, Belgium, and Sweden. The main justification for

Britain's holding back in that way was that they had been most anxious to pull in enough money during April and early May to finance, as far as possible, a very large prepayment--roughly $400 million--to the International Monetary Fund, and a payment to Switzerland, both of which they hoped to make around the middle of May. They had made good progress in getting the money together, and that might open the way for an early reduction in the Bank rate.

Mr. Coombs said that the dollar had weakened appreciably on the continental markets, and the continental central banks were again taking in dollars. As his written report indicated, the System had found it necessary last Friday to use $15 million equivalent of the fully-drawn portion of the swap line with the National Bank of Belgium to absorb some of that Bank's dollar purchases. In the case of the Swiss franc, the spring months were normally a period of weakness and in earlier years the System or the Treasury had been able to pick up as much as $150 million of Swiss francs during that period. It had not been possible to acquire Swiss francs this year; the same apprehension that was affecting the gold market, together with a liquidity squeeze in Zurich, was frustrating the normal pattern. The Swiss franc had moved close to its ceiling and there would probably be heavy flows of funds to Switzerland during the summer months. In fact, nearly all of the continental currencies might strengthen further over coming months, and it seemed quite possible the System might have to make very heavy drawings on its swap lines between now and next fall.

Mr. Robertson asked whether Mr. Coombs knew of any basis for assessing the accuracy of recent reports to the effect that the production of gold in Russia had been accelerated.

Mr. Coombs replied that the Central Intelligence Agency, which followed the Russian gold situation reasonably closely, had published a report a few years ago which tended to discount stories about important new gold discoveries in Russia. He did not know whether that agency had prepared a more up-to-date version of its report, which had suggested that Russia was producing no more than $150 to $200 million of gold per year.

Mr. Brimmer inquired about the extent to which continental central banks might have benefited from the recent reflow of funds to the Euro-dollar market through foreign branches of U.S. banks.

Mr. Coombs said he thought that the main beneficiary thus far had been the Bank of England, but clearly some of the funds had gone to the continent. More generally, there had been a tendency for dollars to shift from private to foreign official hands--an important and dangerous development which was likely to have implications for the System's use of its swap arrangements. In part, perhaps, that development was a consequence of the continued relative tightness of the continental money markets, but in part it was attributable to the alarms of recent months about the outlook for the international monetary system.

> By unanimous vote, the System open market transactions in foreign currencies during the period April 4 through May 1, 1967, were approved, ratified, and confirmed.

Mr. Coombs noted that the System's standby swap arrangement with the Bank of England in the amount of $1,350 million would reach the end of its twelve-month term on May 31, 1967. He recommended its renewal for another full year.

> By unanimous vote, renewal for a further period of twelve months of the $1,350 million standby swap arrangement with the Bank of England, scheduled to mature on May 31, 1967, was approved.

Mr. Coombs then reported that he had had discussions with the Governor and Deputy Governor of the Bank of Mexico regarding a possible standby swap arrangement with that Bank, and they had indicated that they would be prepared to join in an arrangement in the amount of $130 million. They had apparently chosen that figure to round out to an even $500 million the total of their swap line with the System, their $100 million swap line with the Treasury, and their International Monetary Fund quota of $270 million. Although $130 million was an unusual figure for a swap arrangement he did not think it raised any substantive question and would recommend its acceptance. From his conversations with the Mexicans it seemed quite clear that they understood the rules of the game as they had been developed in connection with the swap network and could be relied upon to adhere to them. He understood that the Bank of Mexico had accomplished all of the necessary clearance within their Government and that they would be prepared to make the agreement final within the coming week. Mr. Lang of the New York Reserve Bank staff would be going to Venezuela this week in order to discuss the swap network with the Governor of the Bank of Venezuela and to brief him on the progress of the negotiations with Mexico. The Bank of Mexico had been advised that the Venezuelans would be kept informed.

Mr. Coombs noted that he had also been in touch with officials of the National Bank of Denmark. They told him that Denmark had qualified for Article VIII status in the International Monetary Fund yesterday and that they would be prepared to join in a swap agreement with the System, in the amount of $100 million, at almost any time. They still felt, however, that it would be useful for the announcement of a swap arrangement between their Bank and the System to be timed to coincide with an announcement of a similar arrangement between the Bank of Norway and the System. There was a problem in this connection, however, since the Norwegians were still negotiating with the IMF about one remaining technical obstacle to their qualification for Article VIII status. Even after they reached agreement in substance with the Fund, it might take a little while for all of the formalities to be cleared up. He could see some possible advantage in anticipating the completion of such formalities by proceeding with the swap arrangement with the Bank of Norway once they had reached agreement in principle with the Fund. In his judgment there would be advantages in announcing all of the new agreements simultaneously rather than sequentially; the latter procedure might lead to some speculation as to how far the System might be intending to go in broadening the network to include other countries.

Mr. Coombs said he would, therefore, recommend Committee approval of new standby swap arrangements in the amount of $130 million with the Bank of Mexico and $100 million with the National Bank of Denmark. He would also recommend approval of a $100 million arrangement with the Bank of Norway, contingent on their indicating that they had reached an agreement in principle with the International Monetary Fund which would enable them to qualify for Article VIII status as soon as the necessary papers were executed. He believed that all three central banks would be prepared to join in standby swap arrangements with a maturity of a full year.

Mr. Mitchell commented that the System would be placing Venezuela in a difficult position if it declined to make a swap arrangement with them because they had not attained Article VIII status, and at the same time entered into an arrangement with Norway before that country had met the requirements of Article VIII. He thought it would be preferable to give Venezuela the same opportunity that

Mr. Coombs was suggesting should be given Norway; if they could achieve Article VIII status, it would be appropriate to include a swap line with them in the package.

Mr. Coombs said he suspected that Venezuela's qualifying under Article VIII would involve a rather lengthy process. In the case of Norway, on the other hand, only a few weeks were likely to be required to complete the negotiations and to process the necessary papers.

Mr. Mitchell replied that he still believed the Venezuelans would be put at a disadvantage in the Carribean if they were not given a chance to achieve Article VIII status before the System announced new swap arrangements with Mexico and the two European countries. He thought it would be better to defer action on the other arrangements until discussions were held with the Venezuelans. If Mr. Coombs was correct in his judgment that they could not achieve Article VIII status relatively soon, they would at least be informed for the present, and a swap arrangement with them could be made at some future date. It was important to avoid any suggestion of discriminatory action.

Mr. Brimmer recalled that at its previous meeting the Committee had agreed on the desirability of holding informal discussions with the Venezuelans.

Mr. Coombs noted that he had been authorized to negotiate with Mexico with respect to a possible swap arrangement, and to keep the Venezuelans informed. It was not until yesterday that the Mexicans had advised him that they were prepared to join in the arrangement. The Venezuelans would be informed about the discussions with Mexico in the course of Mr. Lang's forthcoming visit.

Mr. Solomon commented that when this matter was discussed at the previous meeting the judgment of the Committee had been that it was rather unlikely that Venezuela would attain Article VIII status soon enough to be included in the present package, but that it was important that they be informed of the standards for admission to the network before an arrangement with Mexico was announced.

Mr. Robertson said that he could see the justification for announcing the new swap arrangements with Mexico, Denmark, and Norway simultaneously but he did not understand the need for moving ahead on them before Norway had attained Article VIII status.

Mr. Coombs replied there was a potential reason for acting within ten days or so, which was related to the forthcoming maturity of the System's swap line with the Bank of France. He had intended to raise that subject next.

Mr. Robertson suggested that the Committee defer action on the three proposed swap arrangements until after Mr. Coombs had discussed the situation with respect to the Bank of France.

Mr. Coombs remarked that he had some rather unpleasant developments to report. It appeared that some of the System's swap network partners in the European Economic Community were trying to subject the network to a new dimension of surveillance by arranging to have the swap lines with the central banks of Common Market countries mature on the same date. He felt that they were planning eventually to go even further to seek also some sort of Common Market control over the actual drawings under the lines. This movement had begun in the Netherlands Bank, with considerable backing from the National Bank of Belgium. The attitude of the central banks of Germany and Italy had been relatively neutral; indeed, the Italians had made some effort to achieve a compromise that would be satisfactory from the point of view of the United States.

The Netherlands Bank official primarily concerned originally had been one of the strongest supporters of the swap network, Mr. Coombs continued, and it was not entirely clear why he was now engaged in an effort of this kind. Part of the explanation, perhaps, was that he had become increasingly pessimistic about the U.S. balance of payments problem and about the damage he thought the United States had done by "exporting inflation" to Europe in the process of running persistent payments deficits. Secondly, his views had shifted from an acceptance of the kind of exchange guarantee involved in the swap drawings to a preference for a gold guarantee. Third, he and others in the Netherlands had been consistently pessimistic with respect to sterling and had strenuously opposed some of the sterling rescue operations of the past three years. The fact that those rescue operations had been successful had not lessened his opposition, but had served only to increase his disaffection.

That disaffection had been particularly whetted by the increases in the swap lines negotiated last September, Mr. Coombs said. The first reaction of the Netherlands Bank official at that time had been to try to persuade all the Common Market countries to treat such increases as temporary and separate from the previous swap lines. His effort to develop a solid Common Market front on that point had been spoiled when the Germans and Italians agreed to consolidate their enlargements into new over-all swap lines. Having failed in that effort, he had shifted his objective to that of achieving a common maturity date for the various Federal Reserve swap lines--with all lines maturing at the end of each quarter--so as to facilitate surveillance by the Common Market central banks at renewal dates.

Those efforts to subject the Federal Reserve network to special surveillance, Mr. Coombs observed, had been pursued through private conversations with other Common Market central bankers. Although some of the latter had suggested open discussions with Federal Reserve representatives, thus far no direct approach had been made to the System. He (Mr. Coombs) had heard of the plan indirectly through the Germans and Italians, and had urged those central banks not to participate in it.

Mr. Coombs noted that the Italians had attempted a compromise by suggesting that their swap line with the System, which was already on an annual basis, might be scheduled to mature at the end of each year. He thought that had been a constructive suggestion. The swap line with the German Federal Bank was on a six-month basis, and when it had approached maturity in February the Germans had agreed to its renewal for another six months, through August. The swap lines with the National Bank of Belgium and the Netherlands Bank had been scheduled to mature around the middle of March, and ten days in advance a telex had been sent to both banks proposing renewal for another three months. The Dutch had not replied at all. The Belgians' reply indicated that they were agreeable to renewal, but would like to place the next maturity date at June 30 rather than at the normal maturity date of June 13. In reply they had been told that unless they had a strong preference for June 30 the Federal Reserve would prefer to employ the normal date, and if they did have a strong preference for June 30 the System would like to know the reason. There had been no response to that message. At the Basle meeting held a few days later, he had approached the Belgians directly with a request for an explanation of their preference for a June 30 maturity date. They had replied that that preference was based on "purely internal reasons." He had then agreed to a June 30 maturity date, and the renewal was executed on that basis.

He had also approached the Dutch at the Basle meeting, Mr. Coombs continued, but their only response was that they wanted to hold further discussions within their own group. There was no word from them until the day before the arrangement matured, when they called the New York Bank and proposed June 30 as the new maturity date. He had been in Copenhagen at the time, and had instructed the New York Bank staff to inquire about the significance of the June 30 date. The response from the Netherlands Bank was that it was suggested "to facilitate consultation." At that late hour it was impossible to get in touch with the Committee. Accordingly, he had told the Trading Desk to agree to that date for purposes of the present renewal, but to indicate that the Federal Reserve would want to discuss the matter of future maturity dates before the June 30 maturity was reached.

The following weekend, Mr. Coombs said, he had met with a representative of the Netherlands Bank and had received the impression that the consultations contemplated by the latter might involve no more than the central banks of Belgium and the Netherlands. If that was the case, such consultations were likely to be relatively harmless; but the question remained as to whether they might be broadened to include all Common Market countries. As he had indicated, the German Federal Bank had not gone along with the approach in February and the Bank of Italy was removed from the issue by the fact that their swap line with the System had a one-year term. The key to future developments was the attitude of the French, whose swap line with the System would mature on May 10.

Recently, Mr. Coombs said, he had been approached by a representative of the Bank of France who said he simply wanted to give advance notice that if a three-month renewal was requested the French would be unable to agree; they were prepared to renew only to June 30. He (Mr. Coombs) had indicated in reply that such a proposal would raise significant questions of principle. Subsequently, Mr. Hayes and he had talked with officials of the Bank of France, and had urged them not to press for a June 30 maturity date. Mr. Hayes also had been in touch with the German Federal Bank and would be visiting that Bank again on Friday. And, of course, there would be discussions at the Basle meeting next weekend.

Superficially, Mr. Coombs observed, the question of coordinated maturity dates for swap lines with Common Market countries might not be considered a matter of great concern to the Committee. The underlying danger, however, was that the proposal reflected an intention of ultimately subjecting the System's network of swap arrangements with the Common Market countries to tight control by those countries acting in concert. That would give a disproportionate degree of power to small nations such as Belgium and the Netherlands.

In general, Mr. Coombs said, the events he had reported had a number of unfortunate aspects. First was the failure of the countries involved to consult the Federal Reserve directly. More importantly, the approach seemed to reflect an unwarranted attitude of distrust of U.S. motives and actions. The only justification that he could see for the intended consultations was the risk of some abuse of the swap network, while in fact there had been no abuse. The nature of the whole approach to the matter of uniform maturity dates suggested that it was a testing operation. His own strong inclination would be to have the issue thrashed out now, when the swap lines were virtually clear, rather than to let matters drift on and possibly come to a head during the summer months when there might well be heavy drawings outstanding under the swap lines.

At the previous meeting, Mr. Coombs noted, the Committee had approved his recommendation that the swap line with the Bank of France be renewed for three months when it matured on May 10. The French had now advised that they would not accept a renewal for three months, but only one through June 30. In effect, they had taken the initiative in trying to dictate terms to the Federal Reserve. His own view was that the System should not acquiesce. He would recommend that the French be told that the Committee would let the arrangement lapse if they were willing to renew it only until June 30. In the weekend discussions at Basle Mr. Hayes and he would be talking with the Germans and Italians on the matter, and it would be helpful to have the views of the Committee in this respect.

In response to the Chairman's request for comment, Mr. Daane said that he had mixed feelings. To a large extent he shared Mr. Coombs' views; in his judgment the effort to coordinate maturity dates of swap lines ran counter to the spirit of international cooperation that was reflected in past practice of undertaking bilateral arrangements to deal with disruptive swings in payments flows between countries. But while he sympathized with Mr. Coombs' view he found the underlying issue a difficult one to resolve.

Mr. Daane noted that he had discussed the matter with Under Secretary Deming who, like Mr. Coombs and himself, was disturbed about the implications of the recent developments in light of the purpose of the swap arrangements. Mr. Deming had suggested making a maximum effort at Basle this weekend to persuade the French to renew their swap line on the customary three-month basis. Whatever the French reaction, Mr. Deming would favor having the usual telex sent out, proposing a three-month renewal; and if the French rejected that proposal he would favor letting the arrangement lapse.

Mr. Daane said there was much merit in the case Mr. Coombs had made for following such a course, but he was not sure that he could go along with it. There had been considerable pressure recently to extend the degree of multilateral surveillance a step further. He did not know whether this was the point at which the Federal Reserve should try to resist that pressure, and he did not know whether System efforts at resistance would be successful.

Mr. Daane's own recommendation would be to postpone any decision with respect to the French swap line until it was learned what course the Germans and Italians were likely to follow. If they were willing to retain the present maturity dates he was not sure that it would make a great deal of difference whether or not the arrangement with the French was permitted to lapse. On the other hand, if it was clear that the Germans and Italians were going to join in the movement to common maturity dates he did not think there was anything to be gained by dropping the French swap line. In short, he thought the Committee needed more information before it could reach an appropriate decision. He favored one more effort this weekend to persuade the French to stay with the 90-day maturity date, and he thought Mr. Coombs should be authorized to report that it was the Committee's view that the arrangement should be renewed, and for 90 days. He would also favor talks on the subject with the Germans and Italians this weekend. If they were prepared to join with the French he was not sure the Committee could stave off a common maturity date. If they were not, it would be very useful to have their counsel.

Mr. Coombs observed that the attitude of the Italians posed no problem, since they had already indicated they were fully prepared to retain a one-year period for their swap line, with maturity at the end of the year. The Germans at the moment were not on a quarterly basis; as he had indicated, they had agreed in February to a six-month renewal, and their swap line would mature on August 9. He was hopeful that they could be persuaded to renew the line for another six-month period at that time. However, if the System agreed to a June 30 maturity for the line with the Bank of France, the Germans would be put under very heavy pressure. Perhaps the best hope was to try to persuade the French to defer the question, if only to extend to the System the courtesy of having an opportunity for thorough discussion. Central bank relations were based on a spirit of mutual trust and confidence, and unilateral actions were contrary to that spirit.

Mr. Coombs added that the costs of permitting the swap line with the Bank of France to lapse could easily be exaggerated. That line had been useless for some time, and market participants were aware of that fact. Indeed, there would be an advantage in discontinuing the French swap line; if France was no longer a member of the network, any plan for coordinated surveillance of swap line activity by all the Common Market countries would fall through.

Mr. Daane said he had two additional comments. First, he thought further consideration had to be given to the question of whether agreement on coordinated renewal dates for the swap lines with Common Market countries would necessarily mean that those countries subsequently would move toward control of the conditions of use of the lines. Secondly, an official of the Bank for International Settlements had suggested that part of the present ferment about the swap lines might reflect the enlargements that had been made last fall. Accordingly, while the enlargements had been useful and necessary at that time, he (Mr. Daane) wondered whether it might not be helpful in the present situation to suggest some over-all cutback in the sizes of the swap lines.

Mr. Coombs replied that if the Dutch or Belgians were to suggest a cutback in the size of their lines he would propose simply to repeat what he had said in the past--namely, that the System wanted no reluctant partners in the network, and if any partner thought a line of the present size was not to its benefit the System would agree to reduce it. On the other hand, a general scaling down of the network was likely to have unfortunate effects on market confidence.

Mr. Brimmer said that he would favor following the course Mr. Coombs had recommended with respect to the swap line with the Bank of France. To agree to a renewal only for the period until June 30 would appear to him as going a long way toward accepting multilateral surveillance by the Common Market. The Committee had resisted such surveillance in the past and he thought it should continue to do so.

Chairman Martin commented that he thought Mr. Coombs had taken the right approach in his negotiations on maturity dates. He agreed that it would make little difference from the point of view of monetary affairs whether or not the swap line with the Bank of France was renewed, since it had not been used for several years. However, that decision might have important international political implications, affecting the foreign relations of the United States. He would be reluctant to see the Federal Reserve take any action that could be construed--whatever the facts of the matter--as a System initiative to discontinue the swap line with the French. Accordingly, he would favor deferring a decision until after the System's associates in the network could be consulted at the Basle meeting this weekend.

Mr. Brimmer asked whether it was the Chairman's feeling that the Committee should run the risk of having its swap arrangements brought under the surveillance of the Common Market. The Chairman replied that it was not yet clear to him how serious that risk was, since much depended on the attitudes of the Germans and Italians.

Mr. Mitchell agreed that Mr. Coombs had taken the right approach in his discussions about renewal dates with the Belgians and Dutch, as well as with the French. He also agreed that the swap line with the Bank of France had been of no value for a number of years. However, there were likely to be political repercussions to any announcement that that line had been discontinued. He did not know what the political consequences of that step would be, and he questioned whether the Committee was in a position to assess them accurately.

tell the French that it was unlikely that the Committee would agree to renew their swap line only until June 30.

Mr. Treiber noted that both Mr. Coombs and Mr. Hayes would be in Basle this weekend and would be holding full discussions with the French, Germans, and Italians. It would be helpful to them if the Committee today reaffirmed the action it had taken at the previous meeting of authorizing an extension for three months in the swap line with the Bank of France. If the French proved to be adamant, there would still be time before May 10 for the Committee to hold a telephone conference meeting for the purpose of reviewing the developments at Basle and considering the best course of action.

Mr. Daane concurred in Mr. Trieber's suggestion.

Mr. Maisel commented that before reaching a final decision it would be desirable to consult with the Treasury and the State Departments on the political implications of various courses of action.

Chairman Martin agreed that the Committee should reaffirm the action it had already taken with regard to the French swap line if that was likely to be helpful to Messrs. Hayes and Coombs in their discussions at Basle. But he would not cross the bridge of deciding to discontinue that swap line until there was a better opportunity to assess all of the implications of that action. It would be unfortunate, he thought, if the French were in a position to say that they had been prepared to renew the line but the Federal Reserve had refused to go along.

Mr. Coombs commented that he also had been concerned about political effects. He had assumed that the current international liquidity discussions were one important area of possible repercussion. He gathered from Mr. Daane's remarks, however, that the Treasury would have no objection to discontinuing the line if the French insisted on the June 30 maturity date.

Mr. Daane said he understood it was the Treasury's impression that France's position in the liquidity discussions would not be affected by actions with respect to their swap line with the System. On the other hand, that was an initial reaction, and he was not sure that the Treasury had fully reviewed all of the political implications of the situation. It probably would be desirable for them, as well as for the System, to give further thought to possible consequences not only for the liquidity discussions but on a wider basis.

Mr. Coombs said it would be helpful if the Committee reaffirmed its action approving a three-month renewal of the French swap line. It would also be helpful if Mr. Hayes and he were able to report that it was the sense of the Committee that the proposals under discussion were contrary to the spirit of cooperation underlying the swap network.

Mr. Daane remarked that he thought it would be appropriate for Messrs. Hayes and Coombs to point out that the proposals were viewed by the System and the Treasury as inimical to the spirit of the network.

Mr. Hickman said that in his judgment the approach Mr. Coombs had suggested was exactly right. However, in view of the fact that the Committee had been working to extend the network and to increase its usefulness, he was concerned about the possibility that some other present members might follow if the French dropped out. Accordingly, he hoped it would be possible to continue the swap line with the French.

Mr. Mitchell remarked that if a special meeting was found to be needed the Committee might consider convening in Washington rather than holding a telephone conference, which was a rather unsatisfactory way to conduct a discussion. In his judgment the French were not likely to yield on the matter at issue.

Mr. Robertson said he thought the procedures that had been outlined were good. If the French proved to be adamant he would not favor having the System back down.

Mr. Brimmer commented that he assumed the Committee would not only reaffirm its previous decision regarding a three-month renewal of the French swap line today, but that it would also authorize Mr. Coombs to indicate that it was disturbed by the recent developments.

Chariman Martin agreed. As he had indicated, however, he thought that the Committee should not reach a decision today regarding the French swap line if the Bank of France was not agreeable to a three-month renewal. Such a decision should be held in abeyance until more information was available.

No disagreement was expressed with the Chairman's statement.

> By unanimous vote, the Committee reaffirmed its action of April 4, 1967, approving renewal of the $100 million standby swap arrangement with the Bank of France for a further period of three months.

Mr. Coombs then noted that he had requested Committee approval of new standby swap arrangements with the Banks of Denmark and Mexico, in the amounts of $100 million and $130 million, respectively, with terms preferably up to a full year. He had also requested approval of a $100 million arrangement with Norway, preferably for one year, if they indicated that they had reached agreement in principle with the Fund as to their achieving Article VIII status within the very near future, and that only final arrangements remained to be completed. It would be his hope that all three new arrangements could be announced at the same time.

Mr. Robertson asked whether it might not be better to wait until Norway had actually achieved Article VIII status before acting on any of the new swap arrangements.

Mr. Coombs replied that if the swap line with the Bank of France were to be discontinued there would be some advantage in announcing all four actions simultaneously. He would not expect any particular market effects from dropping the French swap line, but a simultaneous announcement of three new lines would lessen whatever effects might occur.

Mr. Solomon suggested that the Committee might want to weigh two other considerations. First was the general question of the desirability of admitting a country to the swap network before it had achieved Article VIII status. Secondly, the three central banks with whom the new arrangements were to be made might have questions about the System's motives in making a simultaneous announcement of all four actions. That consideration might outweigh the advantages of a simultaneous announcement since, as Mr. Coombs had indicated, the market effects of dropping the swap line with the Bank of France were not likely to be great in any case.

Mr. Swan concurred in Mr. Solomon's comments.

Mr. Treiber remarked that if the French agreed to a three-month renewal, there would not be any important reason for approving the swap line with Norway before they achieved Article VIII status. On the other hand, if the French did not agree, the Committee planned to hold a special meeting in the course of which it could reach a decision on Norway. Accordingly, he thought no action with respect to the Norwegian swap line was necessary today.

Chairman Martin then suggested that the Committee defer action with respect to the proposed new swap arrangements with the central banks of Norway, Denmark, and Mexico until May 23, or until the special meeting of the Committee if one was held before that date.

There was no disagreement with the Chairman's suggestion.

Chairman Martin then invited Mr. Daane to report on the recent joint meeting of the Deputies of the Group of Ten and the Executive Directors of the IMF.

Mr. Daane noted that the Deputies had met with the Executive Directors of the Fund on April 24 and 25, and for part of the day on April 26. At a press conference held on April 26, Mr. Schweitzer had summarized the developments in the following words: "I think that once more these meetings have proved very useful and very successful and I think we can state with confidence that great progress is being made. I think it is now unanimously agreed that we should proceed with work toward the establishment of a plan for the deliberate creation of supplementary reserves. I think also that everybody is willing to make the maximum effort to make it possible that at the Rio de Janeiro meeting, where our Governors will convene in September, they will already have before them, let's say, the broad outlines of a plan."

What lay behind Mr. Schweitzer's words, Mr. Daane continued, were two and a half days of discussion of the need for new reserves and of the illustrative schemes for reserve asset creation prepared by the Fund staff. In the course of that discussion the U.S. representatives had made a forthright and persuasive case for the proposition that the need for new reserves might be closer rather than further away. As Chairman Emminger himself had said, it appeared that the time for activating a contingency plan was nearer than had been thought a year ago. On the basis of the discussion at the meeting, and at the Munich meeting of the Common Market Finance Ministers on April 17-18, it appeared that there was now unanimous agreement on going forward with respect to a plan; the French had moved that much. The French also had moved to the extent of accepting an unconditional reserve asset in the form of drawing rights without specific credit-like repayment provisions. There was considerable discussion of the alternatives of reserve units and drawing rights. The representatives of the U.S. and other non-EEC countries had insisted that the new asset be money-like rather than credit-like, in order to be a true supplement to gold and dollars.

On the technical side, Mr. Daane continued, the issues still remained of whether, whatever the label, the new asset should be transferable directly or indirectly; whether it should involve pooled resources within the Fund, or separate resources in the Fund or in a Fund affiliate; and whether or not repayment provisions should be attached to the asset. The most important unresolved issue, however, was that of decision-making. The Common Market countries wanted a requirement for a majority of 85 per cent of votes in the Fund, plus a majority of creditor countries. Such requirements would give veto power to the Common Market, and were strongly resisted by other countries, including the United States. Probably that major issue could not be decided at the technical level by the Deputies and Directors, but would have to go to the Ministers and Governors.

Mr. Daane noted that the Deputies would meet again on May 18-19, and that a final joint meeting with the IMF Directors would be held shortly after mid-June. He thought it was fair to say that solutions could be found to the technical issues, and that the elements of a plan, if not a full-blown plan itself, could be available by the time of the meeting in Rio in September.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering open market operations in U.S. Government securities and bankers' acceptances for the period April 4 through April 26, 1967, and a supplemental report covering the period April 27 through May 1, 1967. Copies of both reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Holmes commented as follows:

> Since the Committee last met, short-term interest rates have moved sharply lower, but, despite the reduction of the discount rate, long-term rates have moved significantly higher. The reasons for these disparate developments are not hard to find. Short-term rates have of course been influenced by the comfortable money market and by seasonal demands for Treasury bills from corporations and public funds as well as from net System purchases. Long-term interest rates on the other hand have been under sustained upward pressure from the heavy weight of corporate and municipal demand for capital. In addition there has been a sharp turnaround from pessimism to optimism in the market's expectations about the future performance of the economy, and, more recently, an adjustment for the current Treasury refunding. Changed market expectations about the economic outlook have also led to the belief that not much more in the way of ease can be expected from monetary policy. With the refunding, market participants have begun to focus on the heavy cash needs of the Treasury and of Government agencies in the second half of the year. The current $12 billion estimated Treasury cash need is generally regarded by the market as a minimal estimate. Against the backdrop of the 1966 experience these recent and prospective economic and financial developments have

combined to produce growing uneasiness in long-term markets. Late last week this heaviness spilled over into the intermediate- and short-term market as well.

As the blue book[1] states, the outlook for yields in the capital markets is quite uncertain. The fundamental question is how strong the economy is going to get and how soon. Given the recent rise in yields--as much as 35 basis points for intermediate Government securities and about 20 to 40 basis points on long-term corporate and municipal securities--there are a number of market participants who feel that the pendulum has swung a bit too far and that present yields could provide a trading range for some time to come. The technical position of the Government bond market, where dealers had worked down their holdings of coupon issues substantially before the refunding announcement, is relatively good, and a moderate price rally could be in the cards. The position of the corporate and municipal market, on the other hand, is not so good and little relief seems in sight from the demand side until mid-year at least. Underwriters are quite disheartened by the state of demand and by the rapidity with which inventory profits have turned into losses. All of this, of course, is a commentary on the recent volatile state of expectations.

Yield developments may rest heavily on the strength of private demands for bank loans. If they are relatively weak over the next few weeks--a distinct possibility in the light of the volume of long-term funds being raised--banks might be tempted to stretch out their average maturities of municipals and Governments. Bank demand for liquidity is still strong, but the rate developments of the past few weeks now exact a significant penalty for staying short. Looking further ahead, there are some who anticipate a slackening of private demand for capital in the second half of the year. But there are others who see strong private demand continuing, and in light of the heavy Government demand, including participation certificate sales, a few are going so far as to wonder whether August will be early or late this year.

1/ The report, "Money Market and Reserve Relationships," prepared for the Committee by the Board's staff.

As far as short-term rates are concerned, the outlook is still for some further downward drift in the weeks ahead unless expectations of a booming economy and an end to easy money are such as to outweigh the normal demand-supply factors. In yesterday's Treasury bill auction, issuing rates of 3.77 per cent and 3.91 per cent were set respectively for 3- and 6-month bills, 21 and 9 basis points below the levels established in the auction preceding the last Committee meeting.

System operations supplied a fairly large volume of reserves on a day-to-day basis since the last meeting, as the written reports have spelled out. We bought some coupon issues early in the period, purchased Treasury bills outright on several occasions when the over-hanging market supply seemed rather heavy, and made temporary reserve injections through repurchase agreements. We encountered no real problems in keeping the money market comfortable although, as the written reports note, there were unusually wide fluctuations in free reserves from week to week. The bank credit proxy came out about as expected in April, and as the blue book notes a sharp slowdown is expected in May. It would be helpful in interpreting the proviso clause of the directive[1/] if the Committee members would comment on the general acceptability of such a slowdown.

As you know, the books will be open through tomorrow on the Treasury refunding of May maturities and the prerefunding of June and August maturities. Initially, market participants considered both issues attractively priced. Prices of the refunding issues have held up fairly well in the generally soggy market atmosphere since Friday, although many investors have tended to become cautious. There was some recovery in the intermediate area of the market yesterday after a weak opening, but the market's performance today and tomorrow will have an important bearing on the outcome. There seems to be a very good interest in the shorter of the two options on the part of large commercial banks. Banks outside the money centers hold a substantial part of the rights issues and may find the 4-3/4 per cent coupon on the five-year note attractive, but it is still too early for the market to have even a fair idea of what the

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1/ A draft directive submitted by the staff for Committee consideration is appended to these minutes as Attachment A.

ultimate exchange will be. Expectations are for a less than average interest from holders of August rights, but even a modest exchange of about 20 per cent would reduce the Treasury's August refunding job by about $1 billion and would give some additional debt extension. There seems to be little danger that dealers will wind up with an overextended position in the new issues.

The System holds close to $6.4 billion or about two-thirds of the maturing May 4-1/4 per cent Treasury notes and I would plan, unless the Committee has other views, to place $2 billion of that amount in the new 5-year note, with the remainder going into the 15-month note. This would seem a reasonable distribution in the light of the very ample short-term holdings in our portfolio and the fact that the average maturity of our holdings has been shortening over time.

The System also holds about $107 million of the 2-1/2 per cent Treasury bonds maturing June 15, and I would plan to place this amount also in the new five-year note. In view of the uncertainties of the past few days the market has been singularly unwilling to estimate the likely size of the two new issues. As a wild guess we could end up with about half of the longer issue and a somewhat higher percentage of the shorter issue. I would not plan to prerefund any of our holdings of August maturities.

By unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period April 4 through May 1, 1967, were approved, ratified, and confirmed.

Chairman Martin then called for the staff economic and financial reports, supplementing the written reports that had been distributed prior to the meeting, copies of which have been placed in the files of the Committee.

Mr. Partee made the following statement on economic conditions:

One of the editorials in the Washington press last weekend was entitled "Spring is for Optimists." That is certainly true so far as views on the business outlook are concerned. As everyone in this room is well aware, there has been a very marked improvement in expectations for the economy since the Committee's last meeting. The stock market has reacted buoyantly, rising in virtually all trading sessions--and on substantial volume--over the past three weeks. And bond markets have been correspondingly weak, reflecting both the change in investor sentiment and the continuing heavy volume of new offerings. Most people are now looking through the current period of flatness to renewed vigorous economic expansion later in the year and extending into 1968.

To be sure, the aggregate business measures currently are not a great deal better than was anticipated a month or two ago. The preliminary estimate for first-quarter GNP shows a rise of only $5 billion in current dollars and no net gain in real terms. And the staff projection in the green book,[1/] with which I am in general agreement, forecasts a second quarter rise of only $8 billion in current dollars and less than 2 per cent, annual rate, in real terms--well below the economy's growth potential.

Moreover, there may well be some less favorable economic news items in coming weeks--perhaps enough even to shake the current ebullient sentiment. The substantial rise in insured unemployment over the past two months, for example, suggests weakness in some labor markets; unemployment could rise further, particularly in manufacturing, though we have just learned confidentially that there was very little rise in the over-all unemployment rate in April. Housing starts over the next month or two may not be able to keep up with the very large increases assumed on seasonal grounds alone. The exceptional strength in retail trade indicated in the March advance report may have been exaggerated, though I should note that the weekly figures through the third week of April continued favorable. New car sales,

1/ The report, "Current Economic and Financial Conditions," prepared for the Committee by the Board's staff.

though improved, are not so strong as the year-to-year changes suggest, since the comparison is with a declining trend last spring. With the widely varying timing impacts of sales contests, a bad 10-day report or two is always possible. And the possibility of disruptive strikes and labor difficulties in coming weeks and months of collective bargaining is of course very real.

Nevertheless, it seems to me that the confidence in the underlying strength of the economy is well founded. Within the aggregates, final demands have been considerably stronger--and the reduction in inventory accumulation correspondingly larger--than we had anticipated a month or two ago. Even if revised figures should reduce the dimensions of this shift in the mix of demand, the underlying increase in final demand still seems certain to remain substantial. Stock-sales ratios are still very high, and we think that the inventory adjustment still has some distance to go. Further progress has to be made in cutting back inventories in those areas where they seemed clearly excessive, such as consumer durables and industrial materials. But if the strengthening in final demand persists, as seems likely, this means that needed inventory adjustments will be smaller and can probably be accomplished with only moderate further output curtailments.

Another aspect of the underlying strength of the economy is the failure of recessionary forces to spread and intensify. Thus, the declines to date in employment and hours have been confined mainly to the more volatile manufacturing sector, which in itself has been shrinking secularly relative to the total economy. Aggregate personal incomes have continued to show good--though somewhat diminished--gains, which supports the expectation of further expansion in consumption outlays. The counterpart of a larger rise in personal incomes than in GNP, of course, must be a shrinkage in net business incomes and/or an increased Governmental deficit. Corporate profits are down, but judging from our weighted compilation of first-quarter earnings reports, the year-to-year decline was surprisingly small--5 per cent or a little more. The more important adjustment, quantitatively, was an apparent sharp increase in the Federal deficit (on a national income basis), which reflected both a rise in expenditures and an indicated shortfall in tax accruals. This shift has done much to blunt what otherwise might have been a potentially serious inventory recession.

A third factor of strength in the economy is that several of the major areas of spending that are less dependent on current income flow--construction, business equipment, and military outlays--look somewhat stronger than seemed probable a month or two ago. The most recent McGraw-Hill survey of business capital spending plans showed no tendency toward downward revision compared with earlier surveys; with improved business confidence and greater credit availability, and assuming reinstatement of the investment tax credit as proposed, it now seems to me quite possible that there will be little or no decline in capital spending as the year progresses. In the construction area, where credit availability is also very important, a substantial expansion looks increasingly likely. Not only have savings flows to the specialized mortgage lending institutions been larger than expected, but sizable amounts of Federal funds impounded earlier have been released for public works projects. Finally, defense expenditures appear to be running moderately above the January Budget projections, and the recent news seems increasingly to point toward further near-term escalation of the military effort in Vietnam.

On the whole, therefore, there are good grounds supporting the expectation of significant strengthening in the economy. Our initial third-quarter projection calls for a sizable increase in GNP, and the implication is that there will be a still bigger increase when the inventory adjustment is largely completed--probably by the fourth quarter.

Meanwhile, we have been enjoying some welcome relief on the price front; substantial recent declines in agricultural and sensitive industrial materials prices, and a leveling off in industrial product prices, have pushed average wholesale prices down and moderated the rise in the consumer price index. But inflationary pressures may be building for the future. Unit labor costs in manufacturing have increased markedly--4-1/2 per cent since last summer--as productivity has ceased to grow with the leveling off and decline in output, and wages have continued to rise rapidly. Given this development, the associated squeeze on profit margins, and the larger increases in wage rates anticipated from labor contract negotiations, it seems clear that the pressures will be intensifying for price increases whenever market conditions permit. Thus, resumption of rapid economic expansion could be followed rather quickly by renewed inflationary problems.

Under these circumstances, I would not advise the Committee to push toward further monetary ease. Such a course would seem to offer little benefit in terms of short-run stimulation for the still lagging economy, and could risk contributing to a possible overheating later on. But neither do I feel that excessively rapid expansion is sufficiently certain, or the development of possible overheating sufficiently near, to warrant any move toward increased restraint as of now. Therefore, my policy recommendation would be for "even keel" in terms of market rates, flows, and conditions, even in the absence of the Treasury financing constraint.

Mr. Brill made the following statement concerning financial developments:

Treasury financings, and the even-keel constraints they impose, often come at awkward times for the implementation of monetary policy. This is not the case today. Indeed, we should be grateful for the breather the current financing affords, for we need the opportunity to sit back a bit and assess how the economy has responded to what we've done since last fall, and what this implies for the course of policy once even-keel constraints are lifted.

I certainly concur with Mr. Partee that economic prospects for the balance of the year have brightened considerably. We're not entirely out of the woods yet, and the near-term situation will continue to bear some marks of the recent economic slowdown. But the rapidity of the inventory adjustment and the strengthening in private final sales, along with the apparent likelihood of continued large defense spending, lend credence to projections of more rapid economic growth this summer and further acceleration in the fall. Given these improved economic prospects, the critical question to ponder between today and the end of even-keel restrictions is whether we've done all the economy requires or, indeed, whether it would be appropriate soon to begin backing-off from aggressive easing.

One test is whether we've restored the liquidity wrung out of the economy during 1966. Concepts and measures of liquidity are slippery; the traditional loan-deposit ratio cited as a measure of banking liquidity, for example, fails to capture significant shifts in the forms in which banks may decide to hold liquidity. According to this traditional measure, banks have improved their liquidity positions somewhat since December, but are still less liquid than before the beginning of monetary restraint, particularly so at New York and Chicago banks.

It is more revealing, however, to examine each side of the banking balance sheet separately. Thus, we estimate that bank holdings of short- and intermediate-term securities have rebounded substantially as a percentage of total earning assets. For all banks combined, this ratio has been restored to mid-1965 levels, and at New York City banks it is almost back to these levels.

On the liability side of bank balance sheets, there has been some restructuring of the maturity profile of time deposits. Large negotiable CD's came back strongly after monetary easing developed; between November and early March, banks restored the volume outstanding to the peak levels of 1966. And average maturity of CD's, which had worked down significantly over the summer of 1966 as banks fought to retain CD funds, jumped early this year to pre-restraint levels. But since the early bulge, the volume of CD's has drifted up further only slowly, while average maturities have stayed about at January levels. Rather than continue to seek large CD money aggressively, banks more recently have been content to enjoy an accelerated rise in consumer type CD's. They have reduced offering rates on large CD's sharply in all maturities, but have made only scattered efforts to reduce the rates paid for consumer funds, which proved less volatile last year than corporate money. As a result, time deposits other than large CD's now bulk larger among bank liabilities. Thus, in addition to increasing the liquidity of their portfolios, banks have restored some liquidity to the deposit side of the balance sheet, and over-all, appear more liquid than a comparison of loan-deposit ratios alone would suggest.

The green book details the improvement in liquidity of nonbank institutions, particularly S&L's, and I won't dwell on it here other than to note that S&L's also have improved the liquidity of both sides of their balance sheets, by increasing their holdings of liquid assets and also by rebuilding their credit lines at the Home Loan Bank System.

Liquidity developments among nonfinancial sectors are more difficult to trace, particularly because the information available is scattered and late. Preliminary Flow-of-Funds estimates for the first quarter indicate a marked shift in consumer portfolio behavior, back to saving through intermediaries instead of direct acquisition of market securities, while consumer borrowing for both short-term credit and mortgage money remained low.

Corporations, too, appear to have restored liquid asset holdings, early in the year in CD's but more recently in open market paper. The most important improvement in corporate liquidity, however, has been the stretch-out of debt maturities; growth in long-term security debt has been much larger than the increase in indebtedness to banks. To date, there is little evidence that corporations have actually funded much shorter-term bank debt--the proceeds of recent capital market financing appeared to have been used in large measure to meet heavy April tax payments--but the continuing large volume of long-term financing in the face of reduced financing requirements suggests that bank loan repayment may accelerate in the months ahead.

While monetary policy thus appears to have encouraged a substantial rebuilding of liquidity among the major lending and spending sectors of the economy, it hasn't been quite so successful in restoring pre-1966 interest rate levels, at least not at the long end of the market. Short rates are down almost 2 percentage points from last fall's peak, and are back to mid-1965 levels. However, long rates--particularly on private debt--are still substantially above pre-restraint levels.

Smaller cyclical movement in long than in short rates is to be expected, but it is disturbing that the recent declines still leave long rates historically high. Such cyclical ratcheting in the cost of capital does not bode well for maintenance of longer-term growth. Moreover, the financial system now seems poised to respond to the first evidence of a shift in policy by pushing up long rates even further. Memories of 1966 are still fresh; both corporate investors and banks are wary of an imminent return to restraint, and particularly wary of playing the CD game. Banks are not bidding aggressively for short-term funds, nor are they channeling funds to long-term markets. Rather, they are looking principally to more stable savings flows and investing primarily in short- and intermediate-term assets. Borrowers, meanwhile, are anxious to fund short-term liabilities into long-term debts, and are apparently more interested in holding short-term market securities than bank deposits.

Perhaps this is the price of success for having--in rapid order and brief compass of time--cut short an inflation and then aborted a recession. Perhaps, also, it's a price we have to pay for having used ceiling rates so effectively as a tool of monetary restraint. Markets learn from painful experience, and the next time around we may have to fight on different battlegrounds and with different tactics.

But it's not yet the time to start this fight. Despite the improved economic outlook, it would seem premature now to enhance or justify market fears of a return to restraint. The recovery in housing is still too fragile to permit a diversion of funds away from intermediaries. And it's much too early to abandon hope of help from fiscal restraint. Our projections indicate some subsidence in bank credit demands this month, and the reserves to meet these reduced demands should be provided generously.

But it would not seem advisable, either, to flood the banks with reserves in an attempt to bring down long rates, or to concentrate reserve injections on pulling long rates down. For one, it's not likely that we could accomplish much, given the buoyancy of economic expectations. Nor is it at all clear that we want to stimulate a faster rate of investment than is now projected for six or nine months hence. Therefore, like Mr. Partee, I come out today for even-keeling, not only because of the Treasury financing, but also because it seems appropriate to the economic situation and prospects.

Mr. Solomon then presented the following statement on the balance of payments and related matters:

There is little to add this morning to the green book analysis of balance of payments developments. The payments balance was in substantial deficit in the first quarter, and this has apparently continued in April. We are not yet in a position fully to explain the over-all first quarter outcome. The components we do know about--merchandise trade and bank loans abroad--improved in the first quarter. What we don't know yet is what went the other way.

I thought the Committee might find it useful to have some commentary today about the hullabaloo over U.S. gold policy that was stimulated by the statements last month from the Chase Manhattan Bank and Mr. Rudolph Peterson of the Bank of America. Mr. Coombs has reported on the market effects of those statements.

As you know, an article in Chase Manhattan's bi-monthly bulletin, "Business in Brief," published at the beginning of April, suggested that the United States should decide--and make the decision known now--that in the event of a gold crisis this country would terminate its practice of selling gold freely to foreign central banks. Just two days after the first press reports of the Chase Manhattan article, Rudolph Peterson made a similar proposal regarding the action to be taken by this country if a gold drain of crisis proportions were to develop. Many people immediately assumed a connection between the two statements and Secretary Fowler's Pebble Beach speech of mid-March. You will remember that that speech had hinted that unless other countries accept a larger share of the task of adjusting payments imbalances, the United States may be forced to take undesirable actions, of an unspecified nature.

What were the two bank statements saying to the world? They were saying that if the United States were to stop selling gold, foreign central banks would be faced with a "disagreeable choice." Countries in surplus, which almost invariably realize those surpluses in the form of acquisitions of dollars through their exchange markets, would have the choice of holding these additional dollars or, if they refuse to acquire and hold them, seeing their exchange rates appreciate in relation to the dollar--that is, seeing the dollar depreciate in relation to their currencies. In other words, foreign countries would either have to accept dollars freely or allow their competitive positions to deteriorate in relation to the United States.

Although both the Chase and the Peterson statements proposed that such a cessation of gold sales would be appropriate only in the event of a crisis, what seems to have motivated these statements is a deep concern that the United States will attempt to correct its balance of payments problem by strengthening and extending restraints on private capital outflows. This concern is expressed quite explicitly in both statements. The two banks seem to be saying that the United States should refrain from tightening restraints on private capital outflows. If this means a continued U.S. deficit, if European surplus countries do not take measures to reduce their surpluses, and if they continue to convert their surpluses into gold, we should in due course stop selling gold and confront them with the disagreeable choice.

This proposition raises a number of questions. The first question is, how would foreign countries react to a cessation of U.S. gold sales? The "either-or" choice envisaged by the Chase-Peterson statements is, in my view, a great oversimplification. It seems highly unlikely that European countries would simply accumulate dollars freely if they did not wish to see their currencies appreciate in relation to the dollar. Their desire to avoid an appreciation of their currencies stems from a wish to protect their trade balances--to avoid seeing their exports suffer or their imports increase markedly. But, insofar as capital transactions are concerned, they would have no wish to prevent an appreciation of their currencies and a depreciation of the dollar. Thus, European governments would very likely place restrictions on purchases of dollars that come to them as a result of capital inflows. In other words, they would establish at least two categories of dollars and in this way would restrict the inflow of U.S. capital. It is ironical that while the Chase-Peterson prescription is designed to prevent U.S. Government restrictions on capital outflows, it would result in European restrictions on these same flows. Meanwhile, the international monetary system would have been thrown into turmoil, with a highly unpredictable outcome. It seems likely that the world might very well end up dividing itself into currency blocs reminiscent of the 1930's.

We may also ask what effect this hullabaloo over gold has had. Has it had any beneficial effects? What harm does it do?

Perhaps one useful result is that the world is being reminded that an increase in the official price of gold is not an inevitable outcome of an international monetary crisis. Other options are available to the United States, and we are not completely at the mercy of the gold hoarders. While this is not news to responsible foreign officials, it may not have been clear to private gold buyers.

A second useful aspect of this affair is that it may serve to emphasize that the restoration of balance of payments equilibrium requires action by surplus countries too.

Now, I turn to the harmful effects of these statements. First, the United States is a bank to the rest of the world and it is unwise for a bank to threaten to close its doors unless it wants to go out of business. If a bank threatens to close its doors, and if the threat is taken seriously, the bank must expect depositors to withdraw in anticipation of such a closing. In our case, this means anticipatory gold purchases.

The major disadvantage of the Chase-Peterson thesis lies in the impression it gives of U.S. attitudes. In its rawest form, this thesis proclaims that the rest of the world is on a dollar standard and it has to accept that fact. The rest of the world does indeed use the dollar as a transaction currency and as a reserve currency. What the rest of the world, and Europe in particular, is not prepared to accept is the idea that this gives the United States full freedom to spend and invest abroad and, in the process to create foreign dollar reserves in whatever amounts its balance of payments happens to provide. One need not be a defender of short-sighted European policies to believe that the threatening nature of the two statements is bound to be distasteful to other countries and they are bound to react adversely.

If the gold hullabaloo had sharpened awareness of the need for creating an effective new reserve asset as a supplement to gold, that would have been helpful. But instead of focusing on the gold shortage, the statements appeared to wish to perpetuate the U.S. balance of payments deficit and thereby hardly helped to further the international liquidity negotiations.

I leave to the Committee a weighing of these advantages and disadvantages of the gold hullabaloo.

Mr. Treiber asked whether Mr. Coombs had had any direct contacts with foreign central bankers regarding the subject Mr. Solomon had discussed.

Mr. Coombs replied that he had had such contacts with a few central bankers, and had found them very much upset. Their concern was not allayed by the subsequent Treasury statement indicating that U.S. gold policy had not changed.

Mr. Coombs added that he doubted that the course Chase Manhattan had proposed was an alternative to an increase in the price of gold, as Mr. Solomon had suggested. If the United States were to stop selling gold the price on the London market would rise sharply, and the European central banks undoubtedly would immediately enter into a defensive arrangement, establishing a new official price for transactions among themselves. In due course the U.S. would have to settle deficits in its payments to those countries by sales of gold, and it presumably would accept the price they had established. That was the course of events in the 1930's. Accordingly, he thought that a cessation of gold sales by the U.S. would lead directly to an increase in the price of gold.

Chairman Martin then called for the go-around of comments and views on economic conditions and monetary policy, beginning with Mr. Treiber, who made the following statement:

In the period since the last meeting of the Committee, economic indicators have strengthened significantly, and business sentiment has turned from apprehension to confidence. Retail sales have risen sharply according to preliminary estimates, and a good start has been made toward reduction of the inventory overhang. Housing indicators have continued to be quite strong, and capital spending appears to be on a high, and probably rising, plateau. Defense spending now seems likely to exceed earlier projections by a wide margin. The fiscal stimulus in the second half of 1967 appears to be headed for a record level, and cost-push pressures are apparent. The tentative nature of some of the figures and the fact that the figures cover only a short period counsel caution. But it does seem probable that there will be renewed economic growth at a fast and potentially inflationary rate as the year progresses.

The international balance of payments situation is highly unfavorable. The position of the dollar in the exchange markets is weaker, and the London gold market is more active at higher prices.

In the first quarter of 1967 the liquidity deficit, before adjustment for special transactions, was almost $5 billion on a seasonally adjusted annual rate. But a number of special transactions arranged by the Treasury have reduced the deficit to about a $2 billion rate. Bank-reported capital movements and the merchandise account improved, but there was deterioration with respect to U.S. resident transactions involving both new and outstanding foreign securities. There are indications that U.S. corporations may be hoarding balances abroad in anticipation of tighter investment controls. And military expenditures abroad appear to be increasing.

There have been substantial shifts of dollars from foreign private holders to official holders, and a reduction in our monetary reserves. In the first quarter the official reserve transactions deficit appears to have risen to about $6-1/2 billion on a seasonally adjusted annual rate compared with $1 billion in the fourth quarter of 1966, and a surplus for the year 1966.

Bank credit, money supply, and related liquidity indicators have been very strong in 1967, reflecting the expansive Federal Reserve policy and the efforts of most sectors of the economy to bolster their liquidity positions.

A longer perspective including the second half of 1966 seems more appropriate. On this basis the rates of bank credit expansion and nonbank liquid asset growth appear more moderate and are somewhat below the growth rates of the 1961-64 period. While preliminary projections indicate little growth in bank credit in May, such a development should not be disturbing in view of the sizable expansion over the last nine or ten months and the large corporate tax payments due in June which should stimulate bank credit growth at that time. Nor should it be disturbing if there is a somewhat greater expansion in May than now appears indicated.

It seems to us that economic and financial developments counsel maintenance of about the prevailing conditions in the money market. This conclusion is reinforced by the need for an even keel in the light of the Treasury's current financing operation, which should last throughout most of the period until our next meeting.

The latter part of the second sentence of the draft directive contains the words "and industrial output reduced moderately." In view of the small increase in the industrial production index reported for March, and the inability to make a precise estimate at this time of industrial production in April, it seems to me that it would be preferable to replace those words with the words "and apparently little change in industrial production." With this modest change, I think the draft is satisfactory.

The following comments are offered in response to the Secretary's telegram of last week.[1]

The volume of small consumer-type certificates of deposit has continued to grow rapidly in the Second Federal Reserve District, and the banks are finding the money they obtain this way to be very expensive. Three New York City banks have recently reduced their rates on consumer CD's: two from 5 per cent to 4-3/4 per cent, and one from 5 per cent to 4.8 per cent. Some banks have lessened the attractiveness of their certificates by shortening available

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1/ On April 27 Mr. Holland had sent the following telegram to Reserve Bank Presidents: "Board members indicate they would appreciate any comments the Presidents might make at the FOMC meeting May 2 concerning recent and prospective changes in rates on consumer CD's and savings deposits within their respective Districts."

> maturities, reducing maximum amounts, and restricting eligible purchasers. A number of banks have cut down their advertising efforts. It is likely that other banks will reduce their rates before long. The rates could easily go below 4-3/4 per cent if the mutual savings banks cut their rates on savings deposits.
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> The mutual savings banks have generally been paying 5 per cent on savings deposits since mid-1966 when rates were generally increased by 1/2 of a percentage point. Savings bankers appear eager to lower their rates but are worried about deposit losses should the move to lower rates not be universal. To date only one savings bank, a small one in upstate New York, has reduced its rate from 5 per cent to 4-1/2 per cent, effective May 1. Some savings banks seem to be looking to the regulatory agencies to impose a lower maximum rate. Others are anxious to avoid such a development. In any event, it seems likely that the savings banks will wait as long as they can prior to midyear before taking action. If there is no change in the regulatory ceiling, it is possible, but by no means certain, that one of the large savings banks will announce a cut to 4-1/2 per cent beginning July 1. Presumably other savings banks will follow the leader with great relief.

Mr. Francis remarked that in response to Mr. Holland's telegram fifteen bankers scattered throughout the St. Louis District had been contacted with respect to recent and prospective changes in rates on consumer CD's and savings deposits. Those bankers, in turn, were able to report on recent activities of at least seventy other banks in their immediate areas. Generally, rates had not been changed in the past two or three months, and most bankers expected no change in the next month or two.

Rates on savings deposits were generally in the 3 to 4 per cent range, Mr. Francis said. No changes in those rates had occurred in the past two or three months, and none were contemplated for the near future. Banks in Memphis began compounding savings accounts daily about a month ago, increasing somewhat the effective rate. Interest rates on consumer CD's were generally in the 4 to 5 per cent range. About 90 per cent of the banks had not changed rates recently, and none of those banks said that it was expecting to change rates in the near future. A few banks which paid relatively high rates on small CD's stated that they had recently reduced their advertising for them. At least six suburban banks in the St. Louis metropolitan area reduced their rates on small CD's from 5 per cent to either 4-3/4 per cent or 4-1/2 per cent recently. Also, several rural banks in northern Missouri had reduced rates on CD's from 5 per cent to 4-1/2 per cent.

Mr. Francis commented that the pause in spending and production last fall and winter was of moderate proportions and was probably a healthy development in view of the inflationary pressures and other excesses of last year. The pause now showed signs of ending. Businessmen in the Eighth District with whom he had talked recently were generally optimistic about the sales outlook for their products. The most recent national data--though they had to be used with caution--showed gains in retail sales, personal incomes, industrial production, and construction, and an improvement in the inventory situation. The large corporate and municipal financing of the past two months indicated that investment spending was likely to rise. Such spending was consistent with management's desire to offset increasing labor costs by accelerating the introduction of labor saving devices. The staff's projections of total spending, contained in the green book, had been revised upward, and the Administration remained firm in the belief that a tax increase would be needed to avoid excessive demands for goods and services later this year. Economic activity remained near capacity. The weakening seemed to have been halted and might already have been reversed.

Mr. Francis thought the marked shift in monetary developments from contraction last summer and fall to rapid expansion in the early months of this year had probably been a major factor in the reversal of economic trends. Since monetary developments were generally believed to have their chief impact on spending after some time lag, significant growth of total demand might reasonably be expected over the next few months as a result of recent monetary expansion.

Despite the hesitation of recent months in total demand, Mr. Francis remarked, industrial prices continued under pressure from rising unit labor costs. A rapid increase in spending, combined with the cost-push pressures that were expected as major labor contracts were settled, could quickly cause an acceleration of inflation.

Although short-term interest rates had declined in recent months, Mr. Francis continued, long-term rates remained relatively high, and some believed they were a restraining force on business decisions. The reverse reasoning might be nearer the truth--namely, that the strength in business was bolstering rates. Relatively high rates in the face of rapid expansion of bank reserves, bank credit, and money generally indicated that credit demands were vigorous. Net borrowing by the Federal Government had been a strong upward force on rates, but private demands for credit had also been sizable.

The yield curve had shifted markedly as short-term rates had declined and long-term rates had stabilized or increased, Mr. Francis observed. There were at least two explanations of why such a yield curve shift might indicate forthcoming strength in the economy. First, a large volume of long-term financing frequently preceded a rise in investment, raising long-term rates and lowering short-term rates as funds were temporarily invested. Secondly, a rise in long-term rates relative to short rates indicated that both lenders and borrowers expected a general rate increase. That was probably because of expected increased economic activity and demands for credit.

As to policy for the next several months, Mr. Francis preferred to see a more moderate rate of expansion of bank reserves, bank credit, and money than had been achieved over the past three months. The major thrust of actions taken now would probably not strike until late summer or early fall, given the usual lags of effect. Continuing the recent rapid monetary expansion might add to an inflation that had not yet been brought fully under control. On the other hand, contracting the monetary aggregates might foster recession.

Mr. Francis believed that for the next few weeks continuation of current money market conditions was probably the Committee's best proximate objective and might be desirable during the Treasury's refunding. However, as insurance against undesired movements in proximate measures of monetary action between meetings, he suggested that a double-edged proviso clause be used in the Committee's instructions to the Desk. For example, if money rose at a faster than 10 per cent annual rate from April to May, the money market should be permitted to tighten; if money did not expand at as much as a 6 per cent rate, market conditions should be eased. Those relatively high rates were in recognition of an expected more-than-seasonal decline in Government demand deposits, as pointed out in the blue book, and should be consistent with a growth of money at about a 3 per cent rate over a three-month period. Money seemed preferable to bank credit in the proviso clause because much of bank credit was intermediated funds. However, if the Committee decided to use bank credit expansion as an objective, a range of 1 to 4 per cent rate as projected in the blue book might be appropriate from April to May. That range appeared consistent with a growth in bank credit at a 7 to 10 per cent rate over a three-month period.

Mr. Kimbrel reported that credit availability was improving at both banks and nonbanking financial institutions in the Sixth District. District banks, like banks elsewhere, had been enjoying substantial gains in deposits, especially in time deposits of the nonpassbook variety. In mid-April, total time deposits were up 25 per cent at an annual rate from the first of the year. Flows into the savings and loan associations had been substantial. Florida associations saw an all-time record net savings inflow during the first quarter. A spot check made last week of the principal farm lenders also revealed a larger supply of loanable funds than a year ago.

Although the District's banks had used the inflow of funds chiefly to build up their liquidity, Mr. Kimbrel continued, recently a greater share had been going into loans. In March, loans at the District's member banks rose at a seasonally adjusted annual rate of 8.4 per cent. In the four-week period ending April 19, business loans at the District's large banks apparently rose more than seasonally, and gains were well distributed among most types of industrial borrowers. Although the demand for mortgages apparently was not strong, mortgage lenders were making more loans, and construction loans at the large banks were up in April. Extensions of consumer credit rose sharply in March.

An easing of rates was slowly developing, Mr. Kimbrel noted. Most District banks, after the lowering of the prime rate by the money market banks, went along with the reduction in their prime rates. In Atlanta, savings and loan associations were making mortgage loans at 6-1/2 to 6-3/4 per cent, with more being made at 6-1/2 per cent than a few months ago. Mortgage bankers were discounting 6 per cent FHA's between 1-1/2 to 2 points with a few prime loans at 1 per cent, compared with discounts of 7 points not so long ago.

Mr. Kimbrel said that District commercial bankers were increasingly concerned about the rates they were paying on their time certificates, especially those that had issued a large volume with the guaranteed feature. Right now, however, reductions seemed to be more in the state of wishful thinking than in actuality, presumably because of a fear of a run-off to competitive savings institutions. There had been isolated reductions such as that in one Florida city where the rate on one-year certificates of deposit was cut from 5 to 4-1/2 per cent. In Birmingham one large bank cut its rate on CD's of over a year to 4-3/4 per cent, while another withdrew its 5 per cent CD and now offered only a 5-year 4-1/2 per cent savings certificate. In other areas of the District some banks were de-emphasizing advertising for small CD's.

Mr. Kimbrel observed that the quicker lending activity seemed to be paralleled by a little more vigor in the District economy generally. Retail sales had picked up in March, and there was a sharp upsurge in residential construction contract awards. However, although total nonfarm employment expanded in March, there were further declines in manufacturing employment and the average length of the workweek. Nevertheless, the unemployment rate continued at 3.5 per cent.

Perhaps more slowly than one might like, but rather surely, Mr. Kimbrel said, the easier policy the System had been following seemed to be taking effect, judging from the somewhat limited observation of what was happening in the Sixth District. A lack of time rather than any stringency in reserve availability seemed to be the limiting factor. Much the same developments seemed to be occurring throughout the country. Consequently, he believed it would be on the side of prudence to wait a little before making a decision toward increasing reserve availability even further. On the other hand, the Committee should not allow conditions to tighten merely because it had observed some improvement. As a matter of fact, the System might be limited as to what it could do by the Treasury refunding program.

Mr. Bopp reported that a telephone survey of 17 Third District bankers revealed virtually no changes in rates on consumer time and savings deposits in the recent past. Furthermore, there was little or no prospect for any changes in the near future. As one banker put it, the situation might turn around so fast that a banker might regret lowering rates a small fraction at the present time. Philadelphia banks had been the only group to lower consumer CD rates in the recent past, roughly one month ago. Still, their rates were at the upper end of the structure in the Third District. No prospect for change in the near future appeared.

More noticeable had been a de-emphasis in promoting consumer CD's, Mr. Bopp said. Those that had promoted such CD's rather aggressively in the past noted a marked slowdown in external promotion at the present time. About half the bankers surveyed indicated that CD's continued to grow at past rates; another half noted a leveling off. Perhaps significantly, those who had slowed down promotion and those who did not advertise had not experienced any more leveling off than those who continued to promote such certificates actively. It appeared, as he had already noted, that uncertainty over interest rates in the near future was responsible for the hesitation to drop rates from their peak levels.

Mr. Bopp commented that it was tempting to seize on the rash of relatively good news as a sign that the economic adjustment was already over. On the other hand, there was danger in dismissing it too easily on the ground that one swallow did not make a summer. His interpretation of national indicators was that something different was happening. He had seen more than one swallow. Surveys at the local level confirmed that. But neither national nor local developments suggested that the Committee's concern about the state of the domestic economy should in any way be relaxed. The Committee could feel more confident that a serious recession did not lie ahead, but the pace of expansion seemed likely to be rather slow.

Retailers in the Philadelphia area expected no significant improvement in sales in the next couple of months, Mr. Bopp said, but they looked for a pickup later in the year. Automobile dealers seemed cautiously optimistic. So far in the second quarter, sales apparently were experiencing a normal seasonal upturn. He was unable to detect concern about the fact that car inventories were at a high level. A survey of housing and mortgage conditions confirmed the finding of over a month ago that housing was picking up slowly. Although traffic through sample houses was heavier, there was little evidence of brisk sales activity. Potential buyers were deterred by a shortage of listings, higher prices of houses, and--despite significant change in recent months--persistently rather tight mortgage terms.

Having restored their liquidity, Mr. Bopp continued, lenders were now gearing up to extend credit. High rates for savings prevented them from cutting rates on mortgages. Although a few banks in large cities had cut their rates on consumer CD's and had reduced advertising for savings, their CD rates remained generally high and bankers expected them to continue high. There were some elements of a vicious circle here. Demand for houses was picking up, but until there was an increased volume of new houses available, many families would hold off from selling; they now had no place to move. Demand for mortgage credit was heavier, but until institutions could cut their savings rates, they were unlikely to cut their mortgage rates. Time would solve both of those problems, but time would delay the favorable impact on the economy.

Probably the most encouraging development of all, Mr. Bopp said, was that employment had not been affected more drastically by the adjustment in production. If, as the staff suggested in the green book, the unemployment rate rose in the next several months to 4 per cent or above, the more optimistic observers might change their tunes. But to the extent that the increase came about because new entrants to the labor force were unable to find jobs, rather than because of layoffs, the real impact on psychology, incomes, and spending might not be so great.

So far as the real part of the economy was concerned, therefore, evidence suggested to Mr. Bopp that the "even keel" posture required by Treasury operations would be appropriate. His only concern was for the possible movement of interest rates, given the expected continued heavy borrowing in capital markets. He would be inclined to focus a no-change policy primarily on rates, with a particularly sharp eye on longer-term rates. If it was necessary to increase free reserves to the upper end of the range projected by the staff in order to hold rates where they were, he would urge that that be done.

Mr. Hickman felt that it was more difficult than usual at this time to make a correct policy decision, even with the best information available in the green book and in documents prepared by his staff. Almost all of the information on key sectors of the economy seemed woefully incomplete, inaccurate, or untimely. The GNP data for the first quarter would evidently be subject to considerable revision, and there was almost no information beyond March. Moreover, February-March changes were suspect because of special factors such as weather, labor stoppages, and the Easter holiday. He was convinced that the Federal Government simply did not spend enough money to obtain appropriate informational guides for policymaking.

Serious structural imbalances apparently remained in the economy, Mr. Hickman continued, although the danger of a cumulative decline had perhaps been eliminated, if one could take the data seriously. The ratio of inventories to sales was apparently still rising, and order backlogs were declining. The inventory adjustment was probably not over, although it would not be known what had happened in that area for many weeks.

Information available for April indicated that the rate of insured unemployment was unchanged in the nation and in the Fourth District in the four weeks through April 22, Mr. Hickman said. In the District, only one major market area had a rate of insured unemployment below a year earlier, with rates in many areas considerably higher, due mainly to layoffs in autos and steel. Steel output declined generally in April, and to a greater extent in the Fourth District than in the nation. Currently, expectations were that steel output would rise slightly in May, on a seasonally adjusted basis, but would remain below the first-quarter level. Auto sales had strengthened recently, but preliminary estimates indicated that, even with stepped-up schedules, production (seasonally adjusted) would decline in May.

In view of the major Treasury refunding now under way, Mr. Hickman observed, the Committee had no choice but to maintain an "even keel" policy over the next few weeks, and to foster a receptive tone in the market. Nevertheless, he would like to see the Committee do what it could to hold long-term bond yields at or below present levels so as to encourage plant and equipment spending, and promote a good flow of funds through the mortgage market. That called for at least as much monetary ease as had prevailed since the Committee's last meeting, with the major reserve and credit measures rising at about the same pace as in April.

Mr. Hickman reported that an informal survey of savings deposits at 21 banks in the Fourth District revealed that ten banks had lowered interest rates on consumer-type CD's between 1/4 and 1/2 per cent since the beginning of the year, with most of the reductions occurring in April. Of the 11 banks that had not changed rates, seven had never paid more than 4-1/2 per cent, and four were still offering 5 per cent--although three of the latter group were considering a reduction. All banks were paying the maximum 4 per cent rate on passbook savings except one, and no bank expected to reduce rates in the near term. Several banks indicated a shortening of maximum maturities, greater selectivity in offering CD's to other than established customers, and reduced advertising efforts to attract new consumer-type CD's.

Mr. Sherrill said that he would not make a statement today.

Mr. Brimmer remarked that he was finding the Reserve Bank Presidents' reports regarding rates on time deposits in their respective Districts to be highly interesting. The question of time deposit rates was likely to be arising frequently over coming months, and he hoped that the System would be able to resist pressures to reduce the Regulation Q ceilings in order to lower those rates. He would prefer to avoid frequent changes in the ceiling rates; for the present it would be desirable to wait to see what banks would do on their own.

With respect to open market policy, Mr. Brimmer continued, he was concerned about the level of long-term interest rates. The Committee might be moving toward restraint later this year, and it would be better not to enter a period of restraint with the level and structure of rates that now existed. The current Treasury financing would, of course, inhibit efforts to lower long-term rates at this time, but he would hope that efforts would be made to resist increases, insofar as that was consistent with the need to maintain an even keel. Given the volume of security issues coming to market, he thought that maintenance of an even keel might require free reserves near the upper end of the $150 - $300 million range mentioned in the blue book, although he would be reluctant to specify a $300 million figure as appropriate.

Mr. Maisel commented that the System seemed to be doing a good job of rebuilding the liquidity of the economy, and at the rate things were going the Committee probably should be prepared to move toward more normal expansion rates in reserves and bank credit some time after the June 15 tax date. He agreed that in the interim the Committee should not act in a way that would encourage a shift in expectations. At the moment, the market's expectations for bond prices probably were more pessimistic than the underlying situation warranted. However, if those expectations were resulting in unusually large demands for long-term funds, it should be the posture of the System to help out by directing as large a part as possible of its purchases into longer-term securities.

Mr. Daane remarked that the primary consideration for policy at the moment was that a large-scale Treasury refunding was in process, to which the market reaction was still uncertain. Mr. Treiber had said that current economic conditions warranted maintaining prevailing money market conditions and that the Treasury financing reinforced that conclusion; he (Mr. Daane) would put the main emphasis on the financing in concluding that an even keel policy was necessary.

He suspected, Mr. Daane continued, that the recent increases in long-term rates despite the shift of policy toward greater ease reflected the reaction of market participants to the developments of last year. Those rate increases served as a useful reminder to the Committee that it could not always expect to be able to offset the effects of market forces on the level and structure of rates.

Mr. Daane said that he supported Mr. Brimmer's suggestion that the System should not attempt to move time deposit rates up and down by changing the Regulation Q ceilings. As to the directive, he was troubled by the proviso clause, particularly if it were to be interpreted in terms of the blue book projection for May of bank credit growth at an annual rate in the range of only 1 to 4 per cent. While the proviso probably would not do any real harm, in view of the difficulties of formulating it in an appropriate way at this juncture he would prefer to eliminate it entirely.

Mr. Mitchell said he agreed with the staff analysis today and had little to add to the subsequent comments. He had no strong feelings about the proviso clause, and was agreeable to retaining it as drafted, making it a two-way clause, or deleting it. He agreed with Mr. Treiber that there was a flaw in the language of the phrase in the draft directive relating to industrial production. As he understood the matter, the decline in output was continuing. Accordingly, he would suggest replacing the phrase, "with . . . industrial output reduced moderately" by the phrase, "with . . . industrial output still being reduced moderately."

Mr. Maisel commented that the phrase in the staff's draft was appropriate if the reference was to the first quarter.

Mr. Brill remarked that the staff had in mind the fact that industrial production in the first quarter had declined at an annual rate of 5 per cent from the fourth quarter, and also that the best current estimate for April was for some further decline. He emphasized, however, that the April figure was an estimate, and that the decline expected in that month was slight.

Messrs. Treiber, Mitchell, and Daane all indicated that it was not clear from the draft language that the reference intended was primarily to first-quarter developments. Mr. Daane added that it seemed preferable to him to refer to more current developments, as Mr. Mitchell had suggested, in a directive that was updated at each meeting.

Mr. Ratchford said that he would first report briefly on changes in rates paid on small CD's and savings deposits in the Fifth District. No changes in rates paid on savings deposits, nor any intentions to change, had been found. At least four fairly large banks had reduced their rates on small CD's from 5 to 4-1/2 per cent within the past month, of which one was in Baltimore, one in Washington, and two in Virginia, but none in Richmond. A large North Carolina bank had reduced its rate from 5 to 4-3/4 per cent. A small bank in West Virginia had <u>raised</u> its rate from 4 to 4-1/2 per cent for selected customers. One of the reductions was in Roanoke and was followed by a considerable number of smaller banks in the area, but elsewhere the reductions apparently were not followed by other banks. Some of the banks which had not reduced rates were either encouraging or requiring shorter maturities and one had imposed a maximum of $50,000 on amounts accepted.

Mr. Ratchford then noted that the slowing trend in business activity which had prevailed in the Fifth District for some time had become less distinct. The picture now was more spotty, with small gains reported in several areas. That was accompanied by slightly more optimistic expectations on the part of both businessmen and bankers. Inventories were still heavy, especially in the textile and furniture industries, and manufacturers continued to report considerable weakness in new and unfilled orders, but the number reporting slight gains had risen. Almost all textile manufacturers reported lower prices received for finished goods. Nonagricultural employment declined slightly in March but at the same time the rate of insured unemployment declined in every District State except one. There was also a small decline in man-hours in manufacturing but it was much smaller than the large drop which had occurred in February. Inadequate moisture in many parts of the District had delayed the growth of some crops and the seeding of others.

Mr. Ratchford observed that the Richmond Bank's analysis of national economic conditions was quite similar to that in the staff materials and in the comments around the table today, so he would make only two points. First, it was remarkable that such great strides had been made in bringing the growth of inventories under control with only a modest slowing of industrial production. The March figures on manufacturers' inventories reported in this morning's newspapers indicated that the inventory adjustment was continuing. A second outstanding feature of the adjustment was that it was not proving to be cumulative. It might well be that the massive supplies of reserves provided by the System in recent months had averted the chain reactions in the financial areas which often caused declines to feed on themselves.

As for monetary policy, Mr. Ratchford said, he shared the views that had already been expressed. In light of the very large amounts of reserves already supplied and the indications of a turnaround in expectations of the economic outlook, he thought that the time had arrived for a breathing spell, even apart from the Treasury financing. Accordingly, he favored no change in policy and considered the draft directive appropriate.

Mr. Clay reported that a check in major cities of the Tenth District indicated that most city commercial banks paying 5 percent on consumer time deposits in recent months had reduced the interest rates they now paid for such deposits. He noted that most of the city banks had been at the 5 per cent rate. No change had been made in the rates paid on savings deposits.

However, Mr. Clay continued, the changes in time deposit terms were not universal, and the types of changes made varied considerably. In some instances, the change made was in the maximum amount for which 5 per cent would be paid, such as $15,000, with the rate limited to 4 or 4-1/2 per cent for larger amounts. In other cases, the maximum rate paid on any amount had been reduced to 4-1/2 or 4-3/4 per cent, with individual accounts limited in size or larger amounts subject to negotiation as to terms. In a number of cases, the maximum maturity had been reduced, but that was by no means universal. Only a few banks specified that they contemplated future reductions in time deposit interest rates, and those were invariably contingent upon reduction in rates paid by competing savings and loan associations or other commercial banks.

Mr. Clay noted that adequate information was not available for generalizing about Tenth District commercial banks in smaller cities and towns. Information had become available, however, indicating reductions or contemplated reductions in interest rates paid on time deposits by a number of such banks. That had been a subject of intense discussion among bankers in recent weeks, and it was reasonable to assume that such actions by country banks were in excess of those known by the Reserve Bank.

Mr. Clay pointed out that since last fall the Federal Reserve System had taken stimulative action on a major scale. While monetary policy should continue expansive, it seemed logical to proceed somewhat less aggressively for the present. Business prospects looked stronger than earlier in the year, even though the situation was not altogether clear. Moreover, possible larger military demands upon the economy, arising out of the war in southeast Asia, had to be accorded careful evaluation.

For the period immediately ahead, the current Treasury financing program appeared to Mr. Clay to call for the maintenance of essentially the prevailing money market conditions. He thought it would be desirable to have moderately greater expansion in bank credit than that indicated in the blue book as probable under even-keel money market conditions, but at a somewhat lesser rate than in recent months. Accordingly, it would be desirable to aim toward such a goal insofar as that could be accomplished within essentially prevailing money market conditions.

Mr. Clay proposed revising the proviso clause of the draft economic policy directive to read "and to attaining somewhat greater bank credit expansion than currently anticipated, if Treasury financing permits."

Mr. Scanlon remarked that April saw a pronounced improvement in views of the economic outlook for the remainder of 1967. Seventh District bankers and businessmen increasingly were confident that the decline in activity registered in the first quarter of the year would not cumulate in the second quarter, and that the second half would see renewed growth. Those attitudes were based in part on recent indications of an uptrend in retail trade, the rapidity of inventory adjustments, the highly expansive posture of monetary policy, and the probability that defense spending would accelerate.

Loan demand at major banks in the Seventh District continued strong relative to the country as a whole, Mr. Scanlon said. That strength seemed to be concentrated in the commercial and industrial area. To accommodate that demand, the major Chicago banks had been heavy purchasers of Federal funds. They had not made aggressive efforts to get CD money, which might suggest that no strong upward surge in loan demand was expected or, more likely, that they would not be back in that market until absolutely necessary.

With regard to rates on consumer CD's and savings deposits, Mr. Scanlon continued, there was much discussion of possible rate changes among both banks and savings and loan associations but relatively little action. Conversations indicated that literally everyone would like to see someone announce a forthright reduction. But the demand for bank loans had been strong enough to forestall such a move. Most of the banks and savings and loan associations had stopped advertising for 5 per cent CD money, and some had reduced the amounts they would accept and shortened the maturity.

Mr. Scanlon noted that there had been a meeting yesterday of the National Agricultural Credit Committee at the Chicago Reserve Bank. Participants included the major lenders to agriculture--mortgage and nonreal estate. To summarize the discussion, it appeared that mortgage loans made in recent months and commitments were both down sharply from a year ago. A few lenders had recently sought to increase commitments but had found that farmers were holding back in the hope that interest rates would decline. Policy loans of insurance companies were down from the high volume of last fall but still ran two to three times the normal monthly volume. Delinquencies on principal and interest payments and foreclosures of outstanding loans were at very low levels, as were rates of repayment of outstanding loans. Banks and other lenders were generally expected to be able to accommodate the prospective demand for farm loans--both short-term and long-term--in 1967 at about current interest rates. Many farmers had had losses of $20 to $30 per head on fed-cattle marketed in recent weeks; a few had reported even larger losses. Farm land prices had risen rapidly in recent months but were thought to be rising much less rapidly now. The Farm Credit Administration had sought Congressional action to raise or eliminate the 6 per cent ceiling on interest rates they could charge farmers on mortgage loans and on the rates they could pay on debentures. The first was rejected--no Congressman would introduce the measure--and the second was approved with the greatest reluctance by both the Congress and the President. One FCA official responding to criticism from the insurance company representatives stated, "Apparently we will make mortgage loans within a 6 per cent ceiling or not at all."

As to policy, Mr. Scanlon concluded, he favored maintaining the prevailing conditions in the money market, and his interpretation of that was the one given in the blue book. He found the draft directive acceptable, although he would be just as happy without the proviso for this period and he believed that Mr. Mitchell's point regarding the language of the first paragraph had merit.

Mr. Galusha observed that reports of the April storms which had crossed the great plains were disturbing. The climax, the blizzard of the last five days--which stretched over eastern Idaho, Wyoming, the Dakotas, Montana, and into Alberta--was truly severe. It was being called the worst in history, at least in its economic impact. Coming as it had right at the height of lambing and calving, the storm would likely have far-reaching consequences, although principally within the District. District retailers were going to know that there had been a storm, and so were the country banks. The storm should relieve some of the present pressure on their swollen coffers. For of late, loan demand had not been strong at country banks. They seemed to be relatively liquid and probably would be able to meet emergency loan demands without great difficulty. The loan demand at District city banks had, however, been very strong.

It was possibly the imbalance in District loan demands which explained differences of opinion about the financial outlook, Mr. Galusha said. Some bankers were talking about declines in deposit and share rates and further declines in loan rates. It was difficult to know, however, whether that was prophecy or hope. Anyway, there were others predicting that fall would see a return to higher loan rates. It seemed to him that that was the dominant expectation, and, as such, he believed it explained why consumer rates had not yet been moved lower. In the Minneapolis Bank's sampling, it had found changes only in Minnesota, where two banks had lowered their rates on savings certificates from 5 to 4-1/2 per cent, several banks indicated they were not accepting new large CD's at a 5 per cent rate, and one bank had reduced its passbook rate from 3 per cent to 2 per cent, which he doubted would be a pace setter.

In a way, then, Mr. Galusha remarked, it was too bad that so many of those engaged in finance were doubtful--indeed, understandably doubtful--about the chances of getting a tax increase early in 1968. That, it seemed to him, was ultimately why consumer and long-term rates had proved so sticky.

Mr. Galusha thought it also was too bad that the Committee could not be surer about a tax increase. Were it more certain, it could confidently press further in the direction of monetary ease, and so ease the members' minds about once again having to start off a period of more rapid economic growth from a historically very high level of long-term rates. But without greater assurance about an increase in tax rates, there must be some little doubt about how much further the Committee could prudently press. There was much for the Committee to be uncomfortable about as it contemplated the economic and political environment that would be confronting it next fall or winter. The battle might have been won, but hardly the war--literally or figuratively. The economy was still badly dislocated by Vietnam and there was little reason to believe normal forces of market allocation would be restored very soon.

However, Mr. Galsuah concluded, all of those remarks were distinctly academic this morning, since an even keel was certainly appropriate in light of the Treasury refunding.

Mr. Swan reported that manufacturing employment in the Twelfth District had remained virtually unchanged in March for the third consecutive month, and the over-all rate of unemployment rose by only 0.1 to 4.6 per cent. Although construction employment declined, housing starts had risen. However, starts remained well below their year-ago level.

Mr. Swan noted that the larger banks in the District were still net buyers of Federal funds, but in somewhat smaller amounts than in earlier weeks. The Reserve Bank's check with commercial banks in the larger centers indicated that no changes were anticipated in the 4 per cent rate paid on passbook savings accounts. With respect to rates on consumer CD's, the 5 per cent rate remained general in San Francisco and Los Angeles, but there had been a few reductions below that level in other major cities. A few reports of somewhat less active advertising for funds had been received, and one bank indicated that special approval was now required before larger amounts would be accepted. However, a Los Angeles bank had recently announced a new one-year, 5 per cent "savings bond" which was a certificate issued in amounts from $100 to $100,000. In general, rates offered by banks in the area were related to the 5-1/4 per cent rate paid by California savings and loan associations. There was a feeling among both types of institutions that it would be desirable for rates to come down but they all seemed to be waiting for someone else to act. The hope was that the regulatory authorities would lower ceiling rates.

With respect to policy, Mr. Swan thought that the Treasury financing, the general shift toward a more optimistic attitude on the economic outlook, the Committee's success in achieving declines in short-term rates, and the substantial expansion in bank credit all argued for no change at this point, despite recent increases in long-term rates. He could accept the staff's draft directive, with the change in the phrase relating to industrial production that Mr. Mitchell had suggested. He would be willing to include the proviso clause as drafted or have it eliminated entirely, but he would not favor a two-way proviso clause at this point. The slight increase in bank credit projected by the staff for May was acceptable to him but he would hope that the phrase, "if bank credit appears to be expanding significantly less than currently anticipated" would be interpreted to mean that an actual decline in bank credit over the next three weeks would be avoided, if that was possible within the constraints imposed by an even keel policy. Avoiding a bank credit decline should be one of the Committee's objectives at present whether or not a proviso clause was included in the directive.

Mr. Coldwell remarked that the economy of the Eleventh District was heavily reliant upon a few diverse and widely differing sectors which currently were moving moderately in divergent directions. Strength was continuing from the large defense manufacturing plants and the extensive military installations. New support was developing in construction activities, including residential, highway, and municipal facilities. Oil and gas production had weakened but chemical and petrochemical industries were still expanding. Agriculture had declined sharply under the onslaught of reduced cotton acreage, near drought conditions, and poor cattle grazing. The April 1 wheat estimates might prove optimistic at 24 per cent under last year's crop. Declining prices were reducing income, and cash receipts were 28 per cent below 1966.

District financial conditions reflected April tax borrowing, increased investments in non-Government securities, and a sizable decline in large CD's offset by demand deposit growth, Mr. Coldwell said. Uncertainty in deposit-loan trends, aggressive competition for funds--even of two-year maturity--at large banks, and uneven loan demands characterized District banking today. Bankers were worrying about rapid advances in interest costs and loss of deposits to aggressive banks. Prudence argued against their being panicked into a rate or maturity war, but deposit declines, customer losses, and higher than normal loan-deposit ratios counseled differently. As usual, the smaller banks in outlying areas looked to the Federal Reserve to protect them. They wondered if Regulation Q ceilings moved only upward.

Mr. Coldwell noted that the Reserve Bank had made a survey of time deposit interest rates at 22 banks--half reserve city and half country banks. There had been no change in the 4 per cent pattern on savings deposit rates and there was no prospect of change, but the pattern with respect to changes in consumer CD rates was mixed. In 1966 and early 1967 such rates had moved to 5 per cent in and near metropolitan areas. In April there had been some scattered reductions to 4-3/4 and 4-1/4 per cent in areas of largely conservative bankers, involving ten of the 22 banks surveyed. Dollar limits per customer were coming down and maturities also were being reduced. As to the future, the observation made for other Districts held true in the Eleventh District also--nobody wanted to lead, but they would be delighted if someone would act for them in reducing rates. In selected areas strong loan demand was limiting bank willingness to slow time deposit inflow. Savings and loan associations in many cities reportedly were ready to cut their rates on July 1.

In concluding comments, Mr. Coldwell noted that a director of the Reserve Bank, whose bank was located 60 miles from Dallas, wanted his view brought to Washington that the Board should lower the ceilings on consumer CD's to cut big-city competition for his deposits. Aggressive bankers were still willing to pay the top rate even for two-year maturities to obtain funds for further growth and loan expansion.

Mr. Ellis remarked that spring had been more of a calendar notation than a change of seasons in New England. With full sympathy for those who were snowed in on Sunday in the Dakotas, he could report that New England had had snowstorms, freezing cold, and work interruptions up to just last Monday. That had meaning for District economic statistics, such as those covering hours worked and retail sales, especially of autos, and accordingly it flavored some of the business performance in the period under review.

Mr. Ellis noted that the Boston Bank's latest regional index of manufacturing production derived from an employment survey made during the week including March 15 in which there had been 10 inches of snow and temperatures had fallen as much as 21 degrees below normal. In some ways it was good news to learn that the index had dropped only two points in the month, holding one point above its March 1966 level. He found the projection surveys so heavily influenced by one or a few very large defense producers that it became difficult to appraise their meaning for the whole District. Reports from 193 firms showed that first-quarter sales rose 2 per cent from the fourth quarter of 1966. If a single aircraft manufacturer was added, however, the sample total showed an increase of 15 per cent. It was quite clear, however, that the pressure on the labor market had not abated. Starting wages in Boston (including those at the Reserve Bank) were being raised this week and last from $60 to $65 a week. That also was largely a paper record since it was next to impossible to obtain and/or to hold employees at that wage level.

In the financial picture, Mr. Ellis said, the most notable change in recent weeks had been a thawing in rates. Five of the 10 Boston banks lowered their rates on mortgages from 6-1/4 per cent to 6 per cent (75 per cent mortgage basis). Also, brokers were being offered finder's fees to bring in customers, a practice that vanished about a year ago. Savings banks had been slow to lower rates on savings. Only one savings bank in the sample moved last month and that was down from 4-3/8 to 4-1/4 per cent. District commercial banks, however, had quite generally reduced rates paid on deposits. Within the past few weeks (as of April 24) seven of the eight largest New England banks had lowered the rates they paid on consumer-type CD's, the most common drop being from 5 per cent to 4 per cent.

Mr. Ellis noted that new commitments by the large insurance companies in the District recovered in March to their average level for the first quarter of 1965, before the policy loan breakout had assumed epidemic proportions. Policy loans continued falling, although the March outflow was still more than double early-1965 outflows.

With respect to monetary policy, Mr. Ellis said that the desirability of maintaining prevailing money market conditions during the current Treasury financing could be safely acknowledged in view of improvement, documented in the background materials, in business sentiment and outlook. Having been embarrassed at other recent meetings by his disagreements with the staff regarding the outlook, he took comfort today in agreeing with the analyses of Messrs. Brill and Partee. He would like to highlight the first-quarter strength of final demand; between the fourth quarter of 1966 and the first quarter of 1967, final takings had expanded by $16 billion (annual rate), of which the Federal Government accounted for only $3.3 billion. Consumer spending expanded by $8.1 billion, and the saving rate in the first quarter was now calculated at 6.1 per cent rather than 7 per cent as shown in the GNP projection of four weeks ago. Over-all GNP was presently recorded as rising by $5 billion in the first quarter, but since the preliminary estimates for the quarter depended heavily on data covering the weaker months of January and February, he anticipated that they would be revised upward, perhaps substantially.

Mr. Ellis said he was frank to confess that that retrospective view colored his attitude toward monetary policy appropriate for the next several months. Starting with a conviction that there was strong underlying demand from consumers, business, and government at all levels, it was quite natural to conclude that the Committee should avoid inflating that demand further by credit creation beyond the economy's basic growth needs. He was reminded of a recent comment by Mr. Shepardson to the effect that the Committee should feel committed to reshape policy toward lessened ease just as readily as it had moved to create ease last fall.

In terms of the next three weeks, Mr. Ellis thought that the pattern described in the first paragraph on page 4 of the blue book was entirely appropriate.[1/] However, if the projection of bank credit expansion in May at an annual rate in the range of 1 to 4 per cent was fulfilled, it would be the first time that such a modest rate had prevailed since the Committee's policy change in November. His own expectation was for a higher rate of credit expansion.

In that context, Mr. Ellis said, he would point out that the proviso clause in the draft directive was completely silent on what action the Manager should take in the event bank credit expansion during May substantially exceeded present expectations--rising, say, at a rate twice as fast as projected, or continuing to expand at the 12.9 per cent average rate that had prevailed since November. The proposed clause would direct the Manager to

1/ The paragraph mentioned read as follows: "Maintenance of prevailing money market conditions over the next three weeks would involve a Federal funds rate averaging 4 per cent or a shade below and a 3-month bill rate fluctuating generally in a 3.65 - 3.85 per cent range. Member bank borrowings are likely to be in the $100 - $200 million area. Free reserves could vary more widely, perhaps in a $150 to $300 million range, depending in part on bank reserve management policies, on dealer financing needs and reinvestment flows associated with the Treasury refunding, and the need to maintain an 'even keel' monetary posture."

ease if the rate of bank credit expansion fell below the expected 1 to 4 per cent range. To be consistent, the clause should be amplified to include some expression about desired action if bank credit again surged, or it should be deleted entirely. He was inclined to agree that it would be difficult to frame an appropriate symmetrical clause at this juncture, and accordingly he would urge the Committee to omit the proviso clause.

Mr. Robertson then made the following statement:

> Like all the rest of you, I have been gratified by the signs of an improved business outlook that have appeared since we last met. While I recognize that our economic adjustment is not yet over, it seems to be proceeding constructively. Recession talk seems to have evaporated, and I have the impression that, barring major strikes, a fairly vigorous resumption of economic expansion can easily be under way by the end of the summer.
>
> That outlook has particular pertinence to our present deliberations, because, given the admitted lags in the influence of monetary policy, it is probably the trend of GNP beginning next fall--and running into next year--that we shall be influencing the most with what we vote to do, or not to do, today. To me, that trend looks so promising that further aggressive monetary stimulus at this time would be unwarranted. I think we have come a long way in our reversal of monetary policy since last fall, and it has done much to contribute to the brevity and relative painlessness of the current readjustment. Whether I look back or look ahead, therefore, what I see makes me reasonably satisfied to hold our policy right where it is--on "even keel"--whether or not we had a Treasury financing in process.
>
> Some observers, I realize, are much more concerned than I about the current state of the financial markets. The money market surely is comfortable, and reserve

availability is ample; but the long-term bond markets are undeniably very soggy. The basic reason is equally obvious. Those market participants are smart, too. They can read economic signals just as we can, and at least some of the time they are every bit as right. If a vigorous economic expansion is in the cards later this year, it makes good business sense for supplies and demands for funds in the bond markets to shift in such a way as to hold up bond rates, and that is just what has happened.

What should we do about it? You all know how I feel about our dabbling in long-term bond markets. In the current situation, moreover, with economic sentiment so much stronger, it would undoubtedly take large and sustained operations by us to markedly lower bond rates--and the resultant greatly increased reserve availability might finance a credit and spending bulge whose timing would prove to be very badly wrong in hindsight. Excessive ease now might well increase the chances of our reaping both an excessive rise in demands toward year-end and some nasty tightening consequences in the financial system as we tried to undo what we had done.

I, for one, would much prefer to hold at something like our present posture for as long as we reasonably can, so long as the economic adjustment continues to show signs of proceeding satisfactorily and credit flows remain ample to all major sectors of the community.

Mr. Robertson added that while he could accept the directive drafted by the staff, he would prefer to incorporate Mr. Mitchell's suggested change in the first paragraph and he would certainly prefer Mr. Clay's suggestion with respect to the proviso clause. He did not agree with Mr. Ellis that there was great danger that the projected growth rate in bank credit would be outrun in the weeks ahead, and accordingly he did not think a two-way proviso was necessary at this time.

Chairman Martin commented that there was a high degree of agreement today with respect to policy, and the only problem seemed to be that of deciding on language for the directive.

Mr. Maisel commented that he shared the view that the proviso clause should be deleted.

Chairman Martin said that he also thought the proviso clause might be omitted for this period. The staff might attempt to formulate an appropriate version of the clause for Committee consideration at the next meeting.

The Committee then resumed the earlier discussion of the second sentence of the first paragraph of the directive, and reached agreement on language.

By unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

The economic and financial developments reviewed at this meeting suggest that prospects for renewed economic expansion have improved. The adjustment of excessive inventories is proceeding, as a result of the reduced level of industrial output and with consumer buying strengthening. Average wholesale prices have declined recently, reflecting reductions in farm and food prices and stability in prices of industrial commodities; but unit labor costs in manufacturing have risen further. Bank credit expansion has moderated in recent weeks from its earlier rapid rate. Long-term interest rates have risen considerably under the influence of heavy securities market financing and more optimistic market appraisals of the business outlook, but short-term yields have declined further following the recent reduction in Reserve Bank discount rates. Interest rates abroad have continued to decline and some further reductions have been made in foreign central bank discount rates. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing conditions in the money market.

Chairman Martin then observed that the Committee had planned to pursue its discussion today of the implications for its procedures of the "Freedom of Information Act." He noted that the earlier staff memoranda on this subject had been supplemented by a memorandum from Mr. Hackley dated April 26, 1967,[1/] and he invited Mr. Hackley to open the discussion.

Mr. Hackley said that he would confine his remarks to the principal points at issue, including several questions that had been raised by members of the Committee in the discussion of the Freedom of Information Act at the March 7 meeting. The first was whether the Act would require publication in the Federal Register

1/ A copy of this memorandum has been placed in the Committee's files.

of the current economic policy directives and the other authorizations and directives of the Committee. He had reviewed that question further and had decided that those instruments were clearly "statements of general policy" of the type for which publication was required, and that none of the exemptions listed in the Act applied to them. It had been suggested that the Committee might seek an Executive Order to have them exempted. However, the Act provided for such Executive Orders only where secrecy was required "in the interest of the national defense or foreign policy," and that would not seem to him to apply to the domestic operations of the Committee. On the other hand, it would appear appropriate to seek an Executive Order exempting Reserve Bank operations in the foreign currency area. He had learned only yesterday that the Treasury had referred to the Department of Justice a request for an exemptive Executive Order covering all of its foreign currency operations, including those of the Stabilization Fund. The Committee might wish to consider making a similar request.

A second question discussed at the March 7 meeting, Mr. Hackley continued, concerned the time lag with which the Committee's directives might be published under the requirement that statements of general policy be published "currently." On that point he still felt that a 60-day lag would be more defensible than one of 90 days, but he did not mean to say that the 90-day lag would be indefensible.

He had reason to believe that if the question were tested in court the Justice Department would support a lag of either 60 or 90 days.

With respect to the Committee's minutes, Mr. Hackley said, the staff was agreed that it would be desirable to divide them into "action minutes" and "memoranda of discussion." The latter, which would be similar in form to the documents heretofore described as "minutes," would be exempt from disclosure as intra-agency memoranda. The action minutes would not be exempt, but he thought that would not present any great problem.

Mr. Hackley observed that the Legal Division had drafted proposed new "Rules regarding availability of information" to replace the corresponding present Rules of the Committee. The proposed new Rules were framed in general language and did not appear to pose much of a problem. The principal question on which Committee guidance was needed related to the time-lag for publication of directives. More troublesome than the language of the Rules was the problem of identifying and characterizing records--particularly records held at the New York Bank. It was necessary to determine which were in fact records of the Committee subject to the Act, and of those which appeared clearly to fall within the statutory exemptions. That matter was now under study both at the New York Bank and the Board, and he would hope that by the time of the next meeting the staff would be able to make definite recommendations.

In conclusion, Mr. Hackley noted that the Department of Justice Manual for the guidance of Government agencies in complying with the Act was expected to be issued some time in the latter part of May, so that additional guidelines might be available by the time of the next meeting. Also, the Legal Division wanted to explore some possible further changes in the proposed new Rules. He suggested that the Committee plan on considering new Rules for final adoption at either its May 23 or June 20 meeting.

Mr. Daane said he disagreed completely with Mr. Hackley's conclusions on the first two questions. It seemed to him if the Treasury could ask for an exemptive Executive Order covering all of its foreign currency operations, including those of the Stabilization Fund, the Committee had a very strong case for such an Order relating to its currency policy directives and other records; the Committee's domestic open market operations had highly important implications for "national defense and foreign policy." He thought the Treasury's action was clearly illustrative of proper approach. Secondly, he did not understand why a 60-day time lag in publishing the directives was more defensible than a 90-day lag. If the directives were to be published, he would consider a 90-day lag to be the minimum.

Mr. Hackley said he was suggesting that the Committee might consider following the Treasury's course in requesting an exemptive Executive Order with respect to its foreign currency operations.

Mr. Daane replied that he would favor broadening the request to cover domestic as well as foreign operations. The domestic operations of the Committee influenced the position of the national economy relative to the rest of the world, and in his judgment they could not be separated from other forces affecting the value of the dollar.

Mr. Mitchell asked Mr. Hackley whether he had the Committee's deliberations in mind when he referred to foreign currency operations.

Mr. Hackley replied that he had meant to refer not to the Committee's deliberations but to information on foreign currency transactions and to the authorization and directive regarding such transactions. He added that even if an exemptive Executive Order was obtained the Committee could still publish those instruments, as it had in the past.

Mr. Mitchell then said that he thought Mr. Daane's point had merit. The Committee's domestic policy decisions had important international implications, and at times they were strongly motivated by international considerations, such as concern over capital outflows. If an exemption for the current policy directives could be obtained by Executive Order, he thought the Committee should request such an Order.

Mr. Hackley said that the possibility of getting an Executive Order covering both domestic and foreign currency operations certainly could be explored, although he had some reservations as to whether the effort would be successful.

Mr. Maisel remarked that he saw no reason for even exploring the possibility of getting an Executive Order if a 90-day time lag in publishing the directives appeared defensible. In his judgment, publication with such a time lag would not pose problems.

Mr. Brimmer noted that he had mentioned the possibility of getting an Executive Order in the Committee's earlier discussion, and Mr. Hackley had indicated some reluctance to pursue that possibility at that time. He (Mr. Brimmer) still felt that the Committee needed some indication of the probability that it could obtain a general exemption, within which it could work out appropriate procedures for release of materials. As to timing, he thought it would be unfortunate if important issues were left to be resolved until June 20, and he proposed that the Committee try to reach the necessary decisions at its May 23 meeting.

Mr. Treiber remarked that he also would favor an exploration of the possibility of getting an Executive Order covering all of the Committee's operations.

Mr. Hackley then said that if it was agreeable to the Committee the Legal Division would prepare a letter addressed to the Justice Department requesting an Executive Order of the broadest possible scope, exempting from publication in the Federal Register not only the foreign currency instruments but also the domestic directives.

Mr. Daane suggested that the letter indicate that the Committee was reviewing its general policies on publication.

Mr. Brimmer agreed, and added that it should be made clear that if the Order was issued the Committee would still try to work out the best possible procedures with respect to releasing information.

Chairman Martin then proposed that in view of the lateness of the hour the Committee defer the planned discussion of its policy on publication of information on drawings under the swap network and on other System foreign currency operations, and no objections were heard.

Chairman Martin then reported that the trilateral negotiations among the United Kingdom, the United States, and Germany with respect to the cost of maintaining troops in Germany had finally come to a conclusion which Mr. McCloy would be announcing today. One product of the negotiations was a letter that had been addressed to him (Chairman Martin) by President Blessing of the German Federal Bank, stating that that Bank did not intend to convert any of its dollar holdings to gold for the time being. That letter probably would be released today.

Mr. Daane asked whether the letter did not simply reaffirm a policy the Germans had been following, and the Chairman replied affirmatively.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, May 23, 1967, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

CONFIDENTIAL (FR)

May 1, 1967

Draft of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on May 2, 1967

The economic and financial developments reviewed at this meeting suggest that prospects for renewed economic expansion have improved. The adjustment of excessive inventories is proceeding, with consumer buying strengthened and industrial output reduced moderately. Average wholesale prices have declined recently, reflecting reductions in farm and food prices and stability in prices of industrial commodities; but unit labor costs in manufacturing have risen further. Bank credit expansion has moderated in recent weeks from its earlier rapid rate. Long-term interest rates have risen considerably under the influence of heavy securities market financing and more optimistic market appraisals of the business outlook, but short-term yields have declined further following the recent reduction in Reserve Bank discount rates. Interest rates abroad have continued to decline and some further reductions have been made in foreign central bank discount rates. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing conditions in the money market, and to attaining somewhat easier conditions, insofar as the Treasury financing permits, if bank credit appears to be expanding significantly less than currently anticipated.